

# EUROPEAN VALUATION STANDARDS

10<sup>TH</sup> EDITION – 2025



**TEGOVA**

The European Group  
of Valuers' Associations



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10<sup>TH</sup> EDITION – 2025



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The European Group  
of Valuers' Associations

Dedicated to **Roger Messenger**  
1958-2020  
Transformative Chairman of TEGOVA

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# PREFACE

There is a longstanding relationship between EU law and European Valuation Standards (EVS): the law shapes the standards and without the standards, the law would be impracticable. That relationship has reached a new level of sophistication in the wake of the most valuation-rich legislature in the history of the Union. The Banking Package ensures the safety and security of financial and real estate markets, and the European Green Deal protects and restores the land and decarbonises the building stock. EVS 2025 takes up where these laws leave off, translating them into valuation practice.



The pillar of **the Banking Package** is a revised Capital Requirements Regulation (CRR) that makes valuation even more central to the Regulation's primary objective of buttressing the European financial system by ensuring the quantity and quality of bank capital and raising safeguards against valuation-induced systemic bank risk. Market Value is now 'complemented' by a concept of 'property value' based on valuation using 'prudently conservative valuation criteria' by which:

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

At least as far as the valuation of bank collateral is concerned, the European authorities are no longer satisfied with a stand-alone 'Market Value' that they correctly view as a 'spot value' at the date of valuation. They want to 'secure the future' by excluding expected price increases and internalising the potential for future lower market prices/values.

A year before the Regulation was formally voted, as soon as we knew there was political agreement on this particular provision, the European Valuation Standards Board (EVSB) published guidance on the application of prudently conservative valuation criteria in the various situations a valuer is liable to face: valuing under the income approach, using the direct capitalisation model, a DCF model, treating rent increases and calculating the developer's profit in the residual method of valuation. All that is now a Guidance Note (EVGN 2) in EVS 2025.

**The European Green Deal** is the most ambitious and comprehensive EU legislative package since the 300-law programme to complete the Single Market forty years ago. The well known goal – embedded in the European Climate Law – is European carbon neutrality by 2050 and a 55% reduction in GHG emissions by 2030 compared to 1990 levels. To achieve this, the package had to cover the four great carbon emitters: agriculture, industry, transport and buildings (the last being the single largest source at 36%).

For buildings, everything is now on the statute books: Extension of the EU Emissions Trading System to buildings and transport, Renewables Directive, Energy Efficiency Directive with its accelerated decarbonisation of the public building stock at every level of government and public ownership, and the Energy Performance of Buildings Directive laying down that all new buildings will be zero-emission by 2030, organising the energy efficiency renovation of the worst performing public and private building stock by 2030, 2033 or 2035 according to building type as well as massive rooftop solar installation to even closer deadlines.

EVS 2025 has risen to this challenge as well. Building on the foresight of EVS 2020's EVS 6 Valuation and Energy Efficiency which already instructed valuers to take account of legal deadlines and inflection points like sale or rental for energy efficiency renovation in their estimations of Market Value, the new EVS 6 sets out a residual approach to doing so.

All this is a revolution. Successive Blue Books have documented EU energy efficiency law, but until 2020 the standards proper never instructed the valuer to do anything about it and until now, never indicated how. For years, the European authorities kept urging us to 'value energy efficiency' but we are a necessarily conservative profession – we balked at creating value for political purposes on markets where nothing indicated that energy efficiency renovation had a significant impact on value. It was only when the Green Deal legislated the mandatory transformation of the worst-performing building stock within tight deadlines that we had market-changing regulation that we could act on.

But EU climate law is no longer a distinct and ringfenced environmental issue separate from the rest. The "Banking Package" is symbiotic with the Green Deal for the very good reason that the safety and security of financial markets will not withstand failure to reach EU climate goals. Thus the entire EU banking supervisory system has been reset to incorporate the climate goals.

Under the new CRR and other legislation, banks have a greatly enhanced obligation to report their exposures to environmental, social and governance (ESG) risks, obligations that are not always clearly enunciated due to a certain confusion over the exact nature of the components of E, S & G and the extent to which each letter applies to real estate.

For real estate, clearly the 'E' is dominant. EU regulators and supervisory authorities push banks to go beyond energy efficiency in reporting their exposures to environmental risk. The great challenge for our profession is to address climate issues without ever artificially creating or destroying value.

**Bottom line: Valuation, be it to a spot Market Value or to a longer term prudently conservative value requires recognisable, distinguishable market impacts.** That doesn't mean that subcutaneously more isn't happening to transform the built environment and property markets: Real estate in all its aspects is now part of the EU Taxonomy with its associated reporting requirements for listed and large companies, the Green Deal regulates the entire construction chain, and buildings are also at the heart of the Green Deal's life-cycle approach to circularity. Valuers must be conscious of these phenomena even if they cannot isolate and quantify them in the process of estimating a building's value. EVS 2025 goes even farther

than previously in this, in the Climate Change section 9 of EVGN 4 Valuation of Agricultural Property, in Part VI on Valuation and Sustainability, in EVIP 8 Flooding and the Valuation of Property and in Part X European Union Legislation and Property Valuation. Perhaps most seminally of all, the Part IV Minimum Educational Requirements have been overhauled to better ensure valuer proficiency with these concepts from the inception of their careers.

Sadly, Europe today is not only about advancing and securing the economy and the environment and promoting social progress; it is also the theatre of a terrible war. Since its inception, TEGOVA has helped Ukraine and our courageous Ukrainian colleagues in every way we could. In particular we responded to the request of the State Property Fund of Ukraine to provide guidance on the application of EVS to:

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

Despite its Ukrainian origin, it is valid for all war situations and is now the first Guidance Note in these Standards. I wish to express very special thanks to Jeremy Moody, Vice Chairman of the European Valuation Standards Board, for his extraordinary insight and effort on this subject in particular.

I believe that EVS 2025 has squared the circle, putting valuation at the cutting edge of EU policy implementation with an unerring focus on rigorous evidence-based determination of value.



**Krzysztof Grzesik REV FRICS**

Chairman of the Board of TEGOVA





# INTRODUCTION

An essential purpose of any new edition of EVS is to accompany market developments and regulatory changes. Since 2020, there have been significant transformations, especially as European Valuation Standards are designed in lock-step with EU law which has impacted valuation more than ever before. These rapid and profound EU-led mutations explain the many new aspects of EVS 2025:



- ▶ EVS 6 Valuation and Energy Efficiency now sets out in detail the methodology the valuer must follow to determine Market Value in an EU-legislated context of rapid mandatory renovation of the worst performing building stock. The essentially residual approach adopted has also been enhanced by a review of the residual methods in Part II Methodology.
- ▶ The revised Capital Requirements Regulation's valuation provisions – including a new 'property value' comprising 'prudently conservative valuation criteria' – are treated in depth in European Valuation Guidance Note (EVGN) 2 on Valuation for Mortgage Lending. For TEGOVA's 70 000 valuers from almost every EU Member State and candidate Member State, this will be the key tool for combining Market Value and 'property value' in our professionals' valuation of mortgage collateral.
- ▶ Agriculture has become a major economic and geopolitical concern leading to the return after twenty years of a Guidance Note (EVGN 4) on Valuation of Agricultural Property covering all aspects including climate change and technology and data.
- ▶ Part VI Valuation and Sustainability has undergone an in-depth revision and expansion to take account of the vast changes brought to land and buildings by the European Green Deal.
- ▶ Part X. European Union Legislation and Property Valuation comprehensively documents and explains the impact and professional significance of the most extensive EU legislative property and valuation production ever.

Of course, another key purpose of EVS is to provide valuers with their essential practice tool in the most didactic manner and in a way that is also intelligible to clients and the authorities.

The entire Blue Book has been reviewed to this effect but I would highlight in this regard that the very successful EVS Valuation Report for Residential Property has now been complemented by template reports for office property (EVGN 3. II) and agriculture (Annex to EVGN 4).

EVS 2025 is effective from 1 January 2025.

A handwritten signature in black ink, appearing to read 'C. Perrière', with a large, sweeping flourish at the end.

**Cédric Perrière REV MRICS**

Chairman of the European Valuation Standards Board





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To the Blue Book's designers, Gaby Gentenaar and Olivier Berquin of Hoet&Hoet whose work speaks for itself



# 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.

Except 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
- 2.2.1.** 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 – Definitions of Market Value and Market Rent

#### 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; or
  - ▶ 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 is therefore 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. Providing that the hypothetical binding agreement of the terms of the transaction is deemed to take place on the date of valuation 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 commands. 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 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 6.7 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. and 6.2.4.

## 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.

- 6.74. 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.
- 6.75. 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.
- 6.76. 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 transaction 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.

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

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

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

## 1. Introduction

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

## 2. Scope

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

## 3. Basis of value

**3.1. Definition** – A statement of the assumptions for undertaking a valuation for a defined purpose.

### 3.2. Commentary

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

**3.2.2.** In the event that none of the bases in EVS 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 5. 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.

#### 4.2.2. Commentary

- 4.2.2.1. In respect of financial reporting under IFRS 13 (see EVGN 5), 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 5, 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 2*).
- 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** – 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 the valuer to ensure that he/she is 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
- ▶ Maintenance 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 the valuer has 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)

**4.2. Enhanced competence** – Qualified valuers maintain and enhance their professional knowledge through a relevant programme of continuing education. They reach this level inter alia 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

- 4.3. 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. *(See Part IV)*
  
- 4.4. 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 professional expertise for the preparation and provision of valuations.
  
- 4.5. Recognised European Valuer (REV)** – TEGOVA has developed the Recognised European Valuer (REV) programme to enable individual valuers, through their professional associations, to have an enhanced status, over and above TEGOVA's Minimum Educational Requirements, to assure clients of their valuation expertise. *(REV and TRV are summarised in EVS Part IX and set out in detail on the TEGOVA website)*
  
- 4.6. TEGOVA Residential Valuer (TRV)** – The TEGOVA Residential Valuer programme enables recognition of qualification, knowledge and professional experience for individual valuers undertaking residential valuations.

## 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. Any actual or perceived conflict 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.
- 5.2.3. There may be circumstances where the valuer, despite the client's wishes, will still decline to accept the instructions.
- 5.2.4. Where joint valuers are appointed, each is subject to the same requirements of independence and objectivity 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 a property, or of 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 potentially carries liability, and deficiencies may result in loss to the client and legal action against the valuer.
- 5.4.2. According to 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 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 from a valuation (together with any costs of associated legal action or interest accruing over the period of a dispute) may often be greater than the valuer's personal or corporate assets, professional indemnity insurance is available in many countries. Recognising that such cover is an assurance to the client, many professional associations make the maintenance of appropriate cover a condition of qualified membership. However, it is not universally available or required in all countries in which it is available.





# EVS 4 The Valuation Process

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

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 review

## 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, relevant 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 intended 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
  - ▶ Any restriction placed on publication
  - ▶ The extent to which a duty of care will be provided
  - ▶ Compliance with European Valuation Standards
  - ▶ The basis of fee and other costs to be charged
  - ▶ Basic disclaimer
  - ▶ Timetable for work

*(see table under 5.9)*

## **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    | <p>The address must be stated as well as any specific information enabling exact identification of the property.</p> <p>The following must be considered:</p> <ul style="list-style-type: none"> <li>▶ Where the boundaries of the property being valued are undefined, reference to a plan or other fixed object may be required</li> <li>▶ Where fixtures, fittings, plant or machinery are present in a property, specify what will be assumed to remain with the property</li> <li>▶ Where a property is being valued subject to a tenancy, it is possible that improvements undertaken by tenants will be disregarded upon renewal or review of a lease. This may have an impact on value</li> </ul> |
| The ownership                | If more than one legal interest or legal estate exist, specify which is/are being valued.   |
| The basis or bases of value  | The basis or bases of value that will be reported must be specified. A basis of value recognised in EVS should be used 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 |   |

| Terms  | Details  |
|--|--|
| Conflicts of interest                                    | <p>Declaration that no conflict of interest exists.</p> <p>Declaration of any previous involvement with the property or the parties involved.</p> <p><i>(see EVS 3.5.2)</i></p>  |
| The identity and status of the valuer                    | <p>State that the valuer is acting in an external and independent capacity. Compliance with the valuer's professional association's and with TEGOVA's Code of Conduct must be confirmed.</p> <p>The qualifications and designations of the valuer should be set out.</p>   |
| Assumptions, special assumptions and departures from EVS | <p>All assumptions and special assumptions required by the client in preparing the valuation or valuation report must be specified. Reference must be made to any departures from EVS, setting out the reasoning and justification for departure.</p> <p><i>(see EVS 1)</i></p>  |
| The scope and extent of investigations                   | <p>The scope and extent of the investigations must be clearly set out. The extent of the inspection (internal and external) must be mentioned.</p>   |
| Reliance placed on information provided by the client    | <p>If the client has supplied information relating to the property or if the valuer is advised by the client to obtain information from a specified third party, then the terms must state that the valuer will rely upon this information and will not seek to verify the accuracy of the information provided.</p> <p>The valuer does not accept liability where the client has withheld information or given incorrect information.</p> |

| Terms   | Details  |
|---|--|
| 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
  - ▶ Name and qualifications of the person who physically inspected the property
  - ▶ Statement that responsibility for the inspection falls to the valuer signing the report
  - ▶ 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.
- 6.5.** 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.

- 6.6. The contents of a valuation report will be determined by the purpose and agreed terms. EVS 5 addresses valuation reporting.
- 6.7. 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 EVIP 2*) 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”) 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.

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.

- 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
  - ▶ 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, these 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*).
- 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 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 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 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
2. Scope
3. European Valuation Standard 6 – Valuation and Energy Efficiency
4. The key building and renovation requirements under the Energy Performance of Buildings Directive
5. The exemplary role of public bodies' buildings under the Energy Efficiency Directive
6. Commentary

## 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 compared to 1990 levels.
- 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) 2024/1275 of 24 April 2024 on the energy performance of buildings and Directive (EU) 2023/1791 of 13 September 2023 on energy efficiency: there are direct energy efficiency renovation obligations that are no longer contingent on the owner's sovereign decision to undertake a major renovation.
- 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 legal 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 legal 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-emission<sup>1</sup> 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.

<sup>1</sup> '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).

**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 given 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
- 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.** The effort for buildings 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 m<sup>2</sup>
- f) Buildings owned by the armed forces or central government and serving national defence purposes, apart from single 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<sup>2</sup>
- b) To all existing public buildings with a useful floor area larger than:
  - i) 2000 m<sup>2</sup>, by 31 December 2027
  - ii) 750 m<sup>2</sup>, by 31 December 2028
  - iii) 250 m<sup>2</sup>, by 31 December 2030
- c) By 31 December 2027, to existing non-residential buildings with a useful floor area larger than 500 m<sup>2</sup>, where the building undergoes a major renovation<sup>2</sup> or an action that requires an administrative permit for building renovations, works on the roof or the installation of a technical building system
- d) By 31 December 2029, to all new residential buildings

2 *'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*

- e) By 31 December 2029, to all new roofed car parks 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. They are also required for all buildings owned or occupied by public bodies.

**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.
- ▶ 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<sup>3</sup> is renovated every year to at least be transformed into nearly zero-energy buildings<sup>4</sup> or zero-emission buildings.

<sup>3</sup> *At all levels of public ownership: central, regional, municipal*

<sup>4</sup> *'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).*

**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.

**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.
- 6.2.2.** Zero-emission buildings are harmonised at EPC class 'A'. 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'.
- 6.2.2.1.** 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'
  - ▶ 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<sup>5</sup> 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)

5 *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 methods
10. Using more than one valuation method
11. The final check

## 1. Introduction

- 1.1. Technically speaking, **methodology** is a system of methods used in a particular area of study or activity.
- 1.2. In valuation, the term **methodology** is used to describe the process by which a valuer undertakes the valuation of the property. Thus, for a given valuation, methodology includes the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of models or techniques in order to interpret the valuation inputs and reach conclusions based on them.
- 1.3. There is a hierarchy of definitions; Approaches, Methods and Models. An approach is the first level in a hierarchy of definitions. The three recognised approaches are Market, Income and Cost (*see section 4 below*). All of these are based on the underlying economic principles of price formation and the choice of approach will vary depending on the purpose and nature of the valuation. Each of these principal valuation approaches includes different detailed methods of application and within these methods, there are different models. Some models are quantitative in nature, others more qualitative but all are techniques that allocate value to the component characteristics of a property.
- 1.4. EVS 2025 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, 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 VIII.

**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. Nonetheless, 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 simply 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 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 on 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.
- 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 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.
- 8.12. 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.
- 8.13.** 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.
- 8.14. 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.



- 8.15.** 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.
- 8.16. 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.**
- 8.17. 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.
- 8.18.** 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.
- 8.19.** 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.
- 8.20. 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.

- 8.21.** 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.
- 8.22.** 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.
- 8.23. 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.
- 8.24.** 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.
- 8.25.** 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.
- 8.26. 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.
- 8.27. 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

**8.28. 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.

**8.29. 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.

**8.30.** 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.

**8.31.** 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.

**8.32. 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.

**8.33.** 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).

#### **8.34. Depreciation and obsolescence**

**8.35.** In the context of a DRC depreciation, the valuer ascertains the size of the gap between the modern equivalent replacement and the existing asset.

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

**8.37.** **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.**

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

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

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

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

**8.41.** 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.

**8.42.** 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. For example, some new structures have been designed for a life of as little as 20-25 years. At Year 10, the property is therefore about halfway through its design life, whilst a period structure, though potentially requiring more regular repair and refurbishment, may have a much longer life span.

- 8.43.** 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.
- 8.44. Valuers should be less interested in the expectations of the physical life of the building than in the expected economic life.**
- 8.45. 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.
- 8.46.** 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.
- 8.47. Functional (and technical) obsolescence** is lack of functional adequacy and/or utility.
- 8.48. 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.
- 8.49.** Even a new building can be functionally obsolescent by the time of building completion.
- 8.50.** 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.
- 8.51.** 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.

- 8.52.** It may also affect newly built commercial properties when there is a rapid change of users' requirements.
- 8.53.** 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.
- 8.54.** A very common problem is **technical obsolescence**, usually where economies of scale have been made, machines are quicker, smaller and have re-defined different space and quality of space in which to operate. Technical or functional obsolescence can also be driven by legislative change. Environmental regulations, waste production and disposal may all feature in an industrial setting and for all sectors, health and safety, together with disabled access, requirements may give rise to differing degrees of technical obsolescence.
- 8.55. 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.
- 8.56. 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.
- 8.57.** 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.
- 8.58.** 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.
- 8.59. External factors** that cause locational disutility may be:
- ▶ Market changes. Lack of requirement for product or service provision
  - ▶ Incompatible land uses in the locality

- 8.60.** 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.
- 8.61.** 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.
- 8.62. Measuring depreciation** – This is a difficult task involving many assumptions by the valuer which need to be accurately recorded in the valuation report.
- 8.63.** Depreciation is not a constant, either across industry and service providers or on a year-on-year basis.
- 8.64.** 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.
- 8.65.** 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.
- 8.66.** 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.

- 8.67.** These assumptions need careful consideration by the valuer and, ideally, agreement with the client as to the appropriate approach to be adopted.
- 8.68.** 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.
- 8.69.** 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.
- 8.70.** There will be cases where, in measuring depreciation, the obsolescence is total:

**8.70.1. 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.

**8.70.2. 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.



### 8.70.3. 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.

- 8.71.** 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.
- 8.72. 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.
- 8.73.** 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.
- 8.74.** 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.
- 8.75.** 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.
- 8.76. 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.
- 8.77.** 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.

- 8.78.** 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.
- 8.79. 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.
- 8.80.** 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.
- 8.81.** 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.
- 8.82.** Such an approach can lead to value of the land element appearing disproportionate to the value of the structure. Detailed explanation will be necessary.
- 8.83.** 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.
- 8.84. 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.

- 8.85.** 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.
- 8.86.** 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.
- 8.87.** These considerations need to be explained by the valuer in each instance.
- 8.88.** 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.
- 8.89. Final adjustments** – The DRC calculation draws together many elements, most of which are capable of significant adjustment by the valuer in individual circumstances. Valuers are required to look at the answer and ask whether it is credible against their knowledge.
- 8.90.** 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.
- 8.91.** 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.

## 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 gauge 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 method.
  
- 10.2.** No general rule can be set as to whether the use of a single method or several methods leads to a more accurate and reliable valuation. However, where valuers have used only a single method it is recommended that they at least check their conclusions against other market indicators, if they exist. For example, where a property has been valued using a method within the Income Approach, the valuer will often want to compare the resulting value per square metre with prices observed on the market for similar properties at the valuation date.
  
- 10.3.** In some instances, valuers prepare valuations using two or more different methods, then apply mathematical weightings to the two or more resulting values to obtain a weighted value, which is then reported as the Market Value. Such an approach should be used with caution – there may be merit in it if the weightings are chosen for each individual property according to the valuer’s own view of the relative reliability of the values that result from each of the various methods. However, it may be dangerous to apply standard weightings to a series of valuations or to a whole portfolio of properties, as such an approach precludes any consideration of the reliability of the various methods on a property-by-property basis.

## 11. The final check

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







III.

# European Valuation Guidance Notes



# EVGN 1 Applying European Valuation Standards in Wartime Circumstances

This Guidance was originally undertaken 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.

1. Scope
2. Application of EVS to war damage
3. The valuer
4. The valuation process
5. The valuation report
6. Beyond the valuation – Additional items of claim
7. The cost of post-war reconstruction

## 1. Scope

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 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 be the 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 25<sup>th</sup> 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 military 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 type of asset or property 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 26<sup>th</sup> 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 aid 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:

- ▶ 23<sup>rd</sup> February 2022
- ▶ 20<sup>th</sup> 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** – With the illustration of the invasion of Ukraine, assuming that valuations are to be assessed as at 23<sup>rd</sup> February 2022 (20<sup>th</sup> 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 transaction 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, 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 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 national guidance, drafted with an awareness of national law, practice and conditions could assist considerably. However, with the valuer's task of forming a professional and objective opinion 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 national courts might give particular regard to guidance developed in the country and understand its context, once a case reaches an international court such a valuation based on national 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 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, months or years would have passed. 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)**, 19<sup>th</sup> 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) 2024/1275 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 during 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
  - ▶ 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 that 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 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 24<sup>th</sup> 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 23<sup>rd</sup> 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

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 who 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** – A 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) 2024/1623, 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)<sup>1</sup>." (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 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.*

- 1.4. The CRR provides no guidance on how its new provision on prudently 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 Value 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 is titled 'Valuation principles for eligible collateral other than financial collateral'.

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

- a) the value is 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:
  - (i) the value excludes expectations on price increases;
  - (ii) the value is adjusted to take into account the potential for the current market value to be significantly above the value that would be sustainable over the life of the loan;
  - ...
- d) the value is not higher than a market value for the immovable property where such market value can be determined.
  - ...

**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 d) refer to the ‘value’ of the property, which is clearly distinguished from the ‘Market Value’ of the property in d). Whilst these are not identical concepts, the valuation methodology described in European Valuation Standards 2025, 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 her/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 which would be the lower of either (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 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 value to be significantly above the value that would be sustainable over the life of the loan;

3.14. It is important to identify such potential, 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. It should be assumed that the adjustment should be made to the value derived under subparagraph (i) if such value is lower than the Market Value.

3.15. 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.

- 3.16.** In a comparative approach valuation, an assessment of the risk that the current Market Value 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 cyclicity. If the Market 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 value will be significantly higher than the value that could be sustained over the term of the loan. By contrast, if the Market Value was estimated when the market was at the bottom of the market cycle, there is probably little such risk.
- 3.17.** 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.
- 3.18.** 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.
- 3.19.** Pursuant to paragraph (d) 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

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## A. BASIC ELEMENTS OF THE INSTRUCTION

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### A.1. The property

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

### A.2. The client

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

### A.3. The valuer

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8. **Identification of the valuer** – When the valuation instruction is given to a company, the individual valuer conducting the report must be identified.

9. The qualifications of the valuer (*EVS 3*)
10. The status of the independent valuer (external or internal)
11. Confirmation that the valuer has the experience and market knowledge necessary to value the property
12. **Confirmation that there are no conflicts of interest** – Where conflicts exist, the report must state that these were brought to the client's attention and detail the measures taken to ensure the valuer's objectivity was not affected.
13. **Use of specialist valuers or advisers** – Where the signing valuer has used the services of third party specialists, they must be identified.

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

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

#### A.5. The available information

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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

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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

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### B.1. The location

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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 real estate value in the identified area

### B.2. The property

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32. Site analysis:
  - a) Distance from the city centre and/or the main business district, and from 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.)
  - 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 (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

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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 and building renovations and modifications, and related permits
38. Zoning for physical risks (forest fire, earthquake, flood, etc.) and transition risks ensuing from energy efficiency regulation.
39. Judgment of the impact of the legal situation on the value

# C. VALUATION

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## C.1. The methodology

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- 40. Description of valuation approaches and methods used
- 41. **Explanation of the choice of key assumptions** with reference to the comparables listed

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

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

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

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

## C.4. Valuation

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- 46. Final calculation supporting the opinion of Market Value and/or other basis of value as instructed in the scope of work.

## D. CONCLUSION

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47. The reported value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify it.
48. Confirmation of value
49. Date of valuation
50. If a special assumption is being made, the valuer must clearly state that the opinion of value has been derived under that special assumption.
51. A statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value
52. **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.
53. Statement of compliance with the General Data Protection Regulation (GDPR)
54. Statement of compliance with EVS
55. State “Disclaimers in Annex”
56. The valuation report must be signed and dated by the valuer (*identified above under A.3.8*).

# E. ANNEXES

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## 57. Graphs, maps, disclaimers, photos



## II. The EVS Valuation Report for Office Property

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### A. BASIC ELEMENTS OF THE INSTRUCTION

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#### A.1. The property

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

#### A.2. The client

---

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

#### A.3. The valuer

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8. Identification of the valuer – When the valuation instruction is given to a company, the individual valuer conducting the report must be identified.

9. The qualifications of the valuer (*EVS 3*)
10. The status of the independent valuer (external or internal)
11. Confirmation that the valuer has the experience and market knowledge necessary to value the property
12. Confirmation that there are no conflicts of interest – Where conflicts exist, the report must state that these were brought to the client's attention and detail the measures taken to ensure the valuer's objectivity was not affected.
13. Use of specialist valuers or advisers – Where the signing valuer has used the services of third party specialists, they must be identified.

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

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

#### **A.5. The available information**

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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 and from 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 (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

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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

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## C.1. The methodology

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43. Description of valuation approaches and methods used
44. **The income method**
45. Explanation of the choice of key assumptions with reference to the income growth models (Capitalisation and Discounted Cash Flow)
  - 45.1. The selection criteria for relevant market data
46. The criteria chosen for selections of rent comparables (for example, market area, size, type, energy performance certificate rating, state of repair, etc.) must be clearly stated and consistent with the property's characteristics.
47. 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
48. Information on the main market data affecting lease (for example, inflation, risk free rates, property taxes, management costs, etc.)
  - 48.1. The analysis of the market data
49. Description of each comparable (photographs may be included, chosen as appropriate in terms of confidentiality and privacy)
50. 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.
51. Justification of capitalisation rate, discount rate and exit yield used
52. **The comparative method**
53. Explanation of the choice of key assumptions with reference to the comparables listed
  - 53.1. The selection criteria for relevant market data

54. The criteria chosen for selections of comparables (for example, market area, size, type, energy performance certificate rating, state of repair, etc.) must be clearly stated and consistent with the property's characteristics.
55. 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.
  - 55.1. The analysis of the market data
56. Description of each comparable (photographs may be included, chosen as appropriate in terms of confidentiality and privacy)
57. 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

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58. Final calculation supporting the opinion of Market Value and/or other basis of value as instructed in the scope of work.

## D. CONCLUSION

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59. 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.
60. Statement of Market Value and/or other basis of value as instructed in the scope of work.
61. Date of valuation
62. If a special assumption is being made, the valuer must clearly state that the opinion of value has been derived under that special assumption.
63. A statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value
64. 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.
65. Statement of compliance with the General Data Protection Regulation (GDPR)
66. Statement of compliance with EVS
67. State “Disclaimers in Annex”
68. The valuation report must be signed and dated by the valuer (identified above under A.3.8).



# E. ANNEXES

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69. Graphs, maps, disclaimers, photos



# **EVGN 4** Valuation of Agricultural Property

- 1. Introduction**
- 2. Application of European Valuation Standards**
- 3. Valuation methodology**
- 4. Determination of Market Value**

*Parts 5–8 are an integral part of this Guidance Note and of EVS 2025. They are on the TEGOVA website, not in the hard or electronic copy of the Blue Book.*

- 5. Agricultural land, farms and estates*
- 6. Agricultural crops and other assets*
- 7. Perennial crops*
- 8. Forestry*
- 9. Climate change**
- 10. Technology, data and agricultural property**

## 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:

- i) 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.
- ii) Factors determining the agricultural property market (demand, supply and price) and bearing 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.
- iii) Factors affecting the efficiency of the agricultural property market. These conditions for an efficient agricultural property market are met 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 Annex.

### 3. Valuation methodology

The same methodological approaches as apply generally to real estate (see *EVS Part 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 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.

#### 3.1. 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

### 3.2. 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 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.

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 increase to a stable plateau but then finally declining towards the end of the plants' productive life with costs of removal. 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.

### 3.3. 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 7.34.*).

The optimal way of determining the discount rate is 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 7.40.*).

In such circumstances it is common practice to refer to ten-year government bonds as the risk-free rate and add 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.

### 3.4. 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 if 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.

***Parts 5-8 are an integral part of this Guidance Note and of EVS 2025. They are on the TEGOVA website, not in the hard or electronic copy of the Blue Book.***

- 5. Agricultural land, farms and estates***
- 6. Agricultural crops and other assets***
- 7. Perennial crops***
- 8. Forestry***

## 9. Climate change

### 9.1. 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.

### 9.2. 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.

Declining rainfall in some regions can increase salinity in some aquifers and the build up of soil contaminants.

**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 purchased 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 purchased 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 trail of information, whether from interactions with EU and national government, their 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.

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

### **Essential elements of a 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.



# A. BASIS OF THE INSTRUCTION

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## A.1. The property to be valued

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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

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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

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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**

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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 date of inspection, date of conclusion of the valuation report and date of valuation

#### **A.5. The available information**

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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

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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

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### B.1. The location

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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

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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, energy performance certificate, 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

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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

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## C.1. The methodology

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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

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46. List of comparables (full list and comparables chosen for analysis) 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. Justification and judgement of each selection

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

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- 51.** Description of each comparable (photos may be included as annexes, chosen as appropriate in terms of confidentiality and privacy)
- 52.** Adjustment to the property. The valuer must provide appropriate comment reflecting the logic and reasoning for the adjustments made to the comparables provided.
- 53.** Adequately supported opinion of Market Value

## D. CONCLUSION

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54. 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.
55. Confirmation of value
56. Indication of limitations and assumptions
57. Date of valuation
58. A clear statement as to whether transaction costs such as VAT, fees, etc. are or are not included in the reported value
59. 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.
60. Statement of compliance with the General Data Protection Regulation (GDPR)
61. Statement of compliance with EVS
62. State “Disclaimers in Annex”
63. The valuation report must be signed by the valuer (identified earlier under A.3.9.).



## E. ANNEX

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64. With graphs, location maps, planning charts (planning with environmental restrictions, construction restrictions, etc.), survey maps, photos, etc.



# **EVGN 5** Fair Value for Financial Reporting

1. Introduction
2. Scope
3. IFRS fair value measurement
4. IFRS 13 definition of 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

**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:

**4.2.1.** 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.”*

**4.2.2.** 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

*See also 7.2.*

- 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 speaks 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

## 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.
- 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 connected 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 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 stated 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 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 land-fill 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 (*see EVS 6*). 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.



**IV.**

# Minimum Educational Requirements



- 1. Introduction**
- 2. Outline syllabus**
- 3. Detailed syllabus**

## 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****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

## 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 determines 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 its practical application 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 of valuations of real estate in general and those for secured lending and accounting purposes in particular.

### **3.11. Sustainability in Real Estate**

The European and national 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



V.

# European Valuer's Code of Conduct





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

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

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

This Code embeds the values of:

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

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

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

## The Code

- A.** The valuer must act with honesty, integrity and diligence at all times with a duty of care to the instructing party and all others expected to rely on the valuation advice.
- B.** The valuer must exercise professional judgement objectively and independently in undertaking work and, as relevant, honour the duties of a professional to a court, tribunal or equivalent forum.
- C.** The valuer must maintain a level of professional knowledge and technical skill that is at least that required by the professional valuation body of which the valuer is a member or, for valuers who are REV or TRV, by those requirements, keeping up to date with professional matters and relevant current developments so as to be competent in professional practice.

- D.** The valuer must be transparent and accountable to the instructing party in undertaking professional work for them.
- E.** The valuer must avoid all actual or potential conflicts of interest regarding the property in question, the valuation process and the result of the valuation, must not have any direct or indirect interest in the property and must not be related to either the buyer or the seller of the property. The valuer must inform the instructing party in writing when a conflict of interest arises and before issuing the valuation report.
- F.** When the client commissioning the valuation report is a credit institution, the valuer must not be involved in the loan application, assessment, decision or administration and must not be guided or influenced by the borrower's creditworthiness.
- G.** The valuer must not disclose privileged or confidential information.
- H.** The valuer must have or be subject to a procedure for handling complaints that may be made concerning professional conduct and must advise instructing parties in writing of its existence.

Where a valuation must be signed in the name of a valuation company, this Code applies to the company and also to any legal or natural person undertaking the valuation work.





**VI.**

# Valuation and Sustainability



1. Introduction
2. Sustainability – Definitions
3. Sustainability and property users
4. Legislation
5. Valuation and sustainability

## 1. Introduction

- 1.1. Sustainability and the range of issues it embraces are increasingly relevant to valuation work, driven by economic pressure, advancing climate change with its risks and opportunities, resilience, resource and supply chain issues, and reputational concerns. It can be expected that regulation and market sentiment will make issues of environmental performance and sustainability increasingly important to many of those concerned with property and buildings and so, where relevant, to valuation. Indeed, many lenders, investors, larger corporate clients and those with ethical concerns look to meet rising standards with regard to sustainability and expect similar standards from those with whom they deal. They are likely to raise the matter when seeking valuation advice.
  
- 1.2. It is very clear that these issues are evolving, not only with greater scientific knowledge and the experience of policy but also the much enhanced focus on climate change mitigation and adaptation:
  - ▶ For mitigation, the EU, the UK and other states have adopted the target of reducing greenhouse gas emissions to “net zero” by 2050 to deliver the 2015 Paris Agreement’s goal of limiting global warming to 1.5°C above pre-industrial levels. The EU has then developed this in its European Green Deal using regulation, trade and investment policy to cut carbon emissions in conjunction with tackling wider environmental concerns.
  - ▶ Adaptation is about creating resilience in the face of climatic change, whether that be flooding, extreme heat, water shortage or storm.

That is being joined with a focus on nature and biodiversity with consequences for decisions about land use. These real pressures and the gathering momentum of policy interventions in response seem likely to drive major changes for land use and buildings, understood as both problems and solutions in reaching the net zero targets. In bare summary, the more that mitigation policies are effective the less we will have to adapt to climate change; the less effective they are, the more we will have to adapt. Either way and with further climate change inevitable, property faces major challenges while further climate change is already inevitable.



**1.3.** Those challenges can be considered as the physical risks of change and the requirements of policy interventions intended to achieve the transition to net zero:

- ▶ The physical risks to property from the growing extremes of variable weather, such as:
  - ▶ The increasing incidence of destructive flooding putting land and built property at risk with people's lives, businesses and investments whether from sudden storms, widespread rainfall or rising sea levels with consequent effects on development potential
  - ▶ Periods of extreme heat result in increasing mortality, make many buildings uncomfortable for use and increase the risk of landscape-wide fires – 2022 saw the worst drought for significant areas of Europe since 1540
  - ▶ Heat and water shortage constrain both development and food production as well as imposing stress on forestry
  - ▶ Destructive storms
  - ▶ Some land use patterns in Europe are challenged by serious soil erosion with resulting problems
  - ▶ The wider resulting hardship and pressure for migration

People, property and business do not simply face increasing temperatures but have to cope with a wider range of extremes, testing materials, construction, land uses and lifestyles in new ways.

The challenges from policy actions to answer climate change (“transition risk”) include:

- ▶ The combined transition from fossil fuel to renewable energy sources and the transfer of much heat and transport to electricity with associated infrastructure
- ▶ The drive for energy efficiency in businesses and buildings
- ▶ Management of water and soil
- ▶ Expecting carbon sequestration through land use and other means
- ▶ With legislative and policy frameworks supporting these changes and requiring corporate disclosure of climate-related issues

These are matters of risk management for businesses and they will affect or come to affect values.

- 1.4.** Climate change brings issues for both water and soils. Flooding resulting from torrential rain is one of the largest risks to property but in some areas it will cause mudslides and avalanches. Water scarcity, especially longer term shortages, can limit development potential or existing uses. Water quality is a rising concern with its effects on water availability and use as well as on the environment and ecology. Reducing water flows and depleted aquifers can lead to salination, changing land uses. Poor soil management and increased rainfall can accelerate the erosion of top soil, losing productivity but also adversely affecting water courses with nutrients and sediment. That changes ecology and clogs drainage, adding to flood risk. In more northern areas, climate change can open up opportunities for new uses of land but also melt permafrost, releasing greenhouse gases and creating unstable terrain.
- 1.5.** As with any change in circumstances, the effects of climate change can include changing values as buyers and sellers come to assess new advantages and risks. In extreme cases, some properties and business uses may become untenable but elsewhere new opportunities can be created. In some cases, significant capital expenditure may be expected; others may see new potential or the threat of obsolescence. Increasing knowledge, sophistication and scientific advance also open up new challenges – few would have been troubled by CO<sub>2</sub> emissions forty years ago – but also new ways of mitigating and adapting to them. New asset classes bring new questions. The large energy demands of data centres, now being compounded by the use of artificial intelligence, are not only formidable in themselves but can prejudice other development in the vicinity. However, solar farms often find it easy to create new habitats for biodiversity. Markets with property uses and the desires of buyers, sellers and users will evolve, changing values.
- 1.6.** The pressures on insurers, trying to track the fast-changing probabilities of risk for economies with more value at stake, are an early indicator of prospective financial strains. The Banque de France has suggested that unchanged policies could see insurance premia triple by 2050; insurers have been withdrawing offers of cover against fire in California and storm in Florida. Policies will evolve and markets will change.
- 1.7.** With that illustration of potentially systemic financial risks from climate change, national and international financial institutions and the banking sector have acted together to increase awareness, consideration and disclosure of these risks for lending and investment, potentially influencing behaviour in the market and reducing risks to values. In more detail, they have sought to:

  - ▶ Integrate the monitoring of climate-related financial risks into day-to-day supervisory work, setting expectations for investment and lending to consider the financial risks from climate change, embedding an awareness of risks

- ▶ Ease access to data on climate-related risks
- ▶ Build capacity and knowledge on managing climate-related risks across the financial system, including understanding the risk profile of secured lending loan books (“green asset ratios”)
- ▶ Encourage the development of metrics and classification systems to identify which economic activities contribute to the transition to a green and low-carbon economy, supporting financial actors to make sustainable investment and lending decisions

The IMF’s financial stability report now includes a chapter on sustainable finance and the European Banking Authority issued a report on the management and supervision of environmental, social and governance risks in its prudential framework for lenders and investors.

**1.8.** These concerns led to two particular international initiatives:

- ▶ The Taskforce for Climate-related Financial Disclosure (TCFD), supported by banks, asset managers, pension funds, insurers, credit rating agencies, accounting firms and shareholder advisory services to drive climate disclosure as part of financial decision making at this level with the bearing that would have on property:
  - ▶ Physical risks from the exposure of mortgage books to flood risk and the impact of extreme weather events on sovereign risk
  - ▶ Transition risks including exposures to carbon-intensive sectors and property lending with new energy efficiency requirements

This work was also intended to promote the allocation of financial resources to resilient and sustainable development. Considering its role fulfilled in October 2023, the work of monitoring the progress of companies’ climate-related disclosures was passed to the IFRS Foundation with IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures*.

- ▶ The more recent Taskforce for Nature-related Financial Disclosure (TNFD) with a similar role to ensure robust information on nature-related issues enabling businesses to incorporate nature-related risks and opportunities into their strategic planning, risk management and asset allocation decisions

- 1.9.** As the work of the TNFD shows, wider issues around other environmental themes from bio-diversity to the quality of air and water are all now feeding into the discussion of sustainability, the optimal use of resources for the future. The energy and related shocks (including those for agriculture) following Russia's second invasion of Ukraine have compounded concern for resilience.
- 1.10.** The emphases between the issues involved will change as legislation and market sentiment develop. While they may often still be externalities in economic terms, not influencing values, regulation (including taxation) and new markets such as for carbon are likely to increase the impact of these issues. Thus, while the market may often not have taken significant account of many of these issues, it seems increasingly likely that it will. Where specific issues crystallise as material factors for value and become understood, so they are likely to become part of standard practice. However, some aspects included in the discussion of sustainability might not become material to values.
- 1.11.** The developing concepts of natural capital assessment may offer tools to assist decisions, especially public policy choices, but these should not be confused with market valuation. They might though guide values in some private transactions intended to achieve environmental outcomes, as through the management of property, and so could begin to bring market mechanisms to this area and so potentially aid resolution of the many current externalities. Such approaches, commonly developed from an environmental economics background but using words apparently recognisable to valuers can result in expressing a natural capital value. However, this will be on very different assumptions from those required by the valuation profession's standards, might not always be objective and will not result in either a Market Value or a fair value but possibly an answer more akin to investment value.
- 1.12.** Regulations are creating new markets as means to help Europe's sophisticated economies manage the transition to net zero, the improvement of nature and other goals. The EU Emissions Trading System (EU ETS) and schemes of non-EU countries such as the UK's ETS put a price on carbon and are echoed by the developing array of more informal offsetting and carbon credit schemes. Other new markets affecting property are illustrated by England's biodiversity net gain requirements from 2024 and nutrient neutrality trading, both putting a cost on the impact of development, the first on habitats and second on water quality. All such regulatory markets may have unintended consequences from their design and are vulnerable to changes in their regulatory framework. Those intended to achieve a transition, as to net zero by 2050, may have an immediate relevance that wanes if and when that transition is achieved.

- 1.13.** As such concepts become clearer in practice and guidance develops so they may create intangible assets which will themselves need valuation where they can be separated from the underlying asset, with possible consequences for the value of that asset.
- 1.14.** Energy issues, driven by cost, resource issues and climate change concerns, are at the cutting edge as the European Green Deal's building energy efficiency laws organise the rapid renovation of the worst performing building stock (*see EVS 6, Valuation and Energy Efficiency*). As a result, national regulations on energy codes will become stricter and subsidies and tax relief might be available when building energy efficient houses – due to the internalisation of negative external effects. As and where such rules and any differences between more and less compliant properties come to matter to owners, buyers, tenants, lenders and others, then the market will take that into account in capital and rental values, alongside all other factors. It may well be that concerns over water scarcity and quality or other matters will follow a similar path.
- 1.15.** Many of the issues covered by sustainability involve a long term perspective, such as expectations as to energy prices or handling developing risks, whether environmental or regulatory and transition risks, while the necessary specific information may often be uncertain and the analytical tools still developing.
- 1.16.** Valuers can only value on the basis of the market as it is, not hypothesise about the future or be advocates of a cause, and must act within the limits of their professional skills and current market expectations. This will usually mean that they will need to call on relevant expertise, certification and reports as to a property's sustainability rather than prepare them personally. This follows existing practice regarding environmental issues such as the assessment of contamination, asbestos, flood risk or soil erosion for which valuers need to be able to understand what the specialist reports might mean and judge what weight to give to them.
- 1.17.** Valuation turns on observation and appraisal. In present circumstances, considering sustainability issues in relation to a property requires careful analysis. It may only rarely be that sustainability issues as a generality will be relevant, but more often that specific issues and particularly, specific standards will be of concern. Standards, certification and rating regimes can summarise and encapsulate information on, say, energy in ways that the market may more easily take into account. It thus becomes more important to know how to:
- ▶ Identify, describe and assess the relevant characteristics of properties

- ▶ Interpret and judge assessments of them, especially in the context of asset class, scale and location
  - ▶ Consider whether those characteristics are already taken into account so far as they are relevant to value
  - ▶ Select the appropriate way to take any remaining points into account without double counting
- 1.18.** Once relevant factors are identified and appraised in this way they can, in principle, be taken into account for valuations in just the same way as any other specific factors. They do not require new valuation methods but rather objective, practical assessment under the terms of the valuation basis instructed. They will need to be covered in the valuation report to the extent and in the manner that is appropriate. Where sustainability issues are not considered as material to value, it may sometimes be useful to explain why.
- 1.19.** The extent to which the report refers to sustainability will be a matter of judgement in the circumstances. This will in part reflect the extent to which sustainability issues are relevant to the value and in part the interests of the client. These two points come together where a client interested in sustainability issues instructs a valuation on the basis of investment value.

## 2. Sustainability – Definitions

- 2.1.** Sustainability has proved to be an enduring, broad but vague, portmanteau concept with different practical connotations for different people, in different contexts and over time. Its formulation does not arbitrate between economic, environmental and social objectives where they conflict.
- 2.2.** At a general level, sustainability is the capacity to endure. While this section of EVS focuses on the environmental aspects of sustainability, it also has economic and social dimensions and many of the issues of economic sustainability may already be material to valuations. Indeed, economic concepts such as sustainable rental income or sustainable cash flow long pre-date the current uses of the word. Regulation (EU) 2024/1623 (latest amendment to the Capital Requirements Regulation) introduces prudently conservative valuation criteria requiring inter alia that the value be adjusted to take into account the potential for the current Market Value to be significantly above the value that would be sustainable over the life of the loan (*see EVGN 2 Valuation for Mortgage Lending*). Resilience is the capacity to withstand, absorb and recover from shocks.

- 2.3.** As pressures on resources and natural systems have grown, so attention has focused on the extent to which this capacity can be protected by intervention and management. The focus on environmental constraints has led to one definition of sustainability as improving the quality of human life while living within the carrying capacity of supporting eco-systems. One aspect of the discussion of natural capital and the attention to eco-system services is the potential to re-build stocks of natural resources that have been depleted, adding resilience to the future economy.
- 2.4.** With the developing momentum of such policy discussions, sustainable development may be best understood as a process rather than a defined end, that process currently being increasingly influenced by concerns over climate change and resources. In that process, a variety of tools and concepts have evolved to consider environmental and other sustainability issues for property.

- 2.5. Sustainable development** – The concept of “sustainable development” (with the tensions it poses for any action or change) was promoted by the World Commission on Environment and Development (the Brundtland Commission) which reported in 1987. It has since been a key component in many policy discussions on economic, social and environmental issues. In its report, *Our Common Future*, the Brundtland Commission defined it as:

“development which meets the needs of current generations without compromising the ability of future generations to meet their own needs.”

The World Commission’s proposals were approved by the United Nations Conference on Environment and Development at Rio de Janeiro in 1992 leading to both national and international attention, including the United Nations Commission for Sustainable Development.

- 2.6. Environmental principles** – Generally established environmental principles as set out at the 1992 Rio Summit and the mitigation hierarchy provide a framework of important concepts for decisions, including those about property. The leading environmental principles, all relevant to property, are:

- ▶ The integration principle – environmental protection should be integrated into policies
- ▶ The prevention principle – environmental harm should be prevented
- ▶ The rectification at source principle – environmental damage should, as a priority, be remedied at its origin
- ▶ The polluter pays principle – the costs of pollution should be met by those causing it

- ▶ The precautionary principle – where there are threats of serious or irreversible environmental damage, a lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation

For the EU, the precautionary principle has been extended to exclude actions for which “there is no reasonable scientific doubt as to the absence of adverse effects” (see *Coöperatie Mobilisation for the Environment UA, Vereniging Leefmilieu v College van gedeputeerde staten van Limburg, College van gedeputeerde staten van Gelderland (C-293/17), Stichting Werkgroep Behoud de Peel v College van gedeputeerde staten van Noord-Brabant (C-294/17)* – the CJEU “Dutch N” decisions bearing importantly on developments that might affect ecologically important sites).

**2.7. The mitigation hierarchy** – Decision making, including for development, land use and value, is then assisted by the mitigation hierarchy under which actions in respect of environmental damage are to be taken in this order:

- ▶ Avoid causing damage
- ▶ Minimise the damage being caused
- ▶ Restore the damage where it was caused
- ▶ Offset the damage by actions elsewhere

That last step of offsetting damage is the approach of some of the new markets (notably for carbon) but is the last resort under the hierarchy. It requires significant monitoring, verification and reporting for it to be credible, even where there are agreed definitions and regulations.

**2.8. “Green value”?** – In the same way as a property’s potential for development, there is no such separate value as a “green value” that can be considered as distinct from a property’s Market Value, however much it might be useful shorthand where a more sustainable property had a greater value. The Market Value takes into account all aspects the market thinks relevant, including an appreciation of its sustainability aspects, whether they are seen to add or subtract value. It can be seen as a cost and a restriction. Equally, economic opportunities can be seen in green growth with its accompanying technical innovation, while meeting standards may protect or enhance value. Once a regulatory or market standard is seen as the norm, then failing to meet it may see the values of non-compliant properties penalised (a “brown discount”) as regulatory compliance becomes the “licence to trade” giving wider assurance.



- 2.9. “Green buildings”** – A “green” or “sustainable building” is one that is identified as using resources such as energy, water, materials and land more efficiently than buildings constructed to existing minimum standards. It may produce less waste and fewer emissions and potentially offers a better internal working environment, benefitting health, comfort and usefulness with fewer contaminants despite being more airtight. As sustainability expects that the needs of the present should not compromise the ability of future generations to meet their own needs, green buildings should also take social, ecological and environmental issues into account. That broader definition includes external effects and the impact across generations and so the property’s life cycle.
- 2.10. Life cycle assessments** – There is increasing discussion of judging the sustainability of a property across its whole life cycle together with its associated externalities. Concern over greenhouse gas emissions often points to making the best of existing buildings in preference to demolition and replacement. Life Cycle Cost Analysis (LCCA) calculates the present value of all costs for the whole remaining life of a building, including construction, operation, maintenance and end-of-life costs. Such approaches may not yet capture all the externalities that can be involved. Some European countries have national standards and guidelines for carrying out LCCA while the international standard is ISO 15686-5 Buildings and constructed assets – Service life planning – Part 5: Maintenance and life cycle costing set the framework but it does not prescribe a common format for this analysis, allowing different approaches in practice.
- 2.11.** Adopting life cycle assessment may move the balance towards property renovation from building anew, given the embedded costs of construction even with ultra-low carbon concrete and steel. Where the concern is to meet the 2050 net zero target, reductions in greenhouse gases after that date would not contribute to it and so not be relevant to achieving the policy goal. Thus, a proposal to demolish a building put up in the 1930s and replace it with a much more energy efficient building faces these points:
- ▶ As greenhouse gases have a century’s life, those emissions caused by its construction are still around.
  - ▶ More emissions will be created now by its demolition and the new building work.
  - ▶ While there would be significant savings in emissions from the new building, they will not balance those emissions by 2050 (even if they might well do that in the longer term).

On these arguments, that project for an energy efficient building would hinder achieving net zero.

**2.12. “Green leases”** – This is a label developed to offer a focus on the sustainability aspects of a letting which may have an impact on the valuation of some properties. This has partly arisen in response to the common imbalance of interest between landlord and tenant on environmental issues. Capital investment, sometimes with long pay back periods, is often required to improve a property’s performance. Landlords and investors may often be reluctant to incur that cost without an appropriate return while tenants can be cautious about investing in a property they do not own, indeed may only hold for the balance of a short lease. The green lease, which may in practice only be agreed between parties interested in the issues for their own commercial or personal reasons, endeavours to tackle identified sustainability concerns between them and meet rising legal standards. A prospective tenant could want confirmation that the building can reasonably achieve the proposed environmental targets if the tenant complies with the covenants in the lease. Whether the building is new or retro-fitted, the landlord may in turn need equivalent warranties from the developer or architect.

**2.13.** While there is no precise definition of a “green lease” that is widely accepted in the market, a green lease generally refers to a lease of a sustainable/energy-efficient property on terms that promote sustainability with regard to green or energy-efficient standards or operational control and audit procedures related to energy performance measurements. Such provisions might:

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

as well as cover building management, waste disposal, transport, catering and janitorial services. Other aspects of such a lease may need to adjust where these are burdensome on the tenant.

**2.14.** Such terms vary widely in practice on a spectrum between:

- ▶ “light green leases” with just a few basic green obligations, such as co-operation on energy-saving initiatives, provision of information on energy, water and waste, the use of sustainable materials, and prohibitions on harming the building’s energy performance

- ▶ “dark green leases” with more demanding provisions setting targets for the use of energy, waste and water, reports, rent review assumptions, alterations, and reinstatement. They may cover such topics as waste disposal or the avoidance of volatile organic chemicals in cleaning materials.

The leases may include incentive and penalty clauses based on agreed upon service and energy performance levels which may affect the rent or be considered as improvements or dilapidations on termination of the tenancy.

- 2.15.** Where considering a green lease, it is prudent to make a record of condition using an energy and environmental audit to establish a baseline from which to judge the issues and commitments of the lease.

- 2.16. Natural capital and ecosystem services** – A growing body of work, at first for determining and applying economic and environmental policy but now bearing on property valuation and management, is developing approaches to put values (or at least relative values) on such resource and environmental issues as:

- ▶ Pollution, energy and materials
- ▶ Environmental protection and resource management
- ▶ Natural resource assets

and can include other aspects such as health and recreation. Noting the existing guidelines for integrating ecosystem services into decision making, the European Green Deal expects that “All EU policies should contribute to preserving and restoring Europe’s natural capital”.

- 2.17.** The underlying model is to see the stock of nature, whether recognised by markets or not, as natural capital giving rise to services from food to the quality of air and water, from cultural landscapes to soil quality and pollination. Generating more ecosystem services may enhance the stock of nature; eroding natural capital diminishes it.

### 3. Sustainability and property users

- 3.1. Especially after the 2015 Paris Agreement on climate change, work on sustainability was increasingly driven by climate concerns and so focuses on energy and carbon issues, bearing on all aspects of a business including property and buildings. That has now been joined by concerns over nature with biodiversity and species abundance as key themes as well as wider concerns about air and water quality.
- 3.2. Owners and occupiers of property may have a variety of motives for considering sustainability in general or specific aspects of it, such as energy efficiency in particular. These may range from personal commitment to cost-cutting, from complying with regulation to seeing it as an advantage with customers.
- 3.3. For those owners and businesses that make purely commercial judgements, the necessary investment has to show an acceptable return. It may be that investment in improving building equipment (such as heating, ventilation, air conditioning or for chilling) may not appear justified by the financial benefits of the improved energy efficiency or the market premium of that property though it might make a property more attractive for staff retention. Green leases (*see 2.12 above*) are a means to try to reconcile the common imbalance of interests between landlords and tenants in these matters.
- 3.4. As businesses increasingly operate in ways more sensitive to these issues, their owners and customers may tend to demand more relevant credentials to prove this. For larger businesses, such credentials might include:
  - ▶ The increasing expectation on them to report on their performance in this area
  - ▶ Demonstrations of Corporate Social Responsibility (CSR)
  - ▶ Demonstrating environmental, social and governance (ESG) performance
  - ▶ A Carbon Reduction Commitment (CRC)
  - ▶ Accreditation according with ISO 14001 – the international standard for environmental management systems or EMAS, the EU-wide Eco Management and Audit Scheme
- 3.5. For property, these may require consideration or publication of data on such matters as:
  - ▶ Property occupation costs
  - ▶ Energy costs

- ▶ Greenhouse gas emissions
- ▶ Staff welfare

**3.6.** An analytical issue now more prominent since the Covid pandemic comes with the rise of home and hybrid working. A company may improve the performance of its property, even using less but higher specification space, if only to attract staff to use the office. However, it may, in reality, be displacing its corporate environmental footprint on the costs of home working in more and possibly less efficient properties. Which is the basis for measuring sustainability – the property or the business?

**3.7.** Internationally recognised property certification schemes can offer common standards for investors. They include the Building Research Establishment Environmental Assessment Methodology (BREEAM), Leadership in Energy and Environmental Design (LEED), the Comprehensive Assessment System for Built Environment Efficiency (CASBEE), the Deutsche Gesellschaft für Nachhaltiges Bauen (DGNB), the Haute Qualité Environnementale (HQETM), the Sustainable Building Tool (SBTool) and Green Star. These approaches depend on the availability of the data required.

**3.8.** While legislative interventions for sustainability are considered in Section 4 below, other broad approaches are also promoted – both will influence how property and other markets evolve as policies and expectations for sustainability continue to develop.

**3.9. Corporate Social Responsibility (CSR)** describes companies' voluntary choice to integrate the consideration of social and environmental issues into their daily business to demonstrate ethical behaviour and improve social conditions. This may include considering:

- ▶ Inputs, such as raw materials, energy, water
- ▶ Processes, such as environmentally friendly production and associated waste
- ▶ Publicity, such as community relations

The more developed policies will cover property occupation and investment and so may have an effect on both capital and rental values.

**3.10.** While voluntary, an increasing number of companies accept CSR as an element in business plans and annual company statements. In some cases, it may be seen as a proxy for quality and good, sensitive management. The largest companies may

anyway be legally required to report on these matters and, in some countries, the law already regulates the presentation of non-financial performance indicators.

- 3.11.** A CSR policy may be driven by a company's strategic plan, its corporate risk strategy, the needs for grants and funding or pressure from investors, customers and others. A clear statement of the company's rationale will be needed for any appraisal of its impact but it is hard for these to be other than generic, not offering a basis for measurement.
- 3.12.** Companies anxious to show such credentials may seek B Corp certification as a marker for standards of social and environmental performance, transparency and accountability. More generally, CSR policies and statements may be associated with concern to reduce reputational risk and include control of its supply chain. Increasingly, litigation by environmental NGOs and action by shareholders are used to apply pressure.
- 3.13. "Triple Bottom Line"** – Some companies encompass the ecological, social and economic aspects of sustainability in the concept of the "Triple Bottom Line", analysing and reporting performance under each heading. This is, of necessity, a permanently evolving approach and indeed sustainability could be extended to consider technical and functional quality. That triple bottom line approach overlaps with the widely mentioned concept of ESG.
- 3.14. ESG – Introduction** – "ESG" is used to refer to environmental, social and governance as factors for the behaviour of business and finance, presented as moving from exploitative actions to environmental improvement, respect for and the welfare of those employed or affected by a business and considerate and ethical corporate governance. It has become widely used as a label and concept alongside the development of sustainable investment approaches but the perspectives and priorities in that vary between counties and over time. With changing knowledge, pressures, concerns and markets, ESG is always in evolution.
- 3.15.** That diversity is illustrated by this non-exhaustive list of factors that can appear in ESG reporting supported by an even wider variety of data:

  - ▶ Environmental – greenhouse gas emissions (whether in the business or its full supply chain), climate change, energy efficiency, biodiversity, forest cover, pollution, water management, resource efficiency
  - ▶ Social – equality, diversity and inclusion in employment and the supply chain, pay ratios, health and safety, working conditions, staff engagement, customer satisfaction, wider work in the community, charitable and political involvement

- ▶ Governance – ownership and control, management and board composition and operation, executive remuneration, ethics, action against bribery and corruption, data protection

- 3.16. The Development of ESG** – While there is a long history of the concerns over and scrutiny of business conduct, ESG was first set out as framework by the 2004 report, *Who Cares Wins*, published by the United Nations and sub-titled, “Recommendations by the financial industry to better integrate environmental, social and governance issues in analysis, asset management and securities brokerage”. Aimed at global businesses, investors, lenders and governments, this coincided with wider international attention to these issues and others that could be closely related to them, including diversity and respect in employment. The label, ESG, has remained a focus for much of this discussion. Legislation and practice have taken many of the concerns within it into account, including corporate governance, carbon. nature and eco-system services issues and discrimination and welfare.
- 3.17.** Again a shifting portmanteau concept, the ESG approach can be seen as either a framework for applying ethical business practices, recognising the longer term issues important for corporate success or a theme for campaigns distracting from business purpose and profit – a spectrum from altruism to self-interest, vulnerable to such challenges as greenwashing. Much of the discussion of ESG for property and business is now about analysis and reporting for investment and finance. Where ESG concerns are perceived to influence the availability of money, they may then influence behaviour in markets.
- 3.18.** However, while ESG gives an increasingly adopted language for this discussion, it is not a single unified framework, even within countries. With no uniform reporting standards, there may not be a common understanding of the possible trade-offs between its aspects. Investors, lenders, businesses and property owners are naturally focused on what is most relevant to them and so measure those points in different ways and report or seek some information but not other data.
- 3.19.** ESG can be seen as an approach, the design and utility of which will vary with time, circumstances and need – and the concerns of different markets. That may be illustrated by the changing views of defence-related businesses following Russia’s second invasion of Ukraine, having previously been excluded, they have now moved into greater favour.
- 3.20.** Some aspects that can be considered within it are also large free-standing topics, such as energy and net zero, which can simply be seen as important in their own

right and evolving at the same time as ESG itself evolves. For the valuation of property, it may most often be that the impact of climate change, its mitigation and adaptation to it is the most salient aspect of these topics. As urged by leading central banks, climate change poses major challenges to the world's financial systems requiring a commensurate response with an understanding of risks and then reporting and corresponding action to meet the demands of financial prudence and fiduciary duties.

**3.21.** While there is an ESG approach, there is not a necessarily consistent or objective basis for financial decisions and the allocation of investment. There have been several international initiatives to fill this gap, including

- ▶ The Taskforce for Climate-related Financial Disclosure (TCFD) – see 1.8. above
- ▶ The Taskforce for Nature-related Financial Disclosure (TNFD) – see 1.8. above

developed by major financial institutions. These have been accompanied by legislative approaches in the EU, the UK and other countries.

**3.22.** Responsible Property Investment (RPI) is a framework for investors to maximise the positive effects and minimise the negative effects of property ownership, management and development on society and the natural environment. As well as Principles for Responsible Banking and for Sustainable Insurance, the United Nations Environment Programme (UNEP) Finance Initiative has set out Principles for Responsible Investment to incorporate ESG issues into company policies and practice, offering a series of toolkits for this. Its declaration requires companies to look to their “investment service providers (...) to integrate ESG factors into evolving research and analysis”. Its Property Working Group aims to drive best practice in innovation and regulation to these ends with such work as the Sustainable Real Estate Investment Framework. Recognising the constraint of a tenant's legal possession, it sees the role of the property investor as particularly critical for construction, refurbishment, management of common space and the opportunities given by lease termination. At each point, that direct investment provides more control over sustainability issues than an investor in equities (including REITs) can have with a financial stake. The Principles expect the responsible property investor to engage with its tenants to manage the environmental and social impact of a property, albeit that few historic leases have many clauses relevant to sustainability issues. The focus of this effort may often in reality be more relevant to primary, rather than tertiary, properties.

**3.23. ISO 14001** – This sets standards for businesses to be audited for:

- ▶ Environmental policy
- ▶ Planning of action



- ▶ Implementation and operation of project
- ▶ Checking and corrective action
- ▶ Management review

**3.24. The Eco Management and Audit Scheme (EMAS)** – This has been developed by the European Commission for companies and other organisations to evaluate, report, and improve their environmental performance and offers a European standard that is voluntary but once adopted is subject to mandatory auditing (unlike ISO 14001). As some of its requirements are supported by legislation (Regulation (EC) 1221/2009 as amended), it may be more demanding than ISO 14001 to which it is essentially similar. A business is to identify its direct and indirect environmental impacts and assess their significance. Internal audits must cover the management of the issue, performance in doing so and compliance and there is an external audit on a three year cycle.

**3.25. “Level(s)” – The EU Initiative for Sustainable Building Construction** – This has been developed by the EU and some major companies as a common EU voluntary reporting framework to assess environmental performance in the design and construction of buildings that are sustainable by virtue of using less energy, using fewer materials and benefiting occupiers’ comfort and health. It uses existing standards and a lifecycle or circular economy approach for the building sector with its demands for energy, minerals and water and generation of waste. This broadens the focus of attention from the use of a building (overall accounting for 28 per cent of global emissions) to include the emissions and resources embodied in it (a further 11 per cent of emissions), so responding to the EU’s Circular Economy Action Plan and the desire for substantially improved efficiency in the use of resources.

**3.26.** With its focus on the life cycle of a building, Level(s) moves beyond many current green certification schemes but has been supported by BREEAM, DGNB, HPI, HQE and Verde which intend to explore alignment with it.

**3.27.** Level(s) is intended to support standardisation of data, giving a mutually intelligible basis for architects, assessors, contractors, suppliers, investors and others to consider these issues for a property. Each indicator can be used in a graduated way with levels from simple assessments using basic metrics to more thorough and complex ones, through to a full Life Cycle Assessment. It can be used as a building project progresses from design (using the plans) to completion (as built), post completion once commissioned and tested and then actual occupation in real use.

**3.28.** Level(s) uses a series of indicators linked to the EU's priorities for sustainability:

- ▶ *Greenhouse gas emissions* over the life cycle of the building, moving from energy performance to life cycle global warming potential to a full "cradle to cradle" Life Cycle Assessment
- ▶ *Resource efficiency and circular material life cycle*, moving from a life cycle assessment of materials used to considering scenarios for a building's lifespan, adaptability and demolition to the waste and materials in construction and demolition to a full "cradle to cradle" Life Cycle Assessment
- ▶ *Efficient use of water resources*, considering water consumption in use
- ▶ *Healthy and comfortable spaces*, moving from indoor air quality to assessing the extent to which it may be outside the thermal comfort range and then reviewing light and noise issues
- ▶ *Adaptation and resilience to climate change*, with scenarios for possible climatic conditions and then a review of extreme weather events and floods
- ▶ *Life cycle cost and value*, with assessment of life cycle costs in €/m<sup>2</sup>/year and then considering value creation and risk factors

## 4. Legislation

**4.1.** A growing framework of relevant legislation is being put in place by the EU and by countries within and outside the EU, some implementing global commitments. The valuer will need to be aware of the legislation relevant to the property in question.

### **4.2. The European Green Deal**

**4.2.1.** Primarily driven by the aim for the EU to reach net zero greenhouse gas emissions, the European Green Deal, agreed by the EU in 2020, is a set of policy initiatives, reviewing existing legislation for climate-related policy instruments and introducing new legislation on the circular economy, building renovation, biodiversity, agriculture and innovation.

**4.2.2.** The European Climate Law of 2021 sets an interim target of a 55 per cent reduction of greenhouse gas emissions from 1990 levels for 2030 with the "Fit for 55" package setting out how this could be achieved and a net zero target for 2050.

**4.2.3.** Perhaps the most significant step in reaching net zero is decarbonising energy systems with key elements being:

- ▶ Prioritising energy efficiency
- ▶ Developing a power sector based largely on renewable resources
- ▶ Securing an affordable EU energy supply
- ▶ Achieving a fully integrated EU energy market

**4.2.4.** Meeting the wider objectives includes:

- ▶ A circular economy action plan with expectations on Member States to create sustainable, low-carbon, resource-efficient, and competitive economies
- ▶ A Farm to Fork strategy intended to move the CAP to sustainable methods of production, rewarding farmers for managing and storing carbon in the soil, improving nutrient management, reducing emissions and enhancing nature while reducing the use of fertilisers, other nutrients and sprays. There has been some erosion of the initial policy measures as a response to the agricultural discontents of 2023.
- ▶ A forest strategy to promote afforestation and forest preservation and restoration
- ▶ Supporting research and innovation in clean technologies, including those for buildings
- ▶ A Carbon Border Adjustment Mechanism (CBAM) with tariffs on the imports of specified goods the production of which has not curtailed greenhouse gas emissions at the same rate as the EU. Other countries are also developing such an approach.

**4.2.5.** With the estimate that the present rate of refurbishment of buildings would need a century to reach an energy-efficient and decarbonised building stock, one aim is to increase that rate sharply with new technologies, the climate-proofing of buildings and improved energy performance. The Energy Performance of Buildings Directive 2024 requires Member States to adopt their own paths to reduce the average primary energy use of residential buildings by 16 per cent by 2030 and 20-22 cent by 2035. For non-residential buildings, they will need to renovate the 16 per cent worst-performing buildings by 2030 and the 26 per cent worst-performing buildings by 2033. Further legislation includes the Energy Efficiency Directive, requiring the renovation of 3 per cent of the public sector building stock to a near zero emissions standard each year, and the Renewable Energy Directive.

**4.2.6.** The Zero Pollution Action Plan intends to achieve no pollution from “all sources” by 2050.

**4.2.7.** With 81 per cent of EU habitats and 63 per cent of protected species deemed by the European Commission to be in poor status, the EUs biodiversity strategy for 2030 aims to protect nature, prevent the loss of species and the degradation of

eco-systems and promote their restoration. These policies with the use of nature-based solutions are seen as an integral part of climate change mitigation as well as an essential support for economies that are substantially dependent on the natural resources that have been depleted.

**4.2.8.** While there is an international commitment under the Kunming-Montreal agreements that 30 per cent of land and 30 per cent of sea be managed for nature by 2030, the EU has approved the Nature Restoration Law with a legally binding 20 per cent target for each of land and sea for 2030 and to restore all ecosystems in need of that by 2050. EU Member States are to restore at least 30 per cent of specified habitats (such as forests, grasslands, peatland, wetlands, rivers, and lakes from poor to good condition) by 2030 and 90 per cent by 2050. They are to develop Nature Restoration Plans and must also ensure that, once restored, these areas do not deteriorate. However, the Law includes an “emergency brake” for targets affecting agriculture to be suspended “under exceptional circumstances” that threaten food security. The Law also protects urban green space. Such measures have potentially significant consequences for countries like Denmark and the Netherlands. It illustrates the political contention over the practical effects of the Green Deal which has increased with the economic strains of the pandemic, the invasion of Ukraine and concerns about security and competitiveness in farming and other sectors while there is environmental criticism that the Green Deal does not go far enough.

### **4.3. Legislation on sustainability reporting**

**4.3.1.** The European Commission’s Sustainable Finance Action Plan has been developed with

- ▶ The Taxonomy Regulation (2020/852)
- ▶ The Sustainable Finance Disclosure Regulation (SFDR) – 2019/2088
- ▶ The Corporate Sustainability Reporting Directive (CSRD) – 2022/2464

**4.3.2.** The **Taxonomy Regulation** provides a classification system (“taxonomy”) defining criteria for economic activities that are aligned with a net zero trajectory by 2050 and the broader environmental goals other than climate under the European Green Deal. The aim is to ensure a common language for these issues with clear definitions of what is sustainable that can guide investment with six environmental objectives in mind:

- ▶ Climate change mitigation
- ▶ Climate change adaptation
- ▶ Sustainable use and protection of water and marine resources
- ▶ Transition to a circular economy

- ▶ Pollution prevention and control
- ▶ Protection and restoration of biodiversity and ecosystems

4.3.3. The development of that taxonomy in subsequent legislation (Delegated Regulation 2023/2486) was necessarily political and difficult with a contested result, the issues, including energy sources, touching on important economic and social concerns of EU Member States and their different perceptions. For property, relevant economic activities include:

- ▶ The acquisition and ownership of buildings
- ▶ The construction of new buildings
- ▶ The renovation of existing buildings

To be classified as environmentally sustainable under the Taxonomy Regulation, such economic activities should:

- ▶ Substantially contribute to one of the Regulations six environmental objectives
- ▶ Do no significant harm to the other five environmental objectives
- ▶ Meet defined “minimum safeguards” (such as the UN Guiding Principles on Business and Human Rights) so as not to have a negative social impact
- ▶ Comply with the technical screening criteria

4.3.4. While using the Taxonomy Regulation is still largely voluntary at this stage, other EU regulations and directives require disclosure of the eligibility and alignment of economic activities with it. Entities subject to the Non-Financial Reporting Directive have had to disclose the proportion of turnover derived from, and capital and operational expenditure associated with, EU Taxonomy aligned activities. At least in these early stages, it appears that the data collection for this is challenging but will be needed. It can suggest how much of a business’ economic activity is sustainable and what might be done to improve this. For some markets, good evidence of the extent of environmentally sustainable economic activities may offer a competitive advantage. Some investors or lenders may want to be assured that action is being taken to reduce the environmental impact of properties and in the terms of agreements for purchasing, constructing and letting properties.

4.3.5. The **Sustainable Financial Disclosure Regulation (SFDR)** provides a framework of disclosure for financial services businesses with more than 500 staff as to how activities and investments are aligned with the EU Taxonomy. As a regulation, it applies directly in EU Member States to require financial service providers and owners of financial products (and so many investors in real estate and asset managers) to assess and disclose environmental, social, and governance considerations publicly, now on an annual basis. Intended to enable comparison and so informed investment decisions, it has been developed to improve transparency,

reduce greenwashing and so assist willing capital to move towards investments and businesses seen as more sustainable.

- 4.3.6.** Applying to a wide range of financial institutions and advisers, SFDR disclosure obligations are:
- ▶ The adverse impacts of investment decisions on sustainability factors – declaring the potentially negative consequences an investment decision may have on such sustainability factors as energy performance, water usage, biodiversity, employee matters and human rights, and how they are mitigated
  - ▶ Considering how sustainability risk is integrated into investment processes – what might adversely affect investments and how remuneration policies are aligned with sustainability risk management
  - ▶ Provision of sustainability information with respect to financial products with additional disclosures required for some products
- 4.3.7.** Building on the Non-Financial Reporting Directive, the **Corporate Sustainability Reporting Directive (CSRD)** requires businesses including those in real estate businesses, such as investors and developers, within its scope to report on a range of issues, such as energy efficiency, carbon emissions, social responsibility, diversity and inclusion, disclosing policies, targets, and performance, and providing assurance as to their sustainability reports. Intended to create transparency and so aid the judgment of risks and opportunities, it also brings compliance and reporting challenges. The first reports under this regime are due in 2025 on the 2024 financial year.
- 4.3.8.** Outside the EU, the UK's **Sustainability Disclosure Requirements** provide sustainability-related product labels, product- and entity-level disclosures, an anti-greenwashing rule and additional rules regarding sustainable investing for the UK. This builds on the UK's implementation of the TCFD in 2022 and requires an evidence-based standard that is an absolute measure of environmental and/or social sustainability.

## 5. Valuation and sustainability

- 5.1.** A valuer can only provide an opinion of value on the basis of evidence, reflecting the experience of the marketplace. That opinion cannot state that something should have a value or that a current value might not be sustained in the future, just that it has a value assessed from a judgment of the available data. That opinion is to be supported and prepared so that, within the limits of the available evidence, the client can rely on it for the purpose for which the valuation was instructed.

- 5.2.** While the default basis of valuation is Market Value, there will be instructions where the valuer will need to be clear as to whether the valuation is to be on another basis, or on specific assumptions or for the needs of a particular client, as for example using investment value (“value to whom”) Some sustainability criteria may have positive or negative effects on value for those with different interests in the same asset. Carbon offset trading from land assets may offer value to the holder/seller of the carbon units but might reduce the value of the land to a future potential purchaser.
- 5.3.** There can be no general rule as to any typical pattern of premiums or discounts accounting for environmental issues. Even where such issues are significant in the marketplace, much will turn on factors such as the state of the market, transparency of information, location, sector, exposure to environmental risk in the region, and consumer awareness. Ultimately, within any regulatory framework these are issues of supply and demand and so may be influenced by changes in the patterns of demand by businesses, investors and, beyond them, consumers as well as by changes in the regulations themselves.
- 5.4.** Markets are increasingly differentiating between the values of properties on environmental grounds, though this may vary between regions, market sectors and between primary and tertiary properties. Thus, it may be that highly energy-efficient buildings with low energy consumption or properties with a recognised green certification may begin to attract an additional value in some markets. While this may apply for a while, it may then be that as the market begins to expect such standards or regulation requires them, that premium is replaced by a discount for other properties. Such changes will be phenomena of the marketplace and there cannot be any general rule for the impact of these issues on property values, rents and yields. Valuers need to be aware of such market variations as they evolve and of the environmental risks relevant to the property being valued. There may be circumstances in which, according to the instruction and the case, it is appropriate to comment on risks to value.
- 5.5.** The issues on which the concept of sustainability focuses may or may not be relevant to that opinion, according to the nature of the asset, the relevant circumstances and the behaviour of prospective buyers. Thus, their relevance may turn on several factors including the extent to which the issues:
- ▶ Are not externalities but relevant to the price someone will pay
  - ▶ Are of interest as incentives or deterrents to buyers

In essence, it is a question of how far the evidence shows that a willing, knowledgeable and prudent bidder will take them into account when considering the price or rent of a property. Corporate buyers of commercial property may view these issues in a different way from someone buying a house to live in.

- 5.6.** This may also be influenced by market circumstances. Where there is a strong market with a limited supply of buildings, the market may not particularly distinguish between properties on sustainability grounds. However, as these issues come to matter to buyers and occupiers and as more properties meeting recognised sustainability criteria are available, so the market may differentiate on this point, perhaps especially when market sentiment is weak.
- 5.7.** There may be particular classes of bidders to whom sustainability issues may be more important; this is likely to be particularly true for public sector occupiers (for example, see EVS 6 for the requirements imposed on them by energy regulations). Most obviously these will include those for whom the ethical aspects matter more, whether out of personal conviction or under the rules of a specific investment fund. Some may be temperamentally interested in innovation – “early adopters” or see it as giving them a commercial advantage, perhaps with particular weight in a thin market.
- 5.8.** Others may see them as criteria relevant to potential future movements in values. They may think that properties meeting particular standards are more likely to rise in value or that properties failing to meet them are at greater risk of standing at a discount to a future market. Only the future will prove whether they were right or wrong, whether about the future reactions of markets or the specific criteria they have selected. Where such purchasers have chosen the right criteria and markets prove to move as they expect, then they may outperform the general market whether by buying advantageous properties or selling ones at greater risk from environmental factors. Markets may, of course, move in unforeseen directions or regard other factors as relevant. The story of sustainability has seen the emphasis move between particular issues over time, with climate change related concerns now more likely to be dominant. These aspects of markets may be particularly sensitive to new understandings of the issues, regulatory change and perceptions of risk.
- 5.9.** One way of analysing this behaviour is to observe that those parties are approaching their decisions on the basis of investment value (*see EVS 2*) in assessing the value of a property to them for their own objectives. Where the investment value of the property to an investor on its criteria is markedly greater than its Market Value, that investor may see an opportunity. If significant numbers do so, that may move the Market Value.



- 5.10.** When considering properties that are to be let, sustainability issues will be more relevant if they encourage tenants to pay higher rents or the market to see them as more secure income streams. The former will depend on the usefulness of such properties to tenants, over and above other properties – tenants will rarely have an interest in the future capital value of the property. Such buildings may offer relevant differences in energy or other costs, more attractive working environments for staff or help the tenant project its favoured image to its own customers. Some of this will inevitably overlap with the likelihood that the most sustainability-compliant buildings will be those built most recently, so also meeting other contemporary standards and be less likely to need refurbishment in the near future. Less compliant properties may need to incur the greater costs of adaptation in “retro-fitting” to meet rising standards as and when this may be required, whether by market expectations or as legislation develops (for the example of energy see EVS 6) or risk standing at a discount to the value of more compliant properties. Some may, nonetheless, retain appeal in the market for other qualities altogether.
- 5.11.** Should such an approach become more widely adopted by parties in the marketplace in respect of particular criteria, whether just, say, for energy or for a wider range of issues, then it would over time influence Market Values. In practice, analysing this may often not be a matter of general sustainability, but of appraising the role of specific issues (such as energy) which may interact with operational costs or be currently salient issues in the marketplace – and may be more directly measurable.
- 5.12.** These issues can become more difficult where a building is in several different occupations where the owner and occupiers may all have differing obligations, interests and objectives.
- 5.13.** Legal intervention, including any prospective limitations on letting or using properties that do not meet particular specifications, may also colour views. An approach once generally limited to the habitability of a property or the provision of basic services such as sanitation, is now being extended to energy efficiency and could be developed more widely.
- 5.14.** While some commentary might suggest that many might pay a premium for a property meeting a stated standard, this may be less evident from actual behaviour, where traditional factors may often appear to explain the outcome. As ever, the context of the transaction may aid understanding.

- 5.15.** Conversely, as legislation, market sentiment and perhaps taxation increasingly enforce sustainability issues, so the costs of compliance and improvement for many existing properties or more complex development proposals (such as some urban regeneration schemes) could adversely affect their values.
- 5.16. Approaches** – While ever greater attention is being focused on sustainability issues, it is often commented that they may often not be reflected in Market Values. That may simply be an observation that, at that time, they are not seen as material to values. Longer term issues may matter less to participants for markets in which transactions are with short term horizons or are funded using shorter term loans.
- 5.17.** However, as any one issue becomes of general concern to buyers, so it just becomes part of the general matrix of factors underlying Market Value. Moreover, as some studies show from analysis of large data samples for transactions, the effects may be subtle but pervasive, not distinct in themselves and possibly only driven by a fraction of buyers or tenants but sufficient to affect values. Other markets may be influenced by large scale or well publicised environmentally-oriented purchases. The effect may, of course, not be that of a premium over other properties, but that less compliant properties may be at a discount.
- 5.18.** Any recognised certification or rating awarded to the property should usually be reported.
- 5.19.** Sustainability, energy efficiency and green features can only be reflected in the valuation where this is supported by observable market evidence. There is no reason to assume that meeting or failing to meet any aspect of sustainability will automatically and of itself see a premium or discount in the property's value. The impact of a feature may vary over time, between different sectors, uses or regions.
- 5.20.** All existing valuation methods – direct value comparison, income and replacement cost – can be suitable for the valuation of sustainable buildings. Comparable transactions are the best proof of the market's willingness to pay for certain building features but as owners and users of property respond to the developing issues, there may be fewer direct comparables and more adjustment might be needed.

- 5.21.** In some markets, valuers may try to apply advanced statistical methods to identify green value as part of the analysis. This may depend on the quality, range and relevance of available data and skill in its objective analysis. The use of multiple regression analysis may persuade more sophisticated clients. Contingent valuation, hedonic pricing or even cost-benefit analysis may offer approaches to do this but these can risk producing results that are uncertain, unduly sensitive to changing assumptions, with large ranges and that are not obviously supported by the marketplace or even produce a Market Value. The valuer may also draw on the analysis of very large data samples that is now possible. While that can illustrate even relatively subtle effects, the statistical associations apparently demonstrated need objective testing and might anyway not be relevant for many properties such as those that are more individual or in smaller sectors.
- 5.22.** Discounted Cash Flow (DCF) can be a way of taking into account and comparing differing profiles of operating and refurbishment costs but also require a view on the potential obsolescence of assets, the approach to depreciation and the risks involved.
- 5.23.** One practical problem is that sustainability issues do not exist in isolation but, as noted above, will overlap with other factors. For example, energy efficiency may be a virtue, a cost saving, allow a higher quality of working environment and be an aspect of a modern building which, as such, has lower maintenance costs, less need of refurbishment and may be in a more attractive location. Taken on its own, energy efficiency might not be the decisive factor in value.
- 5.24.** The suitability or potential of a property, such as but not only farmland or forestry, to offer opportunities in its use or management to meet sustainability objectives or commitments, whether for transactions to deliver biodiversity offsetting to enable developments elsewhere or for its use for carbon sequestration, flood attenuation, air quality improvement, renewable energy development or other purposes, may offer additional value to the property. Where these transactions create new asset classes, their definition and robustness may be relevant. If some tradeable sustainability aspect, such as a carbon credit, has been sold away that might reduce the potential future opportunities for the property or create a liability for the property or its owner with potential adverse effects on value. Becoming subject to the limitations of a statutory environmental or other designation, as being within a Special Area of Conservation under the EU Habitats Directive, a Special Protection Area under the Birds Directive or within a water catchment held to affect ecologically important sites may also affect value according to market preferences.

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





**VII.**

# European Valuation Information Papers





# 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. 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.
- 9.** 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.
- 10.** Due to the diversity of properties and sellers’ expectations, the range of offer prices is large, often greater than that of transaction prices.

11. 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.
12. 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.
13. 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.
14. There are two types of market imbalance: overdemand (seller's market) and oversupply (buyer's market).
15. 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.
16. 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.

17. 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.
18. 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".
19. 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).
20. 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.
21. 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.





# EVIP 2 Portfolio Valuation

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

## 1. A portfolio valuation

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



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

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

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

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

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

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

## **2. Undertaking a portfolio valuation**

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

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

- 2.2.** The full scale of the portfolio will need to be defined and recorded. There should be no doubt as to what property has been considered and so to what the valuation relates. That may require assumptions as to uncertain boundaries or facts.
- 2.3.** A portfolio of a large number of properties may, of practical necessity, be undertaken by closer inspection of only a fraction or sample of properties, so that the valuer uses them to appraise the issues that are relevant and, so far as they are representative of the portfolio as whole, determine its value. That requires care both in selecting the sample involved so that it is informative as to the portfolio as whole and in the professional use of any statistical techniques that are used in this task.
- 2.4. Using statistical tools and AVMs** – The valuer might use statistical tools to test measures of the distribution and variance of values and the sensitivity of the outcome to particular assumptions. These may be bespoke tools, general statistical packages or derived from an Automated Valuation Model (AVM).
- 2.5.** That issue may, according to the scale of the portfolio, prompt consideration of the use of an AVM. As a desktop exercise, this is more apt for large scale valuations than for individual properties.
- 2.6.** Where valuers are confident in:
  - ▶ The representative nature of the data being used, including its relevance to properties in the portfolio (such as geographical area and market sector), its type (actual results from transactions or just asking prices or other valuations) and its volume; and
  - ▶ The appropriateness of the rules that the model uses to estimate price, potentially including how they are reviewed for changing markets

an AVM may assist them in forming the final opinion of value.

- 2.7.** It is important to remember that statistical techniques, statistical tools and AVMs are mathematical aids to calculation and do not offer the professional judgment that is needed to report on value: that is the valuer's task and responsibility.

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

### 3. The result

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

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

## 4. Values of the component properties

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

## 5. Reporting the fair value of a portfolio for accounts

*(see EVGN 5 for a larger discussion on measuring fair value for IFRS)*

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

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

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

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

property, property held on lease and agricultural property. Leases pose the additional question of whether they are, for IFRS purposes, finance or operational leases.







# **EVIP 3** Apportionment of Value between Land and Buildings

1. Introduction
2. Scope
3. Definitions
4. Commentary
5. Apportionment in practice
6. Apportionment between components of buildings under IFRS accounting standards

## 1. Introduction

- 1.1. Valuers often encounter situations where the value or the purchase price of a property has to be apportioned between its different components. In particular, EVGN 5 – Fair Value for Financial Reporting, makes reference to apportionment.
- 1.2. Apportionment of value between the components of a property is not a valuation. The outcome of the apportionment should not be taken as corresponding to the Market Value of the components.
- 1.3. This Guidance Note reviews the assessment of apportionment between land and buildings on that land, neither of which can usually be marketed separately. This is thus a distinct topic from the valuation of undivided shares in a property (i.e. the valuation of one person or body's share in a property whose ownership is shared between several people or bodies). Apportionment may also on occasion involve equipment and machinery or intangibles. In addition, the value attributed to the buildings may have to be further apportioned between different components of the buildings.
- 1.4. Apportionments will generally be required in order to allow the owning entity to depreciate the value of the buildings over their remaining useful life. It is generally considered for accounting and taxation purposes that land is permanent and does not lose value. Any depreciation is therefore limited to the buildings and to any improvements to the land, hence the need for an apportionment of a price or value between the land, on the one hand, and the buildings and improvements, on the other.
- 1.5. The financial consequences of an apportionment can be considerable. Some entities may have special interest in improving the benefit to them and valuers must be aware of this. Therefore it is imperative that any figures they report be prepared in accordance with best practice and can be supported if they are subsequently challenged.

## 2. Scope

- 2.1. The purpose of this Guidance Note is to analyse the valuer's approach to this apportionment of a property's value or purchase price. This may be required for financial reporting purposes, the classification of a lease under IFRS, or taxation.

Values may also need to be apportioned for rent reviews in some jurisdictions or to apply agreements between parties. EU law and international and national accounting standards all require an apportionment for depreciation purposes.

- 2.2. In addition, entities adopting the cost approach to accounting under IFRS for operational properties (IAS 16) will be required to apportion the fair value of the properties between the various components of the buildings. Similar 'componentisation' may also be required under some national accounting or tax regimes.
- 2.3. This Guidance Note will address general approaches to apportionment in the first instance, then deal in more detail with apportionments required under IFRS accounting standards. For any apportionments required under national or local accounting, taxation or other regulation or legislation, the valuer should refer to the appropriate national or local texts and associated case law and should take account of any specific requirements expressed therein.
- 2.4. Finally, it should be noted that if apportionments are challenged, the challenge can take place many years after the figures were originally reported and the financial consequences of a successful challenge can be serious for the reporting entity. For this reason, it is important for valuers to give due consideration to the apportionments they carry out and to document them carefully, in order to be able to defend them at a much later date.

### 3. Definitions

- 3.1. Common terms used in the apportionment of the value established for a property between land and buildings on the land are:
  - ▶ Depreciation
  - ▶ Depreciable amount
  - ▶ Residual value
  - ▶ The useful life
  - ▶ Depreciated replacement cost (DRC)
  - ▶ Excess or surplus land

These are defined below. Where appropriate, IFRS definitions are given. However, valuers providing apportionments for non-IFRS purposes should ascertain which regulatory or legal system applies to the work they are carrying out and read the relevant texts to see how the various terms are defined in them.

- 3.2. Depreciation** – This is defined in IAS 16 as *“the systematic allocation of the depreciable amount of an asset over its useful life”*. It is the reporting entity, not the valuer, who will decide how to depreciate the depreciable amount and who will prepare the depreciation calculations.
- 3.3. Depreciable amount** – This is defined in IAS 16 as *“the cost of an asset, or other amount substituted for cost, less its residual value”*.
- 3.4. Residual value** – Under IAS 16, this is *“the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life”*.
- 3.5. Useful life** – IAS 16 defines useful life, as it applies to real property, as *“the period over which an asset is expected to be available for use by an entity”*. Therefore if a particular building is shortly to become surplus to the entity’s operational requirements and demolished, its useful life for the particular reporting entity may be less than the useful life that other owners would have attributed to the building if it had not been surplus to their needs. If asked to establish or to assist in establishing the useful life of buildings, the valuer should therefore liaise with the reporting entity, so as to be aware of the entity’s intentions for the various buildings.
- 3.6. Depreciated replacement cost** of a building is the cost of replacing it so as to fulfil the functions for which it is used, after allowing for ageing, wear and tear and obsolescence. It is generally determined by starting with the replacement cost as new using reconstruction costs current at the valuation date. These will generally be based on current technical standards for buildings with modern materials and methods. The depreciated replacement cost will include the fees associated with the construction. It will generally be used as the basis for apportionment in cases where the valuer has decided to approach it by first determining the ‘value’ of the buildings.
- 3.7. Excess land (or surplus land)** is land within the property that is not essential to the operational purposes of the buildings. Thus land that is used by the entity for parking or for external storage should not be considered as surplus land, whereas unused land or land let out to third parties would be considered to be surplus to the entity’s requirements.

## 4. Commentary

- 4.1.** The valuer's judgment and selected methodology will determine the adjustments necessary to provide a realistic and justifiable opinion of apportionment.
- 4.2.** The sum to be apportioned is commonly either:
- ▶ The Market Value or fair value of the property established by appropriate use of the three internationally recognised valuation approaches; or
  - ▶ The price of the transaction by which the property was acquired by the entity (historic cost)
- 4.3.** In some jurisdictions there may be policies for apportionment of certain classes of property established by law, government agencies or local practice. They may or may not be mandatory. The valuer may need to explain or justify the method used.
- 4.4.** In some countries, permanent buildings cannot be sold separately from the land on which they stand. Similarly, the land element of a built property cannot usually be sold separately from the buildings that stand on it (apart from any surplus land). While evidence of sales of bare land will often be available, such sales will generally have taken place on the basis of the value that the market sees in the property (including its potential uses), whereas in the theoretical world of apportionments the use of the land is deemed to be restricted to the current use. In view of all this, it is unlikely that valuers will be able to directly value either of the two component parts by directly applying evidence obtained from comparable sales of land without its buildings or buildings without the land on which they stand.
- 4.5.** Therefore, where the requirement is to apportion value between land and buildings on that land, the apportionment process will usually be dealt with in one of the three following ways:
- ▶ Determining the value of the unimproved land for its existing use at the relevant date and then deducting this value from the value or price of the property in order to obtain the value attributable to the buildings; or
  - ▶ Determining the depreciated replacement cost of the buildings and of any improvements to the land at the relevant date and deducting it from the value or price of the property in order to obtain the value of the land; or

- ▶ Determining the value of the unimproved land, then the depreciated replacement cost of the buildings, adding the two amounts together, then adjusting each in proportion to the relationship that the sum of the values of the two components bears to the value or price that is to be apportioned

- 4.6. The land** – The component of the property that is the land is considered to be the bare land in an undeveloped state but with planning permission for construction and for the current use of the buildings. In countries where additional permits are required for particular uses (e.g. for large retail complexes), those permits are also assumed to exist and to be part of the land. The services that exist are assumed to be available for connection but all built improvements within the boundaries of the property such as roads, fences, paved areas and other site works are excluded, as they have to be depreciated. The valuation will thus reflect the advantages and disadvantages of the site and its location for the current use. It must not include any development potential over and above that required for the buildings being considered.
- 4.7.** Bare land in an undeveloped state might still have significant infrastructure installations, the costs of which will, for the most part, be depreciable amounts. Land without any infrastructure might be worth very little, so care is required to avoid double counting.
- 4.8.** If an entity is being valued under a **DRC approach** due to a lack of market transactions for what might be a specialised use, the availability of land transactions for that use is likely to be lacking. If the requirement is for special permits or licences which may be possible in only a few locations there may be an element of premium pricing for land in that use. Equally, where the entity is of low value compared to other uses, the land might be worth a small amount.
- 4.9.** Some valuers and auditors in these circumstances have adopted a value for land that a **prevailing local use** might generate. For example, a site for a school may be in a residential area and the prevailing use would be residential. The logic is that a purchaser would compete to acquire the land at its highest value and may then choose to use it for a lower value end use.
- 4.9.1.** This creates a valuation problem in that there may be no planning approval for the alternative use and it may not be obtained. One common approach is to discount the alternative use value by a percentage, but this has no evidential base.
- 4.9.2.** If the land value is greater than the value under existing use, then the basis for valuing the land needs to form part of the apportionment to maintain consistency.

- 4.10. “Excess land” or “surplus land” is not included in the apportionment. Excess land must be identified and then valued separately on a Market Value basis with any development potential that it may have. If a purchase price of the whole property is to be apportioned, then the value of any excess land must be deducted from the purchase price before apportioning the remainder between land and buildings. The value of any excess land must be reported separately from the value of the operational land.

## 5. Apportionment in practice

- 5.1. The use of one or other of the three procedures in 4.5 above depends on the relevance and quality of available information. It is unlikely that the first two methods, even where supported by good evidence, will give the same result, as they involve different concepts and the ‘value’ of the whole property may therefore differ from the sum of its separate parts. If only one of the first two methods is used, valuers will then use their professional judgment to justify the selection and application of the apportionment procedure used and any subsequent adjustment in reaching their final figures.
- 5.2. **Determining the ‘value’ of the land, then deducting it from the value or price –** In many instances valuers will be more comfortable with this approach, as it starts with a valuation of land for a particular purpose, which can sometimes be based on a comparison with other land sales on the market. If no comparables are available, valuers can use a residual or DCF development appraisal, procedures that they will usually be familiar with.
- 5.3. Again, it is essential to determine the value of the land solely on the basis of the existing use of the property, i.e. the type of property (retail, offices, warehousing, etc.) and the existing built floor area. Where the current property is not in its highest and best use, this will often give a land value that is lower than the price that could be obtained if the actual land were sold with vacant possession on the market. However, that higher value should not be used for apportionment purposes if the reporting entity proposes continuing the current use, which is generally the theoretical basis on which apportionments are prepared. The exception to this is as per 4.9 where existing use values are not easily determined.
- 5.4. The land should be valued on the basis of the unimproved site, ignoring the value of any foundations, paved areas, on-site pipework or tanks, etc. as all of these items are generally depreciable.

- 5.5.** Where existing buildings are nearing the end of their useful life, or where major expenditure would be required to bring them back up to modern standards, the land value will often represent a very high proportion of the total value or price to be apportioned. In extreme cases, such as where a developer has bought a property to demolish it and redevelop the site, the land element may represent close to 100% of the value of the property. High percentages for the land are often seen, for example, with office buildings that were built several decades ago and have not been significantly improved since. This is a logical conclusion of the depreciation process: the buildings have aged considerably and thus the majority of the value is in the land.
- 5.6.** For this reason, valuers should be cautious about adopting ‘short cut’ methods of apportionment, such as tables that purport to give percentages to be applied to a purchase price per square metre in order to obtain the land value. Such methods often only work correctly for new or very recent properties.
- 5.7. Determining the ‘value’ of the buildings, then deducting it from the value or price** – This procedure is more often used:
- ▶ Where there is little or no evidence of values for relevant land
  - ▶ Under jurisdictions that apply a building tax to the book value of the building
  - ▶ When dealing with property where there are other owners in the building and where rights of common interest might exist
  - ▶ When applying the procedure in 4.5, 1<sup>st</sup> indent, results in a value of the building that also includes intangible assets or personal property, which may limit the value of the figure so deduced
- 5.8.** Where the depreciated replacement cost of a building is used, the value to be applied may vary according to whether any consideration has been given to its possible economic obsolescence. Generally speaking, the objective is to reflect the age and suitability of the buildings for their current use – if there is a high degree of obsolescence then the value attributed to the buildings will represent a lower percentage of the total value than would be the case for a more modern property. The choice of percentage deductions for age, obsolescence, etc. is for the valuer to make according to the circumstances of the particular property.
- 5.9.** The presence of other owners in the building, and the existence of common interest on their part, should be established as part of the examination of titles and other documentation prior to the completion of the valuation. There might be cases where complications are encountered in defining or ascertaining the rights of the other owners, but it is essential that if common interest exists, its



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

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

- 5.14.** On occasion, valuers are required to apportion the value of a **portfolio of properties** between land and the buildings on the land. One approach to this is to establish the appropriate apportionment for a representative sample of properties and then extrapolate that to the larger portfolio insofar as the properties in it are comparable. This sample-based approach must not be applied unthinkingly, as some properties in the portfolio may not have buildings at all or may differ significantly from the sample in terms of building density, age, quality and condition.

## **6. Apportionment between components of buildings under IFRS accounting standards**

- 6.1.** Entities that have adopted the cost approach to accounting under IAS 16 (as opposed to fair value) will have to apportion prices or values between land and buildings and then further apportion the value of the buildings element between the various components of the buildings. This will be particularly the case for operational properties (those occupied by an entity for its own business purposes), for which the cost approach to accounting is recommended for IFRS accounting. Valuers who are asked to apportion a price or value between components should familiarise themselves with the relevant parts of IAS 16.
- 6.2.** According to IAS 40, the investment properties should be valued at fair value each year and therefore the buildings of these properties are not depreciated. Apportionment between land and buildings is not necessary in this case. The same treatment should be applied to surplus properties. The over-rented properties may have a contract advantage for a period of time but they should be valued at fair value (IAS 40) and apportionment is not needed.
- 6.3. Identification of the components** – The first step in this exercise is to identify the components between which the value has to be apportioned. Paragraph 43 of IAS 16 states that *“each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately”*. According to paragraph 45, *“a significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and depreciation method of another significant part of the same item. Such parts may be grouped in determining the depreciation charge”*.

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

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

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

**6.5.** It is the responsibility of the reporting entity to determine the appropriate components for depreciation purposes. The financial consequences of a wrong choice of components could be serious for the entity and will often only become apparent many years after the original apportionment was carried out. For this reason, a valuer who is asked to identify the components should involve the entity fully in the final decision process and seek written confirmation of the entity’s agreement to the components that have been identified.

**6.6.** In the absence of relevant case law, it may often be unclear whether it is appropriate to go into great detail or, on the contrary, adopt a pragmatic approach based on, say, four or five families of components. Given that the initial apportionment between land and buildings is a theoretical exercise and therefore often somewhat approximate, many entities prefer that valuers approach the apportionment of the building value between the building’s components in a pragmatic way, only identifying those significant features that differ greatly in character. Excessive subdivision is likely to lead to implausible values of little assistance to the client or other advisers and to yield results that may necessarily differ substantially between valuations according to the assumptions and interpretations applied.

**6.7.** Nevertheless, in cases such as older buildings that have been partially renovated, particularly large complexes such as shopping centres, where the various technical installations may have different useful lives and depreciation patterns, it is appropriate to take this into account. In such cases, valuers must obtain as much information as possible on site and from their client about the ages of the main technical installations and the dates when major renovations or refurbishments were carried out.

- 6.8. Apportionment between the identified components** – Components of a building can generally not be sold separately from the rest of the building, so no sale evidence will be available. Generally, apportionments will therefore be carried out with reference to the relative cost of the various components when new, with appropriate adjustments in cases where some components are much nearer the end of their useful life than others.
- 6.9.** Finally, it is particularly important to prepare and retain accurate notes as to how the apportionment was carried out and the reasons behind the valuer’s key decisions. An apportionment prepared for accounting purposes is likely to be audited and the valuer’s report will help in the audit process. Those records will also make it easier to interpret the figures for any subsequent apportionment.





# **EVIP 4** Valuation and Other Issues for Recurrent Property Taxation

## Summary

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

## Summary

- S1** A basis must be decided for determining the value of each taxable property. That might use capital values or rental values, whether of the property as it is or of the land underneath it, and whether assessed on ownership or on occupation. Those choices may reflect local circumstances and may be different between classes of property, such as residential and non-residential. The valuations will need agreed assumptions which should be applied to all comparable properties so that they are assessed on the same basis. All valuations should be as at the same date so that all properties are treated equally. The process should be transparent to the taxpayer.
- S2** While it is likely that most properties can be valued on the basis of market transactions, sales or lettings, relevant to the valuation date, there will always be some properties for which there may be little or no evidence and for which other approaches will have to be found. These will need to be tested carefully as they are developed.
- S3** A property taxation system requires an accurate and comprehensive register of properties that is kept up to date. European Semester recommendations have focused on the need for Member States to have current and accurate registers; most have taken measures to comply.
- S4** Valuations need to be reviewed and updated on a regular basis so that the tax base accurately follows changes in relative property values. This Information Paper suggests that revaluing all properties on a regular 3 to 5 year cycle is likely to strike the right balance between fairness of valuations and uncertainty. Leaving this task too long will see values used for the tax become increasingly out of date and compound the political difficulty of re-valuing; annual review may be too demanding and not allow appeals to be heard before the next review takes effect.
- S5** An effective and independent appeal system is important both to achieve accurate and fair valuations and also for the political respect that a property tax system needs among taxpayers.



- S6** Property tax systems commonly have defined exemptions, full or partial reliefs and sometimes higher rates for particular classes of property or particular types of potential tax payer.
- S7** Fundamentally, a good tax system must be efficient, serve its objectives, not have perverse outcomes and command taxpayers' respect.

## 1. Defining the properties

- 1.1. Recurrent property taxation relies on a full and current list of taxable properties so that each can be identified. The valuer will need sufficient detail of the property to assess it and for it to be useful as a comparison when considering other properties. That detail will need to include the property's nature, floor area, accommodation and layout.
- 1.2. As properties are improved, their use changed or new properties created, so a system will be needed to ensure that the register is updated for these changes, triggering valuations as appropriate.

## 2. Valuation

- 2.1. In principle, the establishment or periodic updating of the tax base in a developed country with administrative capacity is a conventional valuation exercise, albeit on a very large scale.
- 2.2. It may be handled by national or local government agencies, whether using in-house valuation departments or retaining external valuers. The valuers' skills are applied to the properties recorded on the register of properties. The register needs to be maintained so as to provide a comprehensive and accurate base for the tax.
- 2.3. The process needs an established and clear basis for the valuation – whether capital or rental, on what assumptions, on Market Value or other basis. This is needed not simply to aid the task of the professional valuers concerned, but to ensure taxpayer confidence in the system with the important requirement that it

be clear that all are assessed fairly. That transparency should apply to the procedure as well as to the basis of valuation.

- 2.4.** In order to provide a generally agreed common basis for such valuations, EVS 1 defines “Market Value” as:

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

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

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

- 2.5.** The choice between capital value and rental value as the base for valuation and so for tax assessment may reflect a number of factors, including:

- ▶ **Availability of evidence** – A market with substantial numbers of sales transactions will more readily support capital valuations while another market with much rental evidence will more readily support a rental basis. That will differ between national markets and between sectors – business and residential markets may have different characteristics on this point. For example, when the annual property tax system for England, Wales and Scotland was heavily revised in 1991 a capital value base was adopted for residential taxation but a rental base retained for non-residential taxation. Northern Ireland has moved its domestic rates valuations from a rental to a capital basis.
- ▶ **Whether the tax is more acceptable in the national political culture as a tax on the current use value of the property or the wealth it may represent**
- ▶ **Whether it is better seen as a tax on occupation or on the services that the property provides to an occupier, or a tax on ownership**

These issues pose particular questions for let (or investment) property. Who is to be the liable person, the occupier or the owner? Once known, that will affect the terms of new agreements between them.

- 2.6.** In practice, such issues may often drive separate approaches for residential and non-residential property.
- 2.7.** That analysis reveals again the essential combined influence of policy purpose, political acceptability and practicality. The disproportionate visibility of such property taxes should encourage structures that are easy to assess, accepted as relevant and intelligible to taxpayers.
- 2.8.** Where a full valuation of all affected properties is to be done, it has to be undertaken on a common basis for all properties subject to the charge and at a common date, requiring a range of standard assumptions to be imposed, whatever may be the actual terms of occupation for any individual property. Such potential assumptions might include:
- ▶ That the property is as it stands but is assumed to be in good repair – so that poorly kept property does not benefit. Nonetheless, less tax would be due from a property with poor facilities than for an otherwise equivalent property with better facilities.
  - ▶ That it is vacant, so ignoring current occupation arrangements
  - ▶ That, where relevant, moveable machinery is ignored but the potential of the property for it is recognised. Similarly, a house might be assumed to be unfurnished
- 2.9.** One question is whether improvements made by the current occupier are to be disregarded or not.
- 2.10.** Where a property is very individual, say a mediaeval college, and the answer is thought inappropriate, then it could be that the value of a hypothetical modern equivalent property serving that same function might be considered instead.
- 2.11.** If a rental basis is to be used for valuation, then standard terms for a lease also need to be assumed – as, for example, identifying whether landlord or tenant is to be liable for repairing and insuring liabilities for the property. This may be stated in the relevant legislation.

- 2.12.** With those questions answered, the valuation of many properties will be relatively straightforward where the evidence of transactions from active markets can be readily applied. Many countries maintain registers of land with records of transaction prices available to those assessing values for taxation. The usefulness of this may depend, especially for more individual properties, on accurate knowledge of the nature and location of the property and any relevant legal considerations.
- 2.13.** However, in any such comprehensive exercise there will always be a significant number of properties for which this will be more difficult:
- ▶ **There may be little relevant evidence** – What is the value of a reservoir? Railways, oil rigs and fibre optic networks may need to be valued
  - ▶ It may be felt that applying current values is inappropriate for domestic political reasons
  - ▶ There may be interactions with exemptions or reliefs, as where part of a property is taxable (say, residential) and part not (because it is an exempt use or subject to a different tax such as one on businesses)
- 2.14.** Where there is no sufficient market evidence, then it may be possible to arrive at a value by other valuation techniques:
- ▶ The value of many commercial properties may be tackled by working from the income they will yield, applying a capitalisation rate if a capital value is needed or identifying a standard way relevant to the sector in question to move from that to a rent. Yields for this may well vary between areas, sectors and qualities of property
  - ▶ It may be possible to consider some specialist trading premises on the basis of an agreed relevant fraction of typical profits
  - ▶ If, as may be the case for some specialist industrial property, neither comparison nor income methods appear valid, then it may be necessary to work from a construction cost and then identify an annual equivalent as a rental value
- 2.15.** Other problems can arise where the application of existing law to innovation produces apparently conflicting outcomes. As an example, in Scotland the application of the same legislation for which plant and machinery should be considered now produces very different valuation outcomes for different types of renewable energy generation, disadvantaging hydro-electric installations in comparison to wind turbines.
- 2.16. Actual Approaches** – There is a wide variety of approaches taken under the many different property taxes in EU Member States. Overall, it may be that the larger

the share of taxation that is raised by the tax, the more it is likely to be based on Market Values, whether capital or rental, albeit that their registers of values may now often be very dated. By contrast, countries that have had to put a system in place swiftly before property markets developed tend to apply standard values or mass appraisal with varying levels of adjustment to measured area.

- 2.17.** Within Market Value-based countries, dwellings will generally be valued using transactions evidence but income methods may be more used for commercial property. Many systems will resort to replacement cost methods to assess values for specialist, often industrial, property. Systems that tax land and buildings separately may use Market Value for land but sometimes a cost-based approach for buildings.
- 2.18. Land value tax (site value rating)** – If the tax base is just the value of land without the buildings on it (bringing undeveloped or vacant land into tax alongside developed land), the valuation requires an assessment of just that so that tax can be raised on the potential of the land at the time of the valuation and so, in principle, encourage land to be moved into its most valuable use.
- 2.19.** A century ago, this was tackled in the United Kingdom by the Valuation Office which was created in 1910 to do just this. The register of property values was completed by 1920 when the proposed tax was abandoned. Land value taxes have been implemented in Denmark, some states in Australia and the United States and parts of the Far East. Estonia, in particular, is understood to tax only land value.
- 2.20.** This assessment may be problematic in countries without detailed land use zoning and more specifically in areas (particularly found in city centres) where there are few comparables for such bare land sales or lettings yet high or very high values may be at stake, of a scale that can affect the overall distribution of the tax charges across the area or economy. Its application can then lead to disruptive questions – for example, what is the position for a three storey dwelling subject to a lease with five years to run when the vacant value of the site might be that for a 30 storey building? Is the resulting charge to be paid by the occupier or the landlord?

### 3. Maintaining the valuation register

- 3.1.** However the valuation is done, the result should be a valuation register as at a common valuation date so all properties are treated equally. With changing markets, that valuation date will soon become historic while properties subject

to the tax will change physically or develop new uses and new properties will be created.

- 3.2.** When a new taxable property is created, it will need to be added to the register and given a value. For equity, that should be at the common valuation date for that register.
- 3.3.** Commonly, changes to a property, whether it is extended or part is demolished or it is improved or its use changed, may again be occasions for a revaluation, again at the same common valuation date, so looking backwards rather than at its current value.
- 3.4.** Ordinarily, this is a practical exercise, though ever more retrospective as the valuation date becomes historic. The register itself and the evidence on which it is based give the official valuer an enormous data base for reference. However, this may be more difficult for properties in sectors with substantial technological change since there may not have been comparable properties at the valuation date – where were data centres 15 years ago?

## 4. Revaluation

- 4.1.** The pace of change and volatility in the property market and the economy will rapidly make valuations dated with the result that each taxpayer's relative share of the liability may no longer reflect current circumstances. As values move relative to each other over time, with some areas or sectors becoming more or less valuable relative to others, so that distribution of liability for tax will become less appropriate. Keeping that liability in line with current values assists the political credibility of the system as a tax basis.
- 4.2.** That drives a need for regular comprehensive revaluations, the more so for more dynamic economies. However, this can be politically contentious and it is noticeable (and noticed by the European Commission) that many registers have not been revalued for some decades, even in systems that presume much more regular revaluations.
- 4.3.** The cost and effort involved will rarely make an annual revaluation appropriate. It could also be likely that a significant number of appeals against the previous valuation would still be outstanding, complicating the process.

- 4.4. A continuous, rolling process of re-valuation, in which a fraction of properties is re-assessed each year, might ease the burden of the task but with no common valuation date might not be (or be seen to be) equitable between taxpayers.
- 4.5. However, as time passes it becomes politically harder to undertake a revaluation. There will inevitably be taxpayers whose liability will change as a result (otherwise there is no point to it) and, with the visibility of property taxes, those who lose will object. With the greater political impact of economic losses, those who gain tend not to provide a counter-balancing force to the objectors. That pressure for inertia is, of itself, a major reason for revaluing at regular and fairly close intervals so that the discrepancies being tackled do not become too great. Delay sees the forces for that inertia accumulate.
- 4.6. On balance, undertaking revaluations on a cycle of some three to five years may often balance these pressures best. That may also reduce the pressure that can accrue to introduce further reliefs while giving both some certainty and the time for necessary appeals to be completed before the next review.
- 4.7. Of itself, this process may be one of the political factors setting a limit to how much tax can be raised through an annual recurrent property tax. Without revaluations, some taxpayers will increasingly resist a tax incidence that does not reflect reality.

## 5. Challenges, disputes and appeals

- 5.1. It is inevitable that in large and complex property markets, there will be disagreements about the value of properties, especially where there are significant taxation consequences. The valuation system has to accept and manage that as there will always be some mis-valuations.
- 5.2. Some systems manage part of this by placing properties into valuation bands with each band carrying the same tax charge. In such a system, it is only worth a taxpayer appealing where there is realistic prospect of the property moving to a lower valuation band and so a lower tax charge.
- 5.3. **Valuer's professional advice** – The process of challenge may work best if the taxpayer, taking professional advice from a relevant valuer, can raise a concern

about the valuation with those managing the official register. That may be to ask them to review it, providing evidence either:

- ▶ As to the way in which the property had been mis-described
- ▶ Even if it has been correctly described, showing that it should be given a different value

It may be very obvious from that review that an error has been made or the position appears correct but can be better explained to the taxpayer. However, if a disagreement ensues, there needs to be an independent tribunal that can receive evidence from the taxpayer and the official valuer and settle the dispute. A specialist valuation tribunal is more likely to have the skills for this work but, occasionally, there may be points of law that need to go further into the law courts.

- 5.4. Such a system, working within each national judicial framework, is essential to the proper functioning of the property tax. The prospect of challenge and independent determination should ensure good practice and support professional standards in the whole process and so aid taxpayer acceptance of the system.

## 6. Applying the tax

- 6.1. Once a value is established, the tax regime can be applied to it. In some systems there is a **de minimis** threshold below which very low value properties are not taxed.
- 6.2. The common approach is that the tax rate is set as a percentage of the value. That may be a common percentage but sometimes higher or lower rates may be applied to particular types of property (second homes sometimes see a discount or a higher rate according to the view taken of them). Exemptions and reliefs are considered below.
- 6.3. Where there is major revaluation it may be politically or economically necessary to allow a phasing in of new liabilities.

## 7. Exemptions and reliefs

- 7.1. While there may be some exemptions or reliefs that are necessary for practical reasons, these will more commonly reflect the accumulation of political concerns during the life of the regime. The political process tends to develop more



exemptions and reliefs to resolve issues as they arise but each extension of these narrows the tax base to the cost of other taxpayers.

- 7.2.** An exemption may usually mean that the property does not have to be valued. A relief may give partial or full relief from the tax assessment and may have to be claimed by the taxpayer or be applied automatically.
- 7.3.** The different taxes in different countries will offer exemptions reflecting domestic concerns and history. Religious and heritage properties may often have an exemption. Agricultural and/or forestry land and/or buildings often have their own treatment having, as examples, a separate regime (the current “*Property Tax A*” in Germany) and exemption in the United Kingdom, partly on the basis of being seen as part of the food production process rather than premises within which business activity happens. Embassies and other diplomatic buildings are generally exempt. All or some government buildings are taxed in some countries but not in others.
- 7.4.** Rate relief or exemption is often seen as a way to assist businesses. It may be offered to small businesses, enterprise zones and other development areas (promoting investment as well as easing the costs of business users) or favoured categories.
- 7.5.** Vacant property benefits from relief in some systems. The United Kingdom offers a general discretionary relief mitigating the impact of property taxes on charities while some countries (such as Spain) focus on their Red Cross but there may also be countries where many charitable works are undertaken by exempt religious bodies. Several countries offer initial exemption or relief to new dwellings or other properties.
- 7.6.** The size of household can affect liability to residential tax with some countries such as Spain giving reliefs for larger households, England allows a discount for sole occupiers and Lithuania has progressive banding by value with adjustment for family circumstances.
- 7.7.** There may usually be assistance to poorer residential taxpayers through national social security systems. Relief may be offered to both residential and commercial taxpayers affected by natural emergencies such as sustained flooding.

## 8. Higher or additional charges

- 8.1. In some countries there is provision for higher charges to discourage particular uses, such as second homes or supermarkets.
- 8.2. **Second Homes** – The English Council Tax system started with discounts for second homes but has now developed options for local councils to apply higher than standard rates of tax.
- 8.3. An alternative approach has been taken by the Esch-sur-Alzette commune in Luxembourg in applying tax to empty dwellings, initially based on € 100 per metre of façade and per floor, to encourage owners to sell or rent such properties, following measures taken by the Beckerich and Diekirch communes.





# **EVIP 5** Multiple Interests in Residential Property

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

## 1. Introduction

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

There may usually be a framework of national law as well as the agreement for the tenancy or right which will establish the legal character of the tenancy or right with its benefits and obligations.
- 1.4. It may be necessary to consider how far the dwelling has been altered by works (as for energy efficiency) that have altered it and so questions including:
  - ▶ How is a landlord's investment in a property treated?
  - ▶ How is a tenant's expenditure on the property to be treated?

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

Much of this may be governed by specific national law.

## 2. Valuation

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

## 3. Multiple ownerships

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

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

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

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



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

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

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

## 4. Tenancies and other rights

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

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

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

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

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

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

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

- 4.13.** This creates valuation issues such as:
- ▶ Valuing the interest of the ultimate owner, with a long term right to a very secure, often low (but sometimes increasing) rent and the ultimate reversion
  - ▶ Valuing the head tenancy with its income from the usually still low rents but perhaps also liabilities to the property, whether just to the common parts of the estate or more generally. The levels of those sub-rents will reflect market circumstances in that a developer will usually want capital receipts to make an immediate profit to cover costs, rather than a longer term income stream. Capital receipts are maximised by setting the rents for the long term house leases at low values. Higher rents would reduce the ability of the purchasers of the sub-leases to buy with mortgage finance and that liability would directly reduce their free income to repay the mortgage.
  - ▶ Valuing the residential leases as time passes for everything from sale or re-mortgage to divorce or lease extension. The issues become more critical as the remaining term of the lease reduces with time. That effect is enhanced in markets where residential values are reliant on mortgage finance. Where properties are more likely to be bought by people who can buy outright, values can reflect their preferences more directly.
- 4.14.** That can lead such a tenant to want to negotiate with the landlord for a new or extended lease, whether within any statutory framework or otherwise. Valuations of the various interests involved will be important to those negotiations.
- 4.15.** There may be particular national structures for long residential leases, such as the *amphythéose* in France, and they may more generally be governed by specific national legislation.
- 4.16. Rental value** – While the situations discussed here commonly assume an arrangement at an agreed rent between parties acting independently of each other, there may be cases where tax law will require the assessment of a Market Rent between parties seen to be connected. Thus, where a child leases a house from a parent at a low rent, tax law might assume a Market Rent when assessing the parent's income to tax. That rental value would then need to be provided.
- 4.17.** The process would be exactly the same as with any other determination of a residential Market Rent, relying on an appraisal of the property, a knowledge of rents in the relevant market place and a consideration of the terms of the tenancy agreement or other obligations including those as to repairs.

- 4.18.** National law may require the rent to be assessed on a different basis, as in areas subject to one of the forms of statutory rent control whether that:
- ▶ Requires the rent to be set on a particular basis (as say a ‘fair’ rent)
  - ▶ Limits how existing rents may increase

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

- 4.19.** The valuer may then also need to consider the expectations as to opportunities to revert to a Market Rent or vacant possession value.

- 4.20. Other statutory intervention** – National law may intervene on other matters than rent and security of tenure. There may be relevant issues arising over the quality and physical character of the dwelling that may require works or prevent it from being let. For example, the drive for improved energy efficiency of properties is being applied in some countries to limit the letting of the least efficient properties without some works being undertaken. The valuer will need to be aware of the issues relevant to the dwelling in question.

- 4.21. Usufruct and similar interests** – Usufruct (other names may be used in some countries) refers to a form of limited property right found in civil law and mixed jurisdictions which unites both:

- ▶ The right to use or enjoy the property directly and without altering it; and
- ▶ **The right to derive profit from it as by leasing out a dwelling** – The “fruits” are any renewable proceeds from the property. It is this aspect that distinguishes a usufruct from a simple right to occupy a property

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

- 4.22.** The usufructuary can be required to account for the state of the asset at the end of the usufruct, making an initial record of condition or inventory helpful.

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

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

## 5. Residential caravan parks

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



## 6. Inalienable and legally untransferable property

- 6.1.** There can be valuable rights in property which the holder cannot sell or transfer but which may still, on occasion, need to be valued.
- 6.2.** This will typically arise where:
- ▶ A property has been given to a public body or charity on terms excluding its disposal so that it is preserved for the public good as is the case for some houses of historic, cultural or architectural importance. The asset may still have a positive value or have to be recognised as a liability.
  - ▶ A dwelling has been leased to a tenant on a lease that forbids legal transfer, perhaps because the landlord wishes to control who occupies the property. That lease might still have value in itself, especially if it is at less than a Market Rent or offers other advantages compared to the market for equivalent properties. If it were a significant liability the tenant might seek to repudiate it.

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

- 6.3.** Making a property inalienable does not remove its value. It does mean that the value cannot be realised as a capital sum while the capital value of the property is not available to secure lending. Nonetheless, there could still be reasons why someone might wish to pay to take such a property and it may offer valuable benefits or an income.
- 6.4.** In some cases, it may be important to distinguish between the value of a business using the property and the value of the property itself. That may be most clear where the business is using a tenanted property which it cannot legally transfer but is at an under-rent.
- 6.5.** Among the important questions for a valuer instructed in such a case are:
- ▶ **What is the purpose of the valuation?** It is useful to know if the dwelling is to be valued for a balance sheet, a divorce, a partnership dissolution, taxation, compulsory purchase or valued for rent. Valuing between parties such as landlord and tenant or family members might mean finding a fair or special value, often turning on synergistic or marriage value, rather than a Market Value. In some situations, the task might be to find the investment value of the dwelling to an individual.

- ▶ **How absolute is the restriction on disposal?** While the position may vary between jurisdictions, it may be that the law offers a means for such a prohibition to be challenged in the courts.
- 6.6.** In other circumstances, there may be the commercial opportunity to pay to have the prohibition removed by agreement with the person imposing it. In such cases, the situation becomes closer to those where there are statutory or contractual restrictions on who can own or occupy a property which can see varying levels of discount applied to an unencumbered value for sale. It may be that while the property is not technically inalienable, a complex ownership structure might make it so in practice, with substantial obstacles before disposal is possible.
- 6.7.** Where a company owns the dwelling, then, while the company must remain the owner, the effective ownership may pass with the sale of the company but the critical valuation is likely to be of the company's shares.
- ▶ **Does the restriction allow or prohibit the dwelling being let on a lease or sub-lease for which a rent or premium could be taken?** Allowing the property to be leased out would offer a means to achieve value while preserving ultimate ownership and control.
  - ▶ **Is it the site of the dwelling that is inalienable or is the dwelling itself to be preserved as well?** That distinction may show whether or not there are development possibilities.
- 6.8.** According to the circumstances and instructions, the standard approach to determining the capital value of such a property (as may be required for tax purposes) is to consider what someone would pay to acquire the interest in the dwelling subject to the restriction on disposal. One way to consider that is to:
- ▶ Take the property in question as it is
  - ▶ Assume that the restriction is lifted to allow one disposal
  - ▶ Recognise that the buyer or person or entity the property is to be legally transferred to would then be bound by the restriction

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

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



# **EVIP 6** Listed Property (property protected by law)

1. Terminology
2. Guidance
3. Valuation

## 1. Terminology

- 1.1. **Listed buildings** – Buildings officially protected as part of a designated environment or because of their special architectural or historical merit.
- 1.2. **Listed structures** – Although most listed structures are buildings, other structures such as boundary walls can also be listed. The protection can extend to the property associated with the building or structure.
- 1.3. **Designated environment** – An area designated by law as being of special architectural or historic interest with the object of preserving or enhancing that character. Whether urban areas, town centres, villages or open countryside, dwellings and other buildings in a designated environment are protected, with development more tightly controlled.

## 2. Guidance

- 2.1. Once a property is listed, it becomes subject to special planning controls whereby consent from competent authorities is required for works that affect its special interest. These works might be either internal or external and be anything from the smallest project to complete demolition. Consent has to be obtained for any alterations and demolitions. There may be additional costs of ownership or occupation such as heating, insurance (sometimes requiring specialist advice on re-building costs) and maintenance while parts of the property may, as historic features, not be usable.
- 2.2. The valuer must be able to determine if the property to be valued is listed. In most countries, the register of listed buildings is public and such information is accessible on the relevant authority's website. The client may often be able to advise on this, as where the status is mentioned in the property's documents, title deeds, architectural layouts or other state decisions. If the matter cannot be verified, that should be stated in the Report.
- 2.3. Where the property is identified as listed, the valuer should ascertain whether that is in respect of all or part of the property. It is not always the case that the entire building is listed; the listing may be of just the facade of the building, a single wall of the property or even the internal painting of a single wall. There may be a greater official tolerance of works to the building that do not affect the part that is listed and which may help maintain the building in good order.

- 2.4. A listed building may also be fully or partially exempted from the requirements of Directive 2024/1275/EU on the energy performance of buildings (*see EVS 6 Valuation and Energy Efficiency*).
- 2.5. There may be specific areas in the property that are to be available for public viewing, perhaps as a condition of beneficial tax treatment, the award of public grants to support the building or other reasons. This may limit the way the property may be used and impose additional costs.
- 2.6. The valuer should investigate whether there are restrictions on the use of the property.
- 2.7. The importance of maintaining buildings of the greatest historical or architectural interest may warrant permission from the planning authority for development of other buildings to create the funds to pay for this.

### 3. Valuation

- 3.1. Before deciding on the appropriate approach to the valuation of a listed property, the valuer should consider the nature of the market in which it sits. In some circumstances, the fact of the listing may enhance the value, and in others the opposite.
- 3.2. It is important for the valuer to understand the procedures and standards required for works to a listed property, including its renovation, and how they differ from the rules for other property. It can take a significantly longer time to obtain all the necessary permits and approvals and their requirements may be more onerous. Works to a listed building are likely to be more costly than for other buildings because of the higher costs of project managers and skilled workers with relevant expertise and of the materials used for the renovation and preservation of listed properties. Given the attention to detail that is likely to be required, works on listed buildings can take longer. The valuer's task will be facilitated if he/she is able to review the proposed designs and the construction contract.
- 3.3. The valuation methods that could be applied to listed properties are the comparison, income and residual methods. The depreciated replacement cost (DRC) method could also be adopted in very specific circumstances but it will generally be inappropriate given both the complexity of estimating the depreciated

construction cost for an equivalent property to a listed building and the questionable relevance of such a task in the light of the building's status.

- 3.4. The comparative method** should, as for most properties, be the first choice of method for valuing a listed residential property. It is most suitable where there is an active market for similar properties in comparable circumstances.
- 3.5.** Valuation may be more difficult where a listed property requires substantial renovation. The valuer should ideally use comparables that are in a similar condition and have the same permitted uses. Where these are not available, the adjustments are complicated and, without care, can lead to misleading results.
- 3.6.** For the **income approach**, the **direct capitalisation** of income can only be applied to income producing properties.
- 3.7.** The **residual method** can be adopted to estimate the current value of a listed property which is to be renovated. Under this method, the valuer assesses the value of the renovated property and then deducts costs of renovation, professional, marketing and legal fees, financing costs, other relevant costs, applicable taxes and, if considered applicable, an amount for developer's profit to arrive at a residual value. The acquisition and the financial costs that result from the possession of the property during the renovation 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 in its existing state. The residual method requires considerable care as the value is sensitive to any variation of the estimated costs. Thus, a final review is required to consider if the result is genuinely a price that someone could be expected to pay. *(See The Residual Methods, EVS Part II - Valuation Methodology)*







# EVIP 7 Residential Tenancies and Rent Control

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

would-be occupiers, it may also in turn have effects on the wider housing markets, in particular on the non-regulated segments.

6. The main critical factors for the value of a let dwelling under such regulation will typically be:
  - ▶ The ability of the owner to recover possession of the property either for sale with vacant possession or for re-letting
  - ▶ The extent to which the rent that can be achieved for the property is below the Market Rent
  
7. Many markets with such regulation will have sufficient evidence of sales of let properties to use the comparative method of valuation relying on the figures achieved for other properties under the same regime. Equally, those factors in themselves bear on both the prime motives for holding investment property and the term and reversion analysis for the valuation of assets. It is, thus, relevant to the value if:
  - ▶ The expectation of the reversion to vacant possession, with the option that that event would give to leave the let sector or to re-let, is distant and uncertain
  - ▶ If the income from it is depressed
  
8. Additional factors for the valuer may lie in how far other regulation may add to the costs of being a landlord or of changing tenants. That may be through:
  - ▶ Requirements for improvements, whether for health and safety, energy efficiency or changing national standards for accommodation
  - ▶ Restrictions on the extent to which tenants may pay for the costs of taking a tenancy (costs of preparing the inventory or the lease, seeking credit references, paying the estate agent's fee, etc.)
  
9. The valuer appraising a dwelling that is let or suitable for letting may take into account:
  - ▶ The regime governing the rent and other key terms of the tenancy for, as relevant, the current letting and any prospective re-letting
  - ▶ The current rent, how it may be reviewed and any rent for a new tenancy
  - ▶ The ability or otherwise to re-let promptly and on what terms
  - ▶ The prospect and timing of vacant possession being available and the uncertainties attending that, as well as any opportunities for earlier possession. With a statutory security of tenure regime this may turn on life expectancy.

- ▶ Any legislation under which the tenant can extend the lease, pre-empt a sale or have the right to buy the dwelling
- ▶ The evidence as to let and vacant capital values for such property
- ▶ The availability of and terms for mortgage finance for the let property in question and the existence of buyers not needing to borrow
- ▶ The current condition of the property and any market expectations or legal requirements for it to be improved



# **EVIP 8** Flooding and the Valuation of Property

1. Introduction
2. The wider picture
3. Longer term effects on valuation?

## 1. Introduction

The more volatile and extreme weather seen with climate change is bringing incidents of severe flooding more frequently and more widely. As a result, the interaction between flooding and property values is a recurrent matter for discussion.

## 2. The wider picture

In most cases, flooding results from intense and torrential rainfall. More hard surfaces created by development combined with land management practices increase the speed with which water runs off. All normal drainage systems then fail to handle such a volume and water levels rise across the landscape, often in excess of previous flood records. The consequences can be worst in steep valleys (as with Germany's Ahr or England's Boscastle) or with the confluence of rivers, intensifying the effects, or where rising sea levels or surges occur.

## 3. Longer term effects on valuation?

### 3.1. Considerations in this include:

- ▶ The distinction between flood risk and flood events
- ▶ The measures taken in response to both flood risk and flood events to attenuate flood risk and provide flood defences
- ▶ Institutional and regulatory changes
- ▶ Market reactions by buyers and sellers, landlords and tenants
- ▶ Any changes in the policies of insurers and secured lenders

**3.2. Flood Risk and Flood Events** – In broad terms, the market for property will be informed by the larger picture of flood risk. That is illustrated, for example, by this German study of the flood risk area of Regensburg: *How Flood Risk Impacts Residential Rents and Property Prices – Empirical Analysis of a German Property Market* by Jens Hirsch and Jonas Hahn (2017) finding property values there were lower in identified areas of flood risk.

**3.3.** An actual flood event may confirm the assessment of risk, broaden the areas of risk or show how the risk has changed. However, in general, it is likely to have happened in areas where floods are already a known risk. Experience is that, despite the problems of being flooded, memories seem short and the sense



of risk is low while the context is of generally tight housing markets in developed countries.

- 3.4. Where a flood event is especially intense or affects previously unflooded areas, it seems more likely to be discounted as an unusual event, not affecting longer term values.
- 3.5. A further factor is that in some areas the reasons for buying attractive riverside or coastal property are consistent with accepting some flood risk.
- 3.6. **Measures to counter flooding** – Exposure to flooding is not necessarily a completely unmanageable risk. Governments, communities, owners, occupiers and others can all take measures to reduce (though rarely completely remove) the risk of flooding. Managing land and water courses to reduce the volume and speed of water run-off can attenuate flooding. Flood defences can increase protection against flooding. Measures can be taken to make properties more resilient to lesser flood risks, including altering how some more exposed properties are used. One clear example is the extent to which the flood defences in the Netherlands and England's East Anglia were improved in response to the 1953 floods.
- 3.7. **Institutional and regulatory changes** – These can be made, especially by governments, to manage flood risk better or ensure confidence in markets through development control, building regulations and flood defence organisations. With the potential for annual flooding in some areas, it might be that some locations do finally become untenable for property, as already seen with coastal erosion, or too expensive to protect. That then becomes a further factor in development control policy.
- 3.8. **Market reactions** – One feature of many developed countries is that their property markets, especially their housing markets, are already constrained leaving few options for any radical change in settlement patterns which may already be limited by physical geography. The limited options mean that the local balance between supply and demand will be found for the properties that exist with their flood risk.
- 3.9. **Insurers and lenders** – The inter-related roles of insurers and lenders securing loans on property are a key factor in these issues. If mortgage finance were no longer available for purchasers in some areas, that could be expected to alter financial conditions with consequences for property values. Any reduced availability of insurance cover for properties in flood risk areas (as is now happening for wildfire risk in California) could prompt lenders to change their lending policies

to the detriment of property values. It would also be a direct concern to owners, albeit perhaps also encouraging more to take measures to improve flood resilience. Decisions about purchase would then be left to the more limited number of cash buyers using their own money and judging their risk.

- 3.10. More generally** – It might be reasonable to speculate that, if flooding becomes more frequent, more widespread and not effectively countered by defences and other measures, there could come a point when markets will recognise it as an issue for the most exposed properties, perhaps also intensifying demand for other properties at lesser risk.
- 3.11.** However, even such a radical change might typically not be a change on its own. Much else might be happening in markets from changing financial conditions to demographic change – only textbooks can really assume “all other things being equal”. The effect on values may be so masked by other factors that it would be hard to disentangle them, perhaps especially in higher property value areas but perhaps easier to discern the effect in lower value, more populated areas. One larger issue might be the more insidious and creeping effect of coastal vulnerability but experience of high value coastal areas is that the market appears to discount the risk.
- 3.12.** It is suggested that it is not for valuers to prophesy the nature or timing of such future changes in markets and the policies of others but more for secured lenders to consider such matters with their views about loan-to-value ratios, rates, terms and conditions or their willingness to lend at all. Commentary on risk may be helpful, as also might observations on planned flood defence works and other matters relevant to the property being valued.
- 3.13.** In the meantime, valuers might ensure good access to records of flood history and exposure for reference in reports, including whether properties in risk areas have not as yet flooded. This might include drone photography recording where water reached.





**VIII.**

# European Code of Measurement



- 1. Introduction**
- 2. Scope**
- 3. Definitions**
- 4. Building measurements in practice**

## 1. Introduction

All European countries use similar bases for measuring floor areas in buildings, but the way these components are grouped and coded differs vastly between various countries. This means that comparisons between many types of areas are often highly misleading. Several countries have principles governing measuring practice laid out in country-specific standards and legislation. They must be strictly adhered to. In such cases, if allegations of professional negligence are made against a surveyor a general reference to the use of other codes of measuring practice or recommendations will, most likely be rejected by the Court. This also applies to measurements and calculations conducted under the recommendations of this TEGOVA Code if they differ from local practice and regulations.

## 2. Scope

This Code does not define how different types of property are to be measured in detail as this will depend on local conditions, standards and regulations. Valuation reports should clearly state and explain the bases of measurements used and identify any unusual bases or deviations from this Code.

## 3. Definitions

### 3.1. General definitions

3.1.1. Measurements will usually be made and recorded using the metric system. However, individual countries and sectors may conventionally use imperial or local measurements commonly adopted in national practice or in keeping with market practice.

3.1.2. Subject to any legal provisions or instructions from the client, the choice of units and the number of decimal places used will be a practical matter for the valuer to determine in the circumstances of the property and the needs that a client may be expected to have.

#### 3.1.3. Units

- ▶ Distances are measures of length in one dimension and should be expressed in metres (m)



- ▶ Areas are measures in two dimensions and should be expressed in square metres (m<sup>2</sup>)
- ▶ Larger areas, rural properties and older buildings commonly have irregular shapes. Care should be taken to measure such areas accurately, perhaps by a land survey, or the use of digital maps. The areas can be expressed in hectares
- ▶ Volumes are measures in three dimensions and should be expressed in cubic metres (m<sup>3</sup>)

#### 3.1.4. Distance

- ▶ **Gross length** is measured as the horizontal distance between either the outer faces of exterior walls or between the centres of interior walls. The choice of basis should be stated.
- ▶ **Net length** is measured as the horizontal distance between the inner faces of exterior walls, disregarding internal structural components such as pillars or buttresses that are not complete walls
- ▶ **Gross height** is measured as the vertical distance between the top of a finished floor and:
  - ▶ The top of the finished floor of a room situated above it; or
  - ▶ The top of the roof structure above it
- ▶ **Net height** is measured as the vertical distance between the top of a finished floor and the bottom of a ceiling, floor or roof situated above it, disregarding internal structural components that are not complete ceilings
- ▶ **Free height** is measured as the vertical distance between the top of a finished floor and the underside of a suspended ceiling above it

#### 3.1.5. Areas and volumes

- ▶ **Gross areas** are determined by using gross lengths
- ▶ **Net areas** are determined by using net lengths
- ▶ **Gross volumes** are determined by using gross lengths
- ▶ **Net volumes** are determined by using net lengths

#### 3.1.6. Property boundaries and plot areas

- ▶ **Plot area** is the area of the property within its boundaries. This may be referenced by government agencies (such as a Land Registry, Cadastral or Local authority) measured from a horizontal plan. Plot area can then as appropriate be divided into the built area and the un-built area.

- ▶ **Built area** is the part of the plot area which is covered by buildings in their finished state both above and below ground
- ▶ **Unbuilt area** is the remaining part of the plot area which is not classified as built area

**3.17. Identifying external boundaries** – Valuers should be careful to establish that they have an accurate understanding of the boundaries of the property. It is important to establish whether and which boundary features belong to the property and so be certain of the line of the boundary with adjacent properties. This also applies to party walls between buildings.

### **3.18. Typical issues**

- ▶ The area of the property as documented for the valuer may not be the correct one. Older documentation may be obsolete.
- ▶ Land may, for example, have been subject to compulsory purchase or subdivided. Property areas may also change when boundaries alter as a result of agreements between neighbouring parties who may not always formally register their agreement.
- ▶ Boundaries such as woodland edges, tree lines, hedges and rivers may not prove to be precise descriptions and can change over the years. Fences and other markers may be incorrectly placed or have been moved and consequently the GPS measurements used in preparing digital maps may not represent the true position.
- ▶ Where boundaries are not precisely recorded or are in dispute, there may be local practices and interpretations which may offer presumptions for identifying the boundary
- ▶ **Measuring boundaries** – The methods for recording boundaries and measuring the areas within them have developed substantially from measuring distances and angles to global positioning and electronic mapping. In each case, the measurement will only be as good as the limitations of the method used – even the global positioning systems available for commercial use work to certain tolerances and may be affected by military or other considerations
- ▶ The internet now offers many opportunities to view property, whether from the air or the street. This can be a useful tool, perhaps especially for a preliminary or a general view. However, the pictures may be dated and the property could have changed since they were taken. There are particular problems in taking measurements from such services and these should not be relied upon.
- ▶ Where working from any form of records, as for desk top valuation, the data as to measurements will only be as at the date they were recorded and will be subject not only to changes that may have occurred since but to any omissions or errors in their collection

- 3.1.9. Valuers should cite the source (and its date) for the property area reported in their valuations.
- 3.1.10. In some cases, the value of the land can be influenced by the topography of the land which may give it a greater or lesser usable area – sloping and undulating farmland may offer a larger croppable area than flat land.

## 3.2. Specific definitions of building areas

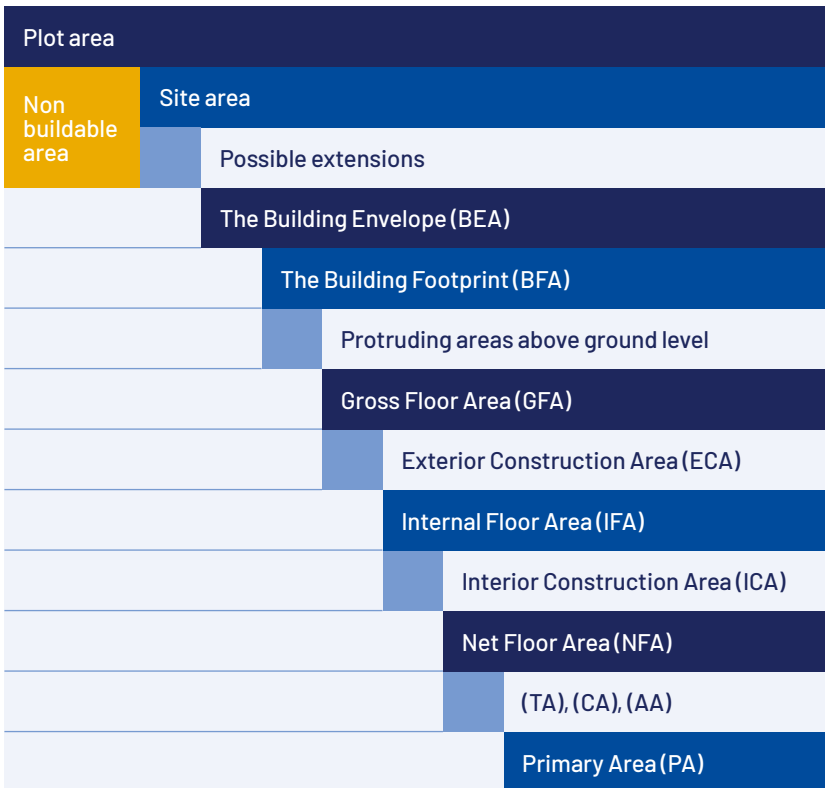
- 3.2.1. **Site area** is the part(s) of the plot area used for one or more buildings or intended for their construction.
- 3.2.2. **The Building Envelope Area (BEA)** is the plan of the part of the site area that is physically occupied by the building both above and below ground, using its maximum dimensions.
- 3.2.3. **The Building Footprint Area (BFA)** is the plan of the part of the site area that is physically occupied by the building above ground level, using its maximum dimensions.
- 3.2.4. **Gross External Area (GEA, also called Gross Floor Area (GFA))** is the area within the outside of the exterior walls of the building envelope and so includes the thickness of the perimeter wall of the building ("extra muros").
- 3.2.5. **Exterior Construction Area (ECA)** is the area of the perimeter walls themselves.
- 3.2.6. **Gross Internal Area (GIA, also called Internal Floor Area (IFA))** is the Gross External Area after deducting the Exterior Construction Area ("intra muros"). Thus,  $GIA = GFA - ECA$ .
- 3.2.7. **Interior Construction Area (ICA)** is the area of the internal structural components of the building within the perimeter walls, so recording the area taken up by load bearing columns and supporting walls.
- 3.2.8. **Net Floor Area (NFA) (also called the Effective Floor Area)** is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA). Thus,  $NFA = IFA - ICA$ .
- 3.2.9. **Gross Lettable Area (GLA)** is defined as the total floor area designed for the occupancy and exclusive use of tenants, including basements and mezzanines. GLA for retail premises is typically calculated by measuring from the building line in the case of street frontages, and from the inner surfaces of the other outer building walls and from the inner surfaces of the corridor and other permanent partitions

and to the centre of partitions that separate the premises from adjoining rentable areas. No deductions are made for vestibules inside the building line or for columns or projections necessary to the building. No additions are made for bay windows extending outside the building line.

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

**3.2.11. Primary area (PA)** is the portion of the Net Floor Area (NFA) used for supporting the core business needs and work processes, for example TA – Technical Area, CA – Circulation Area, AA – Amenity Area.

*Figure 1 – Illustration of the various types of areas and their relationships*



## 4. Building measurements in practice

**4.1.** These measurements will be of all available space in a building on each relevant storey meeting the definition in question.

### 4.2. Gross Floor Area (GFA)

- ▶ Each floor should be measured to include the outside faces and projections of the enclosing wall. The full thickness of the building's perimeter wall is included in this measurement. Non-functional areas such as large open areas (without a floor) should not be included – if such areas are to be included their area must be specified.
- ▶ The measurement should include areas occupied by:
  - ▶ Internal walls, partitions, columns, stairwells, lifts, escalators, air (or other) vertical ducts
  - ▶ Lift motor rooms, central heating or air-conditioning (ventilation) plant rooms, fuel tank rooms, electricity transformer and/or low tension rooms, corridors and other circulation areas, all sanitary areas
  - ▶ Open-sided covered areas, ramps, enclosed parking areas, storage rooms, archive rooms (basement)

### 4.3. Internal Floor Area (IFA)

- ▶ The IFA of each floor should be calculated between the internal surfaces of external building walls. The IFA is the Gross Floor Area (GFA) after deducting the Exterior Construction Area (ECA).
- ▶ Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, valuers should explain how they have measured the area.

### 4.4. Net Floor Area (NFA)

This is the usable area offered by all floors within a building on the following bases:

- ▶ Each floor should be measured at all levels between internal surfaces of external building walls. The NFA is the Internal Floor Area (IFA) after deducting the Interior Construction Area (ICA).
- ▶ Measurements are to be taken at a specified height above the floor. Where ceilings are sloping, the rules for measurement must be specified.

- ▶ The following areas of each floor are to be excluded from the calculation:
  - ▶ Internal structural walls
  - ▶ Vertical ventilation, wiring or pipe ducts and structural columns (generally only excluding items larger than one square metre in area but there may be differing practices between countries)
  - ▶ Staircases and lift wells
  - ▶ Lift motor rooms, tank rooms, (other than those used for processes), transformer rooms, high and low tension areas
  - ▶ Space occupied by permanent air-conditioning, heating or cooling apparatus and surface mounted ducting which makes the space unusable, having regard to the purpose for which it is said to be used. This does not apply to apparatus installed by or on behalf of the tenant or used in the building for special purposes, such as computer operation, processing or manufacturing.

In calculating this area for office buildings, the following areas of each floor should be excluded:

- ▶ Those areas set aside for the provision of facilities or services to the building not for the exclusive use of occupiers of the building
- ▶ Areas set aside as public space for thoroughfares and not used exclusively by occupiers of the building

*Note – Additional common areas that may be created by the subdivision of a single floor to accommodate more than one tenant are to be included in the calculations).*

- ▶ Those parts of buildings such as entrance halls, landings and balconies which are used in common with other occupiers. In some cases, these parts may be apportioned between the building's occupiers.

Figure 2 – Illustration of bases for measuring areas of buildings

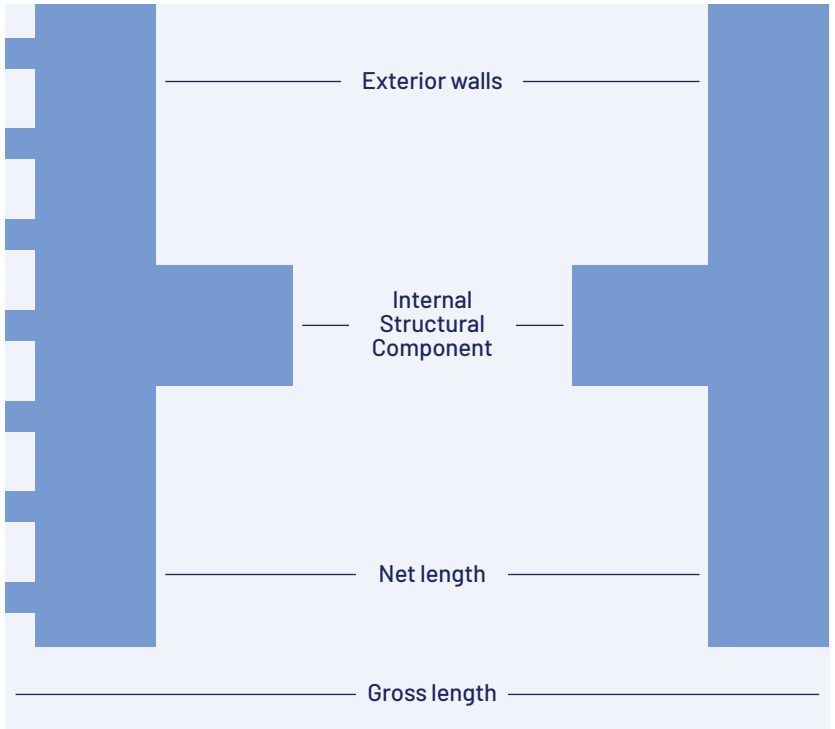
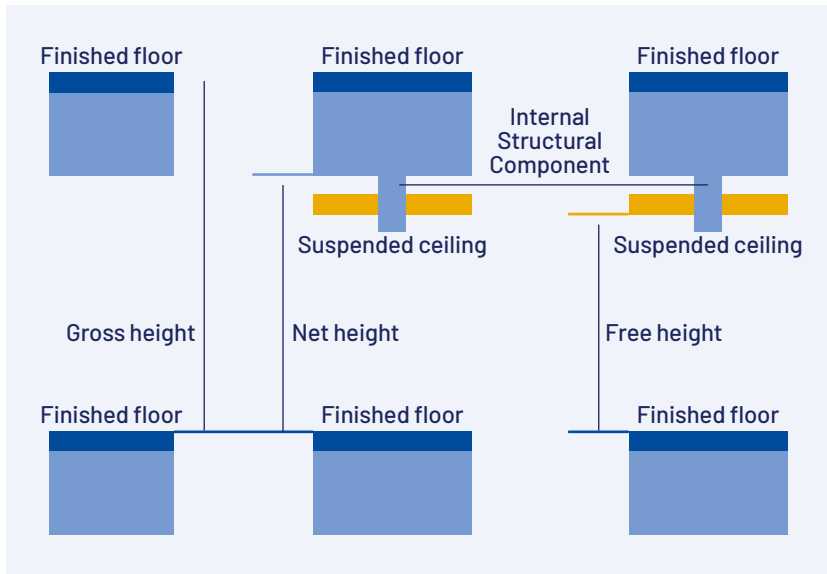


Figure 3 – Illustration of bases for measuring heights of buildings



## 4.5. Zoning

- 4.5.1.** For some properties, particularly in the retail sector, the area within stated depths from the building's frontage may be a significant factor for a valuation. Typically, the area nearest the frontage may be described as Zone A and have the highest value per unit of area – for retail, this may offer the greatest density of sales. The areas at increasing depths beyond that (Zones B, C and so on) will each have a value, usually given as a proportion of the Zone A figure and commonly reducing with growing distance from the frontage (depth). This offers both a means of appraising the commercial utility of the subject building and of analysing comparables.
- 4.5.2.** Discussion of zoning may refer to the Built Depth, measuring the depth of the building back from its commercial frontage onto a thoroughfare within which the relevant zones are established.
- 4.5.3.** It is important that the same zone depths be used in the analysis of comparable properties and in the valuation of the subject property. The depths used may vary between countries and by types of property.



## **4.6. Special provisions**

- 4.6.1. Where relevant, the room height should be reported. The measurement procedures used for rooms with sloping ceilings should be reported.
- 4.6.2. Mezzanine areas, temporary or permanent, should be reported as well as the free height above and below them.
- 4.6.3. Areas for special purposes such as areas and heights designed for special sized pallets and likewise, should also be reported.
- 4.6.4. The height to a building's eaves or of the entrance doors is a key measurement for buildings used for vehicles or machinery in such sectors as transport, warehousing or agriculture.

## **4.7. Applications of specific measurement bases**

### **4.7.1. Gross Floor Area (GFA)**

- ▶ Building costs (also for insurance valuation purposes)
- ▶ Site coverage
- ▶ Planning
- ▶ Zoning

### **4.7.2. Internal Floor Area (IFA)**

- ▶ Building cost estimation
- ▶ Industrial building, shop and warehouse agency
- ▶ Valuation practice

### **4.7.3. Net Floor Area (NFA)**

- ▶ Agency and valuation practice
- ▶ Service charge apportionment

### **4.7.4. Building Footprint**

- ▶ Land usage

### **4.7.5. Building Envelope**

- ▶ Land usage



# IX.

## Recognition of Qualifications by TEGOVA



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

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

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

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

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

## Application and Awarding Procedures

1. The recognitions Recognised European Valuer with the designation REV and TEGOVA Residential Valuer with the designation TRV can be awarded to individual practising valuers and are pan-European indicators of ability and experience that assure clients of their valuation proficiency.
2. Applications for the REV and TRV recognitions are open to qualified practising valuers who meet the relevant TEGOVA requirements and belong to a Full or Associate TEGOVA Member Association that has obtained the consent of TEGOVA to award the recognitions (Awarding Member Association or AMA for REV, Residential Awarding Member Association or R-AMA for TRV). Applications have to be made by the valuer directly to a home country AMA or R-AMA.
3. The process of awarding REV or TRV recognition is divided into two stages. First is the granting by TEGOVA of awarding status AMA (for REV) or R-AMA (for TRV) to the Member Association. The second stage is the awarding of the recognition to the individual practicing valuer applicant by the AMA or the R-AMA.

4. To achieve awarding status, the Member Association must demonstrate that it has in place effective means, policies and quality systems to ensure that applicants meet the TEGOVA requirements as regards education, ethics, experience and lifelong learning.
5. The second stage is the assessment of the applicant by the AMA or R-AMA to ascertain whether the applicant meets the relevant TEGOVA requirements and, if successful, the granting of the recognition and the right to use the designatory letters REV or TRV.
6. Recognition of competence is granted in the name of TEGOVA by the AMA or R-AMA in the form of a certificate of recognition signed jointly by the Chairman of TEGOVA and the Chairman/President of the Awarding Member Association.
7. The applicant who has been awarded Recognised European Valuer or TEGOVA Residential Valuer recognition is permitted to use this title and the designatory letters REV or TRV after her/his name for a period of five years after which time the valuer must seek renewal of the recognition.
8. Details are available from the TEGOVA Secretariat, e-mail [info@tegoval.org](mailto:info@tegoval.org) or from the TEGOVA website [www.tegoval.org](http://www.tegoval.org).







X.

European Union  
Legislation  
and Property Valuation



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

The text is intended to offer assistance to valuers in their professional capacity – not in any other role, including the ownership of property – and is based on an understanding of the law as at 1 July 2024. Where an issue is relevant to a valuation, the valuer is advised to seek further specific information or advice on appropriate points.

*Note: In the electronic version, all references to EU law and case law contain a link to the document in the 24 EU languages.*

## 1. General introduction

- 1.1. **European Union (EU) legislation and property valuation** – EU legislation has an increasingly important impact on the use, management, associated costs, development opportunities and value of property. Indeed, whereas Article 345 of the Treaty on the Functioning of the European Union (TFEU) states that “[t]he Treaties shall in no way prejudice the rules in Member States governing the system of property ownership”, EU legislation does have an impact on property.
- 1.2. EU legislation may directly apply to property or activities closely associated with its ownership, occupation or use. This is for instance the case when EU legislation defines the purpose of a property valuation and/or sets out the criteria for such valuation. But the impact of EU legislation on property and property valuation can also be indirect, where EU legislation applies to an activity on an area or site specific basis, creating opportunities or imposing limitations according to location. Likewise, EU legislation on value added tax (VAT) can be a significant factor in property transactions and, thus, impact the property valuation. Moreover, EU legislation directly touches upon the valuers’ activities.

- 1.3.** Accordingly, for a valuer to act in accordance with EVS, it is necessary to have at least a basic understanding of the applicable EU legislation and to be able to assess the impact of legal obligations on property and/or property valuation. For instance, while housing policy is not covered by the TFEU, the EU is active in legislating in a growing number of policy areas that affect property markets and professions. These include the promotion of energy efficiency and renewable energy, environmental protection, discrimination by landlords, unfair contract terms, access to buildings by the disabled, regulation of retail services including shopping centre development, work site safety, construction products, construction and building-related cartels, State aid to social housing companies, mortgage credit, capital requirements for mortgage lending and insurance, financial market reform, reduced rates of VAT on renovation and repair of housing, and money laundering.
- 1.4. Property valuations imposed by EU legislation** – In some cases, EU legislation makes specific provisions for property valuation. Thus, from a relatively early stage, EU legislation on company accounting bore on the valuation of property for the financial accounts of relevant companies. This has been developed for credit institutions, insurance institutions and investment funds. Moreover, independent expert valuations can be imposed for State aid purposes.
- 1.5. EU legislation as part of the property valuation matrix** – A professional valuation relies on the valuer appraising the property in its context, researching and verifying all matters with a bearing on the value of the property. The valuation of property can only reflect the actual market as it exists on the valuation date with its balance of supply and demand, hopes and concerns and the information the market considers relevant.
- 1.6.** Legislation and policy relevant to property are obviously part of that matrix.
- 1.7.** This is also reflected in EVS 1 where it is stated that the property is to be analysed with its legal, physical, economic and other attributes. To determine the Market Value of real estate and related property rights, the valuer must take due regard to the use of the 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. Accordingly, consideration must be given to establishing relevant legal and regulatory constraints regarding the property, part of which may be directly connected to a specific sector or location.
- 1.8.** The importance of legislation for a reliable property valuation is also attested throughout the valuation process and reporting as set out in EVS 4 and EVS 5. In

particular, the EVS Valuation Reports for Residential and Office Property provide a mandatory description of the legal situation of the property, with a judgment of the impact of the legal situation on the value.

- 1.9. Throughout the past decades and also in more recent years, two particular areas of EU policy have developed enormously in ways that affect property and property valuation, namely the internal market programme and the environmental and energy policy.
- 1.10. From its creation the EU has sought to promote the internal market in goods, services, labour and capital. The creation of the internal market has had an impact on property markets. Indeed, while real estate, being 'immovable', is not subject to EU law ensuring the free movement of goods between Member States, the TFEU and EU legislation do ensure the free movement of capital and so the ability to buy or sell property anywhere in the EU. In particular, the removal of borders between Member States for the free movement of capital has reshaped patterns of demand for all real property, both commercial and residential. In turn, this has affected matters relevant to valuations.
- 1.11. In recent years, the EU has also adopted a wide array of instruments in relation to energy and the environment. Indeed, the ambition of the EU in driving environmental policy and climate action has led to the adoption of various instruments on various matters, such as resource protection, water, pollution, asbestos and biodiversity. Much of this affects property and property valuation. For instance, policy on the protection of fauna and flora can affect both the potential for and the costs of land development. The fight against climate change is also reflected in the energy policy. In this context, property is seen not only to pose key problems of energy consumption and inefficiency to be tackled but also to offer solutions in terms of climate change mitigation and renewable energy as well as opportunities for the construction industry.
- 1.12. **Property valuations and VAT** – Property valuations may also be impacted by the EU framework on VAT. Indeed, whereas Market Value represents the estimated value of a property and so excludes any taxation on the transaction, the VAT regime may affect some or all potential interested parties. As such, VAT is an integral part of the market and may thus, along with all other factors, influence the value of immovable property.
- 1.13. **Valuation services under EU legislation** – EU legislation not only affects property and property valuations, it also impacts the provision of valuation services as such.

- 1.14.** For instance, the freedom of establishment (Article 49 TFEU) and the freedom to provide services (Article 56 TFEU) preclude any national measure which, albeit applicable without discrimination on grounds of nationality, negatively affects the access to the market for service providers or undertakings from other Member States and thereby hinders trade within the EU. Accordingly, Member States cannot restrict the provision of valuation services on their territory. This also means that a valuer established and/or qualified in one Member State is in principle entitled to also provide valuation services in another Member State (*on the condition of the valuer having the requisite local knowledge and experience; see EVS 3 The Qualified Valuer and Part V. European Valuer's Code of Conduct*).
- 1.15.** Valuers must of course also respect EU competition rules. In particular, Article 101 TFEU prohibits agreements between undertakings which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market. Typical examples of such agreements concern the fixing of prices or the partitioning of markets.
- 1.16.** Another important field of law that directly impacts valuers is that of privacy and data protection. In this context, the EVS Valuation Reports for Residential and Office Property contain a statement of compliance with the General Data Protection Regulation (GDPR).
- 1.17. Nature and impact of EU legislation** – EU legislation comes in many forms. The main legal instruments however are Regulations and Directives.
- 1.18.** A Regulation is a binding legislative act. It must be applied in its entirety across the EU. Examples of Regulations that are relevant for property valuation are the Capital Requirements Regulation 575/2013 as amended by Regulation (EU) 2024/1623 and the European Climate Law Regulation 2021/1119.
- 1.19.** Most of the EU legislation under review in the following sections has been made by Directives. A Directive is a legislative act that sets out a goal that all EU Member States must achieve but leaves it to the individual Member States to devise their own laws on how to reach these goals. The effect of a Directive will, thus, depend on how it is drafted. For instance, the Court of Justice of the European Union (CJEU) has ruled that where a Directive prescribes an outcome, that outcome has to be achieved. In such a case, it is not sufficient to take all practical steps. Conversely, when a more general 'framework' Directive does not specify outcomes so precisely, the compliance with that Directive and its assessment may turn more on the approach the Member States have taken. In *Marleasing* (C-106/89), the CJEU has however underlined that national legislation must, as far as possible,



be interpreted *“in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter”*.

- 1.20. In view of these elements, much of this common EU framework is not directly evident to many who are active in their local marketplaces. However, although much EU legislation is applied through domestic measures, that does not detract from the EU's key role as the source of much that affects property and the valuation of property.
- 1.21. This key role is also likely to increase given the vast amount of legislative proposals that are currently under debate and may become final law in the years to come. For instance, in the context of the European Green Deal, the European Commission has announced a restructuring of the taxation framework towards “green taxation” of energy products and electricity. Moreover, whereas these proposals will only become operational once formally adopted and entered into force, they should already be included in the context of property valuation since future changes in legislation that can affect both the potential for and the costs of land development may actually impact current Market Value.
- 1.22. **EU legislation and the EVS** – There follows a brief description of the main policy areas and instruments that, directly or indirectly, have an impact on property and/or property valuation. Considering the broad range of EU legislation that has grown and seems likely to develop substantially, this text cannot provide an exhaustive overview, but outlines the most significant areas.

## 2. Property valuations required by EU legislation

### 2.1. General Overview

- 2.1.1. EU legislation may encompass specific provisions concerning property valuation.
- 2.1.2. Property valuation is a component of EU rules on statutory needs or company accounts. Specific rules have also been developed for credit institutions, insurance institutions and investment funds. Likewise, independent expert valuations can be imposed for State aid purposes.

## 2.2. Valuation of Property for Statutory Needs under EU Company Law

- 2.2.1. Limited liability companies** – The statutory requirements towards limited liability companies are set by Directive 2017/1132, which codifies and replaces a series of previous directives on certain aspects of European company law, such as disclosure of information on companies in business registers, capital maintenance, divisions of companies, mergers within one country and cross-border mergers. This Directive has been amended by Directive 2019/1151 (covering the use of digital tools and processes in company law) and by Directive 2019/2121 (laying down new rules on cross-border conversions and divisions and amending rules on cross border mergers).
- 2.2.2.** Title I of Directive 2017/1132 lays down a number of general provisions on the establishment and functioning of limited liability companies. This also includes a set of detailed rules on capital maintenance and alteration.
- 2.2.3.** In particular, regarding capital requirements, the Directive holds that subscribed capital may be formed only of assets capable of economic assessment (Article 46).
- 2.2.4.** As regards statutory capital, the Directive requires the issuance of a report by one or more experts on any consideration other than in cash before the company is incorporated or is authorised to commence business (Article 49).
- 2.2.5.** Such reports require the involvement of “experts” defined as (Article 49(1)):
- ▶ Independent of the company
  - ▶ Appointed or approved by an administrative or judicial authority
  - ▶ Either natural persons or legal persons and companies and firms under the laws of each Member State
- 2.2.6.** The expert’s report shall (Article 49(2) and (3)):
- ▶ Contain at least a description of each of the assets comprising the consideration as well as of the methods of valuation used
  - ▶ State whether the values arrived at by the application of those methods correspond at least to the number and nominal value or, where there is no nominal value, to the accountable par and, where appropriate, to the premium on the shares to be issued for them
  - ▶ Be published in the manner laid down by the laws of each Member State
- 2.2.7. European company (SE)** – The Council has adopted the two legislative instruments for the establishment of a European company, namely Regulation 2157/2001

on the Statute for a European company and Directive 2001/86/EC supplementing the Statute with regard to the involvement of employees in the European company. This enables a company to be set up within the territory of the EU in the form of a public limited liability company, known by the Latin name “Societas Europaea” (SE).

- 2.2.8.** Regulation 2157/2001 requires the opinion of one or more independent experts in following procedures of formation and winding up of an SE:
- ▶ To certify that the company has net assets at least equivalent to its capital plus those reserves which must not be distributed under the law or the Statutes in case of conversion of an existing public limited liability company into an SE (expert to be appointed by a judicial or administrative authority in the Member State to which the company being converted into an SE is subject)(Article 37(6))
  - ▶ To certify that the company has assets at least equivalent to its capital in case an SE is going to be converted into a public limited liability company (expert to be appointed by a judicial or administrative authority in the Member State to which the SE being converted into a public limited liability company is subject) (Article 66(5))
- 2.2.9. European Cooperative Society (SCE)** – Regulation 1435/2003 on the Statute for a European Cooperative Society (SCE) puts in place a legal statute for the SCE. It enables a cooperative to be established by persons resident in different Member States or by legal entities established under the laws of different Member States.
- 2.2.10.** The law applicable to public limited liability companies in the Member State where the SCE has its registered office, concerning the appointment of experts and the valuation of any consideration other than cash, applies by analogy to the SCE (Article 4(6)).

### Legislation

Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)

Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees

Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)

Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law

Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law

Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions

### **2.3. Valuation of Property for Company Accounts**

- 2.3.1. Statutory audits and auditors** – Companies have to prepare financial statements and provide a true and fair view of their financial position. The EU has introduced rules to ensure consistent and comparable financial reporting.
- 2.3.2.** Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts sets out the framework for statutory audits and the audit profession. A statutory audit is a legally required review of financial records. Statutory audits may only be carried out by statutory auditors or audit firms approved by the Member States' competent authorities. Member States must keep a public register of these. Statutory auditors and audit firms should be independent when carrying out statutory audits and avoid conflicts of interest. Adequate internal organisation of statutory auditors and audit firms should help to prevent any threats to their independence.
- 2.3.3. Listed companies** – Regulation 1606/2002 provides that, with a view to harmonising the financial information and ensuring a high degree of transparency and comparability of financial statements, consolidated accounts of listed companies must be prepared in conformity with international accounting standards (IAS). The IAS, including the International Financial Reporting Standards (IFRS), have been adopted by means of Regulation 2023/1803. IAS 16 outlines the accounting treatment for most types of property, plant and equipment (except where other standards require different accounting treatments). The main issues of IAS 16 are the recognition of assets, the determination of their carrying amounts and the recognition of depreciation charges and impairment losses. In addition, IAS 40 applies for the recognition, measurement and disclosure of investment property. Investment property refers to land and/or a building held to earn rentals or for capital appreciation or both. IFRS 13 provides standards on fair value measurement, which 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.
- 2.3.4.** Regulation 537/2014 indicates specific requirements for statutory audits of listed companies with a view to ensuring that the audits of those entities are of adequate

quality and are carried out by statutory auditors and audit firms subject to stringent requirements (enhancing the integrity, independence, objectivity, responsibility, transparency and reliability of statutory auditors and audit firms carrying out statutory audits of public interest entities).

- 2.3.5.** The European Commission has also issued a Recommendation on external quality assurance for statutory auditors and audit firms auditing public interest entities with a view to providing guidance to quality assurance systems for statutory auditors and audit firms performing audits in such entities.
- 2.3.6. Limited liability companies** – The Accounting Directive 2013/34/EU establishes the requirements for the annual financial statements of limited liability companies. This Directive ensures the clarity and comparability of financial statements and allows for exemptions or simplifications in financial reporting obligations for micro-undertakings and SMEs.
- 2.3.7.** The main requirements are the following:
- ▶ To ensure the disclosure of comparable and equivalent information, recognition and measurement principles should include the going concern, the prudence, and the accrual bases (Recital 16)
  - ▶ The principle of materiality should govern recognition, measurement, presentation, disclosure and consolidation in financial statements (Recital 17)
  - ▶ Items recognised in annual financial statements should be measured on the basis of the principle of purchase price or production cost (Recital 18)
  - ▶ As systems of fair value accounting provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information, Member States should be allowed to permit or require fair value accounting for assets other than financial instruments (Recital 19)
  - ▶ Estimates should be based on a prudent judgement of the management of the undertaking and calculated on an objective basis, supplemented by experience of similar transactions and, in some cases, reports from independent experts (Recital 22)
- 2.3.8.** According to Article 6(1)(i) of the Accounting Directive, items recognised in the financial statements should, as a general rule, be measured in accordance with the principle of purchase price or production cost. However, Member States may permit or require the measurement of specified categories of assets (other than financial instruments) at amounts determined by reference to fair value (Article 8(1)(b)). Following Article 8(9) of the Directive, Member States may permit or require that where assets other than financial instruments are measured at fair value, a change in the value be included in the profit and loss account.

- 2.3.9. Financial institutions and insurance undertakings** – Directive 2003/51/EC amended Directives 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. As regards the annual report and the consolidated annual report, this Directive emphasises the importance of a fair review (Recital 9), including that Member States should be able to permit or require the application of fair value (Recital 8).
- 2.3.10.** In the case of insurance undertakings, Directive 91/674/EEC as amended by Directive 2003/51/EC and Directive 2006/46/EC specifies that in the case of land and buildings current value shall mean “*Market Value on the date of valuation*” (Article 49(1)). Article 49(2) defines Market Value “*as the price at which land and buildings could be sold under private contract between a willing seller and an arm’s length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of the property, is available for the negotiation of the sale*”. In accordance with Article 49(3) “*Market Value shall be determined through the separate valuation of each land and buildings item, carried out at least every five years according to methods generally recognized or recognized by the insurance supervisory authorities*”.
- 2.3.11.** Regulation 537/2014 sets out specific requirements for statutory audits of banks and insurance undertakings with a view to ensuring that the audits of those entities are of adequate quality and are carried out by statutory auditors and audit firms subject to stringent requirements (enhancing the integrity, independence, objectivity, responsibility, transparency and reliability of statutory auditors and audit firms carrying out statutory audits of public interest entities).

## Legislation

Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions

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

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

Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings

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

Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

Commission Recommendation of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities

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

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC

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

Commission Regulation (EU) 2023/1803 of 13 August 2023 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

## 2.4. Valuation of Property for Credit Institutions

- 2.4.1. Banking capital requirements and regulation** – The Basel Framework holds the full set of global standards that seek to impose a prudent framework and to set out a basis for calculating the amount of capital that a lending institution should hold against its liabilities. Those agreements were developed in response to the 2008 financial crisis. In order to calculate the capital that a credit institution is required to hold, the regulators apply a ratio to the value of the available assets depending on the class of the assets. For this purpose, there are also rules for assessing values of property on which lending has been secured, as this is one of the major asset classes involved.

The EU has addressed this issue in successive legislation on capital requirements. The Capital Requirements Regulation 575/2013 as amended by Regulation (EU) 2024/1623 lays down the following rules regarding the valuation of assets when assessing compliance with the Basel capital requirements:

- ▶ It provides the definition of “mortgage lending value” as “the value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property” (Article 4(74))
- ▶ It defines “property value” as “the value of a residential property or commercial immovable property determined in accordance with Article 229(1)” (Article 4(74a))
- ▶ It provides the definition of “Market Value” for the purposes of immovable property, as “the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion” (Article 4(76))
- ▶ It imposes the following requirements on monitoring of property values and on property valuation: “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; ESG-related considerations, including those related to limitations imposed by the relevant Union and Member States regulatory objectives and legal acts, as well as, where relevant for internationally active institutions, third-country legal and regulatory objectives, shall be considered to be an indication that the property value might have declined materially, relative to general market prices; 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” (Article 208(3)(b))
- ▶ It is stated that “institutions may monitor the value of the immovable property and identify the immovable property in need of revaluation, in accordance with paragraph 3, by means of advanced statistical or other mathematical methods (“models”), provided that those methods are developed independently from the credit decision process and all of the following conditions are met:
  - e) The institutions set out, in their policies and procedures, the criteria for using models to monitor the values of collateral and to identify the properties that should be revaluated; those policies and procedures shall account for such models’ proven track record, property-specific variables considered, the use of minimum available and accurate information, and the models’ uncertainty;
  - f) The institutions ensure that the models used are:



- i) *Property- and location-specific at a sufficient level of granularity;*
  - ii) *Valid and accurate, and subject to robust and regular back-testing against the actual observed transaction prices;*
  - iii) *Based on a sufficiently large and representative sample, based on observed transaction prices;*
  - iv) *Based on up-to-date data of high quality;*
- c) *The institutions are ultimately responsible for the appropriateness and performance of the models;*
  - d) *The institutions ensure that the documentation of the models is up to date;*
  - e) *The institutions have in place adequate IT processes, systems and capabilities and have sufficient and accurate data for any model-based monitoring of the value of immovable property collateral and identification of property in need of revaluation;*
  - f) *The estimates of models are independently validated and the validation process is generally consistent with the principles set out in Article 185, where applicable” (Article 208(3a)).*
- 2.4.2. For ‘property value’ and the requirements for the valuation of immovable property including the use of prudently conservative valuation criteria, see EVGN 2 Valuation for Mortgage Lending – Prudently Conservative Valuation Criteria.
- 2.4.3. The Capital Requirements Regulation also holds a specific treatment of income producing real estate (IPRE) mortgage loans, giving rise to “IPRE exposure” which is defined as “*an exposure secured by one or more residential properties or commercial immovable properties where the fulfilment of the credit obligations related to the exposure materially depends on the cash flows generated by those immovable properties securing that exposure, rather than on the capacity of the obligor to fulfil the credit obligations from other sources; the primary source of such cash flows being lease or rental payments, or proceeds from the sale of the residential property or commercial immovable property*”, giving rise to a dependence on cash flow that is an important risk driver (Article 4(75b)).
- 2.4.4. Furthermore, to reduce the impact of cyclical effects on the valuation of property securing a loan and to keep own funds requirements for mortgages more stable, the Regulation allows for upwards adjustment beyond the value at loan origination, but only up to the average value over the last six years for residential property or eight years for commercial immovable property (Article 229(1)(e)).
- 2.4.5. The provisions for the regulation of banking, including those concerning the Basel requirements, are further developed and standardised by the European Banking Authority (EBA) in the Single Rulebook. This document provides a set of

harmonised prudential rules which institutions throughout the EU must respect. The EBA is also mandated to produce a number of Binding Technical Standards (BTS) for the implementation of the CRD IV package which, once adopted by the European Commission, are legally binding and directly applicable as national law in Member States (unless otherwise agreed). Furthermore, the EBA is coordinating a Q&A process in which it answers questions on the practical application or implementation of the CRD IV package and on other legislation falling within the EBA's remit.

- 2.4.6. Further guidance on the valuation of immovable property is provided in Section 7 of the EBA guidelines of 29 May 2020 on loan origination and monitoring. These guidelines apply to any valuation, monitoring and revaluation of immovable property collateral conducted after 30 June 2021.
- 2.4.7. **Asset Quality Review** – As one of the reactions to the 2008 financial crisis, banks have had to screen the quality of their assets. In this context the ECB published its manual for Phase 2 of the Asset Quality Review in May 2023. As regards the valuation of real estate, this manual confirms the leading role of the EVS: ***“Real estate should be valued in line with European Standards EVS-2020 (Blue Book) and other international standards such as the Royal Institute of Chartered Surveyors (RICS) guidelines, with EVS2020 taking precedence in the event of any conflict (for the avoidance of doubt, this should be considered to apply throughout the document).”***
- 2.4.8. **Residential mortgages** – The EU has also put in place rules for the valuation of property for the purposes of lending to consumers, essentially residential mortgages. These rules are laid down in the Mortgage Credit Directive 2014/17/EU.
- 2.4.9. Among other matters, this Directive requires Member States to ensure that reliable valuation standards are used when assessing residential property for mortgage purposes. In this context, Recital 26 of the Mortgage Credit Directive states that for standards to be reliable they should take into account internationally recognised valuation standards, specifically mentioning the EVS, according to which creditors should *“adopt appraisal standards and methods that lead to realistic and substantiated property appraisals in order to ensure that all appraisal reports are prepared with appropriate professional skill and diligence and that appraisers meet certain qualification requirements and to maintain adequate appraisal documentation for securities that is comprehensive and plausible”*.
- 2.4.10. Article 19 of the Mortgage Credit Directive requires that property valuers be *“professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation which shall be documented in a durable medium and of which a record shall be kept by the creditor”*.

## Legislation

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010

EBA Guidelines of 29 May 2020 on loan origination and monitoring

ECB Phase 2 Manual for Asset Quality Review of May 2023

Regulation (EU) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor

EBA Single Rulebook

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

- 2.5.1. Solvency II and Omnibus II** – The insurance and reinsurance sector is now governed by the Solvency II regime established by the Solvency II Directive 2009/138/EC. This framework Directive requires the Solvency Capital Requirement of each insurance and reinsurance institution to be calculated at least once a year. It also provides specific rules for the valuation of assets and liabilities, including technical provisions for the business of (re)insurance.
- 2.5.2.** According to Article 75(1) of the Solvency II Directive, Member States must ensure that, unless otherwise stated, insurance and reinsurance institutions value their assets *“at the amount for which they could be exchanged between knowledgeable willing parties in an arm’s length transaction”*.
- 2.5.3.** Recital 46 of the Directive states that *“valuation standards for supervisory purposes should be compatible with international accounting developments, to the extent possible, so as to limit the administrative burden [...]”*.
- 2.5.4.** The Omnibus II Directive 2014/51/EU and Solvency II Delegated Regulation 2015/35 amended the Solvency II regime in a number of ways. For instance, Article 9(3) of Delegated Regulation 2015/35 provides that, where necessary, Article 75 of the Solvency II Directive prevails over international accounting standards adopted by

the European Commission. In addition, Article 2 of the Regulation provides that valuations “*shall be based on the expertise of persons with relevant knowledge, experience and understanding of the risks inherent in the insurance or reinsurance business*” and that valuers have to provide certain qualification proofs.

**2.5.5.** The key assumptions underlying the valuation of assets and liabilities of insurance and reinsurance undertakings, as well as approaches to be applied for different classes of assets and liabilities are explained in Chapter II of Delegated Regulation 2015/35, stating that insurance and reinsurance undertakings:

- ▶ Shall value assets and liabilities based on the assumption that the undertaking will pursue its business as a going concern
- ▶ Shall value assets and liabilities in accordance with international accounting standards
- ▶ Shall value individual assets and individual liabilities separately
- ▶ Shall take into account the characteristics of the asset or liability where market participants would take those characteristics into account when pricing the asset or liability at the valuation date, including the condition and location of the asset or liability and restrictions, if any, on the sale or use of the asset
- ▶ As the default valuation method, shall value assets and liabilities using quoted market prices in active markets for the same assets or liabilities
- ▶ Where the use of quoted market prices in active markets for the same assets or liabilities is not possible, shall value assets and liabilities using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences
- ▶ Use of quoted market prices shall be based on the criteria for active markets, as defined in international accounting standards
- ▶ When using alternative valuation methods, as little as possible rely on undertaking-specific inputs and make maximum use of relevant market inputs
- ▶ Shall not value property and investment property with cost models where the asset value is determined as cost less depreciation and impairment

**2.5.6. EIOPA Guidelines** – Article 75(2) of the Solvency II Directive 2009/138/EC, as amended by Article 2(22) of the Omnibus II Directive 2014/51/EU, provides that the European Insurance and Occupational Pensions Authority (EIOPA) can develop technical standards on matters such as valuation, that can subsequently be adopted by the European Commission. On 14 September 2015, the EIOPA issued Guidelines on recognition and valuation of assets and liabilities other than technical provisions intending to facilitate convergence of professional practice across Member States and to support undertakings in recognising and valuing assets and liabilities. Guideline 3 regarding investment property and other properties

provides that “[f]or the purposes of Article 10 of Delegated Regulation (EU) 2015/35 when valuing investment property and other properties, undertakings should select the method in accordance with Article 10(7) thereof that provides the most representative estimate of the amount for which the assets could be exchanged between knowledgeable willing parties in an arm’s length transaction. In accordance with Article 10(6) of that regulation these methods should be based on the following: a) current prices in an active market for properties of a different nature, condition or location, or subject to different lease or other contractual terms, adjusted to reflect those differences; b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and, when possible, by external evidence such as current market rents for similar properties in the same location and condition and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.”

## Legislation

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

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

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

EIOPA Guidelines of 14 September 2015 on recognition and valuation of assets and liabilities other than technical provisions (EIOPA-BoS-15/113)

## 2.6. Valuation of Property for Investment Funds

**2.6.1. General** – Investment funds are financial products collecting investors’ money, and investing the pooled capital through a portfolio of financial instruments. The most common investment funds in Europe are undertakings for collective investment in transferable securities (UCITS) which are sold to retail investors. They are regulated

by UCITS Directive 2009/65/EC as amended by Directive 2014/91/EU and AIFM II Directive 2024/927. Funds that are not regulated at EU level by the UCITS Directive, including real estate funds, hedge funds and private equity funds, are alternative investment funds. They are designed for professional investors and are regulated by AIFM Directive 2011/61/EU as amended by AIFM II Directive 2024/927.

- 2.6.2. Valuation for UCITS** – The rules for the valuation of assets and for the calculation of the sale or issue price and the repurchase or redemption price of the units of a UCITS shall be laid down in the national law, in the fund rules or in the instruments of incorporation of the investment company (Article 85 of the UCITS Directive). In case of merger of UCITS, a depositary or an independent auditor approved in accordance with Directive 2006/43/EC should draw up a report on behalf of all the UCITS involved (Article 42 of the UCITS Directive). This report should validate the criteria adopted for valuation of the assets and, where applicable, the liabilities, the calculation method of the exchange ratio set out in the common draft terms of merger as well as the actual exchange ratio and, where applicable, the cash payment per unit.
- 2.6.3. Valuation for alternative investment funds** – The AIFM Directive lays down rules for the valuation of assets and the calculation of the net asset value per unit or share of alternative investment funds:
- ▶ The process for valuation of assets and calculation of the net asset value should be functionally independent from the portfolio management and the remuneration policy of the AIFM and other measures should ensure the prevention of conflicts of interest and of undue influence on the employees (Recital 29)
  - ▶ The valuation procedures shall ensure that the assets are valued and the net asset value per unit or share is calculated at least once a year (Article 19(3))
  - ▶ Subject to certain conditions and qualifications, AIFMs should be able to appoint an external valuer to perform the valuation function (Article 19(4) and 19(5))
- 2.6.4.** The AIFM Directive has been supplemented by Commission Delegated Regulation 231/2013 that complements the common general rules and establishes benchmarks for AIFMs when developing and implementing appropriate and consistent policies and procedures for the proper and independent valuation of assets. It holds that the AIFM should determine and describe the valuation methodologies it uses.

## Legislation

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts,

amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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

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

Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds

## 2.7. Valuation of Property for State Aid Rules

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

**2.7.2.** In this context, Article 107(1) TFEU provides the following:

*“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market”.*

**2.7.3.** Accordingly, Article 107(1) TFEU sets out four cumulative conditions for a measure to be qualified as State aid. In particular, the measure must (i) give an economic advantage, (ii) be financed by the State or through State resources, (iii) selectively favor certain undertakings or the production of certain goods and (iv) distort competition and affect trade between Member States.

**2.7.4.** In 2016 the European Commission issued the Notice on the notion of State aid that gives general guidance on all aspects of the definition of State aid. In particular, the Notice explains when public spending falls within, and outside, the scope of EU State aid control.

**2.7.5. Valuation and the existence of State aid** – In the context of property valuation, the main element will be to determine the existence/size of an advantage.

**2.7.6.** The notion of “*advantage*” is not defined in the TFEU, but the CJEU has ruled that it is to be interpreted in a broad manner. It embraces not only positive benefits, but also interventions which mitigate the charges which are normally included in the budget of an undertaking and which, without being subsidies in the strict meaning of the word, are similar in character and have the same effect. In short, an advantage within the meaning of Article 107(1) TFEU can be defined as any economic benefit which an undertaking would not have obtained under normal market conditions.

**2.7.7. The market economy operator** – Economic transactions carried out by public bodies (including public undertakings) do not confer an advantage, and therefore do not constitute State aid, if they are carried out in line with normal market conditions. To assess whether a range of economic transactions carried out by public bodies takes place under normal market conditions, the European Commission and the CJEU developed the market economy operator (MEO) test. The purpose of this test is to assess whether the public bodies acted as a market operator would have done in a similar situation. If this is not the case, the beneficiary undertaking has received an economic advantage which it would not have obtained under normal market conditions, placing it in a more favourable position compared to that of its competitors.



- 2.7.8. This principle has been developed with regard to different economic transactions. For instance, the “*market economy investor principle*” is used to identify the presence of State aid in cases of public investment. The “*private creditor test*” has been developed to examine whether debt renegotiations by public creditors involve State aid, comparing the behaviour of a public creditor to that of hypothetical private creditors that find themselves in a similar situation. Finally, the “*private vendor test*” and the “*private buyer test*” are used to assess whether a sale or a purchase by a public body involves State aid, considering whether a private vendor or purchaser, under normal market conditions, would have executed a transaction at the same price.
- 2.7.9. The application of the MEO test depends on the available information. In this context, a distinction can be made between situations in which the transaction’s compliance with market conditions can be directly established through transaction-specific market data (e.g. where the transaction is carried out “*pari passu*” by public entities and private operators or where the transaction is carried out through a competitive, transparent non-discriminatory and unconditional tender procedure) and situations in which, due to the absence of such data, the transaction’s compliance with market conditions has to be assessed on the basis of a generally-accepted, standard assessment methodology. According to the European Commission, “[s]uch a methodology must be based on the available objective, verifiable and reliable data, which should be sufficiently detailed and should reflect the economic situation at the time at which the transaction was decided, taking into account the level of risk and future expectations”.
- 2.7.10. **The valuation of public property** – The sale or purchase of public land must be considered in line with the private vendor or private buyer test described above.
- 2.7.11. In this context, it is underlined in point 103 of the Notice of the European Commission that “*in the case of sales of land, an independent expert evaluation prior to the sale negotiations to establish the Market Value on the basis of generally accepted market indicators and valuation standards is in principle satisfactory*”.
- 2.7.12. In addition, reference can be made to a judgment of 22 May 2019 in relation to a settlement agreement concluded between Madrid City Council and the football club Real Madrid CF to offset the liabilities following a failed land swap (judgment in the case T-791/16, *Real Madrid Club de Fútbol v Commission*). In this judgment, the CJEU confirmed that the value of a plot of land must be assessed taking into account the situation at the date of the transaction. In the case at hand, the CJEU noted that, at that date, the plot at issue was part of public land and could not be transferred, it being only possible to grant a right of use. Accordingly, the value of the plot “*had to correspond to the value which it had for that city council, and thus to the right of use of that plot and not the hypothetical value it would have had had it been transferrable*”.

- 2.7.13. Valuation and the compatibility of State aid** – In some cases, the valuation of assets may also be important in order to declare State aid compatible with the internal market.
- 2.7.14.** For instance, in the context of the compatibility assessment, the European Commission will check if the aid subsidises only developments which are not viable without public subsidy and is therefore designed to minimise the extent of the public subsidy up to the minimum needed. This proportionality test may include the need to value property. By way of illustration, reference can be made to the decision SA.102927 of 6 February 2023 regarding an aid scheme to promote the accelerated supply of housing and to enable home ownership in Ireland. This aid has been authorised in so far as it serves to overcome the viability gap due to the fact that in certain parts of Ireland the delivery cost of apartments for sale to owner occupiers can be greater than the sales price achievable on the market. To demonstrate the existence of a viability gap between the delivery cost of an apartment and the market price that could be achieved, a valuation report confirming the anticipated market price must be prepared by a qualified valuer. According to the Irish authorities, these valuation reports must be in line with international standards such as the EVS.
- 2.7.15.** Moreover, reference can be made to the Communication from the European Commission on the treatment of impaired assets in the Community banking sector that sets out criteria for the compatibility of asset relief measures. In this context, the European Commission points out that a correct and consistent approach to the valuation of eligible assets is important to prevent undue distortions of competition and to avoid subsidy races between Member States. In addition, it is underlined that the valuation must be based on internationally recognised standards and benchmarks and that, when assessing the valuation methods put forward by Member States, the European Commission will consult panels of valuation experts.

### Legislation

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

Communication from the Commission of 26 March 2009 on the treatment of impaired assets in the Community banking sector

Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union

### 3. EU legislation as part of the valuation matrix

#### 3.1. General Overview

- 3.1.1. To determine the value of property, the valuer must have due regard to the use of property that is physically possible, reasonably probable, legal or likely to become so. Accordingly, legislation is part of the property valuation matrix.
- 3.1.2. In recent years, the EU has adopted a wide array of instruments in relation to climate, environment and energy. These measures are not limited to certain sectors but have an impact on the entire society. Much of this affects property and property valuation. Property may in this context not only encounter problems linked to energy consumption and environmental standards, but also offer solutions in terms of climate change mitigation.

#### 3.2. Climate and Environment

##### 3.2.1. General

- 3.2.1.1. **Valuation and environmental regulation** – EU environmental regulation can impose large costs on property owners and users, making it important to understand the potential for its impact in any particular situation and its consequence for property values. The valuation of property is closely linked to the compliance with EU environmental rules and standards. These concerns will be shared by lenders and also need to be considered in lettings.
- 3.2.1.2. **Growth of EU environmental legislation** – The EU has over the past decades put in place a broad range of environmental legislation. At first, this was driven by concerns to ensure a safe environment, stimulated by incidents such as the exposure in 1976 of the population of Seveso and neighbouring settlements near Milan to dioxins following an incident at a chemical manufacturing plant. Nowadays, EU environmental policy is mainly extending on the basis that many issues see both causes and effects extending beyond the reach of individual countries.
- 3.2.1.3. **Environment in the TFEU** – The role of the EU in environmental policy is confirmed in Article 191(2) TFEU stating that “*Union policy on the environment shall aim at a high level of protection taking into account the diversity of situations in the various regions of the Union. It shall be based on the precautionary principle and on the principles that preventive action should*

*be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay”.*

- 3.2.1.4. In addition, Article 11 TFEU states that “*environmental protection requirements must be integrated into the definition and implementation of the Union’s policies and activities, in particular with a view to promoting sustainable development*”. Likewise, Article 37 of the Charter of Fundamental Rights of the European Union holds that “[a] *high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the Union*”. The effect is that environmental protection is now an integral part of the framework of EU legislation and that, alongside the precautionary and the polluter pays principles, sustainable development has been affirmed as a core principle.
- 3.2.1.5. However, it should be noted that environmental protection is not (yet) considered to be an overriding objective. Indeed, the CJEU explained in *Austria v Commission* (T-356/15) that “*although protection of the environment must be integrated into the definition and implementation of EU policies, particularly those which have the aim of establishing the internal market, it does not constitute, per se, one of the components of that internal market, defined as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured*”. Accordingly, the CJEU found that State aid for the promotion of nuclear energy cannot be called into question by its possible effects on the implementation of the principle of protection of the environment, the precautionary principle and the polluter pays principle.
- 3.2.1.6. **Environment Action Programme (EAP)** – The EU not only agrees specific legislation but also frames general environmental policies. In 2022 the European Parliament and the Council adopted the eighth Environment Action Programme (EAP) that sets the principles guiding EU environment policy until 2030. The EAP sets out six priority objectives for 2030 and the conditions needed to achieve these:
- ▶ Achieving the 2030 greenhouse gas emission reduction target and climate neutrality by 2050
  - ▶ Enhancing adaptive capacity strengthening resilience and reducing vulnerability to climate change
  - ▶ Advancing towards a regenerative growth model, decoupling economic growth from resource use and environmental degradation, and accelerating the transition to a circular economy
  - ▶ Pursuing a zero-pollution ambition, including for air, water and soil and protecting the health and well-being of Europeans

- ▶ Protecting, preserving and restoring biodiversity, and enhancing natural capital
  - ▶ Reducing environmental and climate pressures related to production and consumption (particularly in the areas of energy, industry, buildings and infrastructure, mobility, tourism, international trade and the food system)
- 3.2.1.7. The mid-term review of the EAP that was carried out in 2024 found that *“[c]onstruction, buildings and infrastructure are still the most energy and material-intensive sector in the EU and a driver for land take and soil sealing. The 2023 State of the Energy Union Report concluded that the building sector must significantly accelerate the shift to sustainable practices. Material use for buildings could potentially decrease by 30% if used more efficiently, in particular by extending the lifespan of existing buildings and reducing demand for new buildings”*.
- 3.2.1.8. **European Green Deal** – The European Green Deal of December 2019 outlines several initiatives relating to the EU’s environmental policies. In particular, the Green Deal led to the adoption of several legislative and policy actions with a high impact on property, such as:
- ▶ An extension of the EU Emissions Trading System to emissions from fuels combusted in the building sector
  - ▶ A new EU Strategy on Adaptation to Climate Change in which the European Commission states that to adapt to the unavoidable impacts of climate change and become climate resilient by 2050, *“[w]e need to do more to prepare Europe’s building stock to withstand the impacts of climate change. Extreme weather and long-lasting climatic changes can damage buildings and their mitigation potential e.g. solar panels or thermal insulation after hailstorms. However, buildings can also contribute to large-scale adaptation, for example through local water retention that reduces the urban heat island effect with green roofs and walls. The Renovation Wave and the Circular Economy Action Plan identify climate resilience as a key principle. The Commission will explore options to better predict climate-induced stress on buildings and to integrate climate resilience considerations into the construction and renovation of buildings through Green Public Procurement criteria for public buildings, the Digital Building Logbook, and as part of the process to revise the Energy Performance of Buildings Directive and the Construction Products Regulation”*.

- ▶ A Circular Economy Action Plan that announces a new Strategy for a Sustainable Built Environment to ensure coherence across the relevant policy areas such as climate, energy and resource efficiency, management of construction and demolition waste, accessibility, digitalisation and skills and should promote circularity principles throughout the life-cycle of buildings

**3.2.1.9. Fit for 55** – As part of the European Green Deal, the European Commission also adopted a package of legislative Proposals named “Fit for 55”. This package aims to strengthen the EU’s position as a global climate leader by making the EU’s climate, energy, land use, transport and taxation policies fit for reducing net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels. According to the European Commission, this package aims to fundamentally transform our economy and society for a fair, green and prosperous future. The package includes new legislation and proposals that will affect buildings and property.

### 3.2.2. Environmental Assessments

**3.2.2.1. EU spatial planning** – In general, the EU has intervened relatively little in spatial planning policy. The most far-reaching intervention in spatial planning is through Directives 2011/92/EU and 2001/42/EC requiring environmental assessments prior to obtaining authorisation for carrying out certain environmental developments. The aim of these Directives is to integrate environmental considerations into the preparation of projects, plans and programmes to reduce their environmental impact.

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

**3.2.2.3.** Annex I of the Directive contains a list of projects which must always be subject to consent and a prior EIA whereas Annex II concerns a list of projects for which Member States must decide on a case-by-case basis whether they must be made subject thereto based on the effects they might have on the environment (Articles 2(1) and 4(1) and (2)). When

Member States carry out a case-by-case examination, they should take into account the criteria set out in Annex III of the Directive (Article 4(3)).

- 3.2.2.4. In order to carry out an EIA, the developer must provide information on the environmental impact of the project for which it requests an authorisation (Article 5). Subsequently, the developer must inform and consult the competent authorities and the public (Articles 6 and 7). The competent authority decides whether it grants authorisation for the project taking into consideration the results of the EIA and the consultations, and communicates its decision to the public (Articles 8 and 9). This decision can be challenged by the public (Article 11).
- 3.2.2.5. Projects that are subject to an EIA may not be developed without prior EIA. If a project has nevertheless been developed, the lack of an EIA cannot be remedied with a retrospective authorisation and Member States must revoke or suspend consent already granted (*Inter-Environnement Wallonie* (C-41/11)). The prolongation of a (nuclear) industrial activity combined with major renovation works requires a prior EIA as well (*Inter-Environnement Wallonie II*, (C-411/17)). It is however possible to regularise projects developed without an EIA by conducting a new EIA if the following conditions are fulfilled (*Comune di Corridonia* (C-196/16 and C-197/16) and *Comune di Castelbellino* (C-117/17)):
- ▶ The regularisation does not provide the parties concerned with an opportunity to circumvent EU law or to dispense with applying it
  - ▶ The EIA is not conducted solely in respect of the project's future environmental impact, but also takes into account its environmental impact from the time of its completion
- 3.2.2.6. **Environmental assessments (EA) for plans and programmes** – Directive 2001/42/EC introduces the obligation of conducting an EA with respect to plans and programmes which are likely to have significant environmental effects. According to the case-law of the CJEU, plans and programmes may relate to “any measure which establishes a significant body of criteria and detailed rules for the grant and implementation of one or more projects” (see, for instance, *Associazione Verdi Ambiente e Società – Aps Onlus* (C-305/18) and *Thybaut* (C-160/17)).
- 3.2.2.7. Pursuant to Article 2(a) of the Directive, an EA must be prepared if the plans and programmes, as well as modifications to them, satisfy two conditions:
- ▶ They are subject to preparation and/or adoption by an authority, or are prepared by an authority for adoption through a legislative procedure
  - ▶ They are required by legislative, regulatory or administrative provisions

- 3.2.2.8.** The plans and programmes concerned include those which are prepared for agriculture, forestry, fisheries, energy, industry, transport, waste management, water management, telecommunications, tourism, town and country planning or land use and which set the framework for future development consent of projects listed in Annexes I and II of Directive 2011/92/EU (Article 3(2)(a)). An EA is also mandatory for plans and programmes which are subject to an assessment pursuant to Articles 6 and 7 of the Habitats Directive 92/43/EEC (Article 3(2)(b)). In addition, Member States must decide on a case-by-case basis whether an EA should also be carried out for other plans or programmes which are likely to have significant environmental effects (Article 3(4)).

### Legislation

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

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

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

### 3.2.3. Water

- 3.2.3.1. Water Framework Directive** – The Water Framework Directive 2000/60/EC establishes a framework for the protection of inland surface waters, transitional waters, coastal waters and groundwater which (i) prevents further deterioration and protects and enhances the status of aquatic ecosystems and, with regard to their water needs, terrestrial ecosystems and wetlands directly depending on the aquatic ecosystems, (ii) promotes sustainable water use based on a long-term protection of available water resources, (iii) aims at enhanced protection and improvement of the aquatic environment, and (iv) contributes to mitigating the effects of floods and droughts (Article 1).

- 3.2.3.2.** This Directive requires Member States to identify the individual river basins on their territory, which are in fact the areas covering one or more river catchments (Article 3). For each river basin district, Member States must establish a “*river basin management plan*” entailing a detailed account of how the objectives set forth in the Directive will be attained



(Articles 4, 11 and 13). These objectives and the accompanying measures differ depending on whether the water constitutes surface water or ground water (Article 4). In addition, the Directive provides additional objectives for “*protected areas*” designated by the Member States, such as bathing areas and areas with water used for the abstraction of drinking water (Articles 4, 6, 7 and 11 and Annex IV).

- 3.2.3.3. The Water Framework Directive is supplemented with several Directives aiming at preventing or reducing water pollution, each covering a specific topic. For instance, Directive 2006/118 tackles the pollution of groundwater, whereas Directive 2020/2184 provides measures for the protection of drinking water. The discharge of urban waste water and industrial waste water is currently regulated by Directive 91/271/EEC. Directive 91/676/EEC aims at preventing and reducing water pollution arising from nitrates from agricultural sources and, in this context, obliges Member States to designate zones vulnerable to nitrate within which certain agricultural practices are to be imposed and certain waters are to be monitored. Finally, Directive 2008/105/EC imposes environmental quality standards for the presence of certain pollutants in surface water and requires Member States to set up an inventory of emissions, discharges and losses of all substances listed in that Directive.
- 3.2.3.4. **Floods Directive** – The Floods Directive 2007/60/EC establishes a framework for the assessment and management of flood risks.
- 3.2.3.5. On the basis of this Directive, Member States are obliged to carry out an assessment for each river basin, prepare flood hazard maps and flood risk maps and set out flood management plans. Flood hazard maps not only have to indicate where floods are probable but also whether they are a low, medium or high probability (Article 6(3)). For each scenario, the flood extent, the water depths or water level and the flow velocity or the relevant water flow should be mentioned (Article 6(4)). Flood risk maps have to mention the indicative number of inhabitants and the type of economic activity of the area potentially affected (Article 6(5)).
- 3.2.3.6. **Implementation Report** – The European Commission assesses the implementation of certain Water Directives over a 6-year cycle. In its 2021 Report, the European Commission found that in the vast majority of Member States the consequences of future flooding on human health, the environment, cultural heritage and economic activity are being considered. However, although “*nearly two thirds of Member States present[...] strong evidence of a clear methodology for the assessment of past floods, [...] in 60% of river basins in the EU there are no data on the costs from flood damages. There is therefore room for improvement since collecting*”

*such data aids the calculation of costs and benefits and the prioritisation of measures.”*

- 3.2.3.7. European Green Deal** – The protection of the environment, the seas and the oceans is a priority of the Green Deal, as they are a source of natural and economic wealth for Europe.
- 3.2.3.8.** In order to pursue this preservation, the EU is committed to:
- ▶ Protecting biodiversity and ecosystems
  - ▶ Reducing air, water and soil pollution
  - ▶ Moving towards a circular economy
  - ▶ Improving waste management
  - ▶ Ensuring the sustainability of the blue economy and fisheries sectors
- 3.2.3.9.** As part of the European Green Deal, the European Commission adopted in 2021 the EU Action Plan “Towards Zero Pollution for Air, Water and Soil”. This plan ties together all relevant EU policies to tackle and prevent pollution and led to Proposals of the European Commission to review and amend the Framework Water Directive as well as Directives 91/271/EEC, 2006/118/EC and 2008/105/EC. Key 2030 targets are set to reduce pollution at source, such as improving water quality by reducing waste, plastic litter at sea and microplastics released into the environment. In addition, the plan details a range of actions, namely:
- ▶ Reviewing the standards for the quality of water, including in EU rivers and seas
  - ▶ Fostering zero pollution from production and consumption
- 3.2.3.10. Importance for property valuation** – The measures under these Directives have an impact when valuing property as they can result in domestic regulation restricting land use or developments close to water.
- 3.2.3.11.** For instance, the value of property may be affected when it is located in the vicinity of a “protected water area” or a zone vulnerable to nitrate. As such, Article 11 of the Water Framework Directive 2000/60/EC includes the requirement for prior regulation or for prior authorisation with respect to discharges liable to cause pollution. The existence and terms of such authorisations or licences to discharge may add to or limit the value of affected premises.
- 3.2.3.12.** In addition, the identification of a site as prone to flooding will have important consequences for its valuation, and this due to both risk of actual

flooding and the impact of that identification on the availability or cost of insurance. In some cases, the value of property can also be impacted by flood control measures that require certain land to be flooded to protect other property by managing water flow.

## Legislation

Council Directive 91/271/EEC of 21 May 1991 concerning urban wastewater treatment

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

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

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

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

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

Communication of 11 December 2019 from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640

Directive (EU) 2020/2184 of the European Parliament and of the Council of 16 December 2020 on the quality of water intended for human consumption

Communication of 12 May 2021 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Pathway to a Healthy Planet for All, EU Action Plan: "Towards Zero Pollution for Air, Water and Soil", COM/2021/400

Report of 15 December 2021 from the Commission to the Council and the European Parliament on the implementation of the Water Framework Directive (2000/60/EC), the Environmental Quality Standards Directive (2008/105/EC amended by Directive 2013/39/EU) and the Floods Directive (2007/60/EC)

Proposal of 26 October 2022 from the Commission for a Directive of the European Parliament and of the Council concerning urban wastewater treatment

### 3.2.4. Biodiversity, Nature Conservation and Nature Restoration

- 3.2.4.1. Designation of protected sites** – Nature conservation was one of the first areas in environmental policy where EU law significantly impacted national legislation. The two Directives in this area that are of particular relevance for property valuation are the Habitats Directive 92/43/EEC and the Birds Directive 2009/147/EC. These Directives require first of all the designation of sites where the habitats and species mentioned in the Directives must be maintained or restored. These sites are called “*special areas of conservation*” under the Habitats Directive and “*special protection areas*” under the Birds Directive. Together they form the ecological network named Natura 2000. The Habitats Directive also provides a list of criteria which Member States must take into account when determining these protected sites. Designation is an objective issue and may thus not take account of economic, social and cultural requirements or regional and local characteristics (*First Corporate Shipping* (C-371/98)).
- 3.2.4.2. Protected sites and project development** – Where a site is part of the Natura 2000 network, Member States have to protect it and the species for which it was designated (Articles 12–16 of the Habitats Directive).
- 3.2.4.3.** Consequently, any project that is likely to have an impact on a Natura 2000 site should be the subject of appropriate assessment. In principle, Member States may only agree on a development proposal after having ascertained that it will not adversely affect the integrity of protected sites (Article 6(3) of the Habitats Directive).
- 3.2.4.4.** However, in the absence of other alternatives, some development proposals that will cause significant negative impact may still be permitted for imperative reasons of overriding public interest, including those of social or economic nature (Article 6(4) of the Habitats Directive). The assessment of imperative reasons of overriding public interest and that of the existence of less harmful alternatives require a weighing up against the damage caused to the site by the plan or project under consideration (*Briels and Others* (C-521/12)). Moreover, in this case Member States must introduce “*compensatory measures*” to ensure the overall coherence of the Natura 2000 network (Article 6(4) of the Habitats Directive). This term is not defined in the Habitats Directive. In practice, however, these measures generally include recreating a habitat on a new or enlarged site

to be incorporated into Natura 2000 or improving a habitat on part of the site or another Natura 2000 site proportional to the loss due to the project.

- 3.2.4.5. The Nature Restoration Law** – As part of the Green Deal, the European Commission presented a biodiversity strategy, including the Nature Restoration Regulation. This regulation establishes a framework within which Member States shall put in place effective and area-based restoration measures with the aim to jointly cover, as a Union target, throughout the areas and ecosystems within the scope of this Regulation, at least 20% of land areas and at least 20% of sea areas by 2030, and all ecosystems in need of restoration by 2050 (Article 1(2)). With regards to certain habitat types listed in Annex I, restoration measures shall be put in place on 30% of the total area of these habitats by 2030, on 60% by 2040 and on 90% by 2050, whereby priority shall be given to Natura 2000 sites until 2030 (Articles 4(1)(a) and 4(1)(b)).
- 3.2.4.6.** In addition, as from 2031, Member States are to achieve an increasing trend in creating urban green space, including through the integration of urban green space into buildings and infrastructure (Article 8(2)).
- 3.2.4.7.** Member States shall prepare national restoration plans to identify the restoration measures that are necessary to meet the restoration targets (Article 14(1)). They may, however, take into account the diversity of situations in various regions related to social, economic and cultural requirements, regional and local characteristics and population density (Article 14(16)(c)).
- 3.2.4.8. Importance for property valuation** – Since the Habitats and Bird Directives can impose significant hurdles for the development or change in use of property located on a Natura 2000 site or in the vicinity thereof, they may also have an impact on the value of a site. As many Natura 2000 sites involve wetland, this can be a particular constraint on the development of coastal sites. A case in point was the project for the development of the port of Le Havre (Le Havre 2000). The presence of bird nests on islets in the Seine estuary caused major delays while the French authorities and the European Commission negotiated adaptations to the project. In some Member States, for instance in certain regions of Belgium and the Netherlands, it becomes more and more difficult to obtain permits for the development of certain industrial or agricultural activities due to the impact of their nitrogen emissions on vulnerable Natura 2000 sites.

- 3.2.4.9.** On the other hand, proximity to Natura 2000 sites may result in higher property values, given the need for green spaces. In addition, Member States may also grant subsidies for measures taken in order to compensate the damage incurred by a Natura 2000 site, as long as they comply with State aid rules.

### Legislation

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

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

Regulation (EU) 2024/1991 of the European Parliament and of the Council of 24 June 2024 on nature restoration and amending Regulation (EU) 2022/869

## 3.3. Asbestos

- 3.3.1. Specific measures to limit exposure to asbestos** – The Asbestos Directive 2009/148/EC primarily provides preventive measures for the protection of the health of workers exposed to asbestos. In essence, when asbestos is presumed to be present in a building, specific measures must be taken before starting any demolition, asbestos removal work, repairing or maintenance in order to limit exposure risks.
- 3.3.2.** The Asbestos Directive has been amended by Directive 2023/2668, since “[i]n view of the upcoming increase in the thermal renovations of buildings, there is a crucial need to support research and development in order to ensure the highest possible level of protection for workers who are or who may be exposed to asbestos”. Since the amendment, there has been an obligation for undertakings that carry out demolition or asbestos removal work to obtain a permit from the competent authority before the start of the work (Article 15).
- 3.3.3. Importance for property valuation** – The Asbestos Directive has a significant impact on the management of many buildings constructed in the twentieth century when asbestos was a cheap and effective building material used in roofing sheets, as panels and in other ways. This can add substantially to the costs of renovation, maintenance or demolition of a property or the remediation and development of a site, and so may affect its value.

- 3.3.4.** Assessment will require specialist knowledge. It is normal for valuation reports to contain exclusions regarding asbestos, recommend the commissioning of a specialist report and otherwise assume that asbestos is present.

### Legislation

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

Directive (EU) 2023/2668 of the European Parliament and of the Council of 22 November 2023 amending Directive 2009/148/EC on the protection of workers from the risks related to exposure to asbestos at work

## 3.4. Energy

- 3.4.1. Energy policy framework** – In line with Article 194(1) TFEU, EU policy on energy aims inter alia to promote energy efficiency and energy saving and the development of new and renewable forms of energy, the main emphasis being on buildings, as they represent 40% of the EU's energy consumption and 36% of its greenhouse gas emissions.
- 3.4.2. Main EU targets** – The European Climate Law Regulation (EU) 2021/1119 is one of the spearheads of the European Green Deal. It enshrines climate neutrality by 2050 and an EU 2030 climate target of at least 55% domestic reduction of net greenhouse gas emissions compared to 1990.
- 3.4.3.** With regard to energy, the EU framework sets two main targets. First, pursuant to Article 3(1) of the Renewable Energy Directive 2018/2001, the share of energy from renewable sources in the Union's gross final consumption of energy in 2030 should be at least 42.5%. Second, Article 4(1) of the recast Energy Efficiency Directive 2023/1791 establishes a reduction of energy consumption target of at least 11,7% in 2030 compared to the projections of the 2020 EU Reference Scenario. This corresponds to a reduction of 40,5% for primary energy consumption and 38% for final energy consumption compared to the earlier projections (Recital 28).
- 3.4.4. European Green Deal** – The European Green Deal focuses on 3 key principles for the clean energy transition, to reduce greenhouse gas emissions:
- ▶ Ensuring a secure and affordable EU energy supply
  - ▶ Developing a fully integrated, interconnected and digitalised EU energy market

- ▶ Prioritising energy efficiency, improving the energy performance of buildings and developing a power sector based largely on renewable sources
  
- 3.4.5. As the construction, use and renovation of buildings require significant amounts of energy and mineral resources, the European Commission addresses amongst others, the need for a (building) renovation wave throughout the EU. New legislation related to the energy performance of buildings and the inclusion of emissions from buildings in European emissions trading has been adopted.
  
- 3.4.6. **Energy performance and energy efficiency in buildings** – The impact on valuation of property of the recast Energy Performance of Buildings Directive (EU) 2024/1275 and of the recast of the Energy Efficiency Directive (EU) 2023/1791 is explained in detail in EVS 6 Valuation and Energy Efficiency.
  
- 3.4.7. **The extension of greenhouse gas emission allowance trading to buildings** – In order to meet the European Green Deal's ambitions, the Emissions Trading System Directive 2003/87/EC was amended by Directive 2023/959 to include emissions from inter alia buildings and the road sector. To this end, a new chapter IVa was inserted in the ETS Directive governing the release of carbon dioxide as a result of fuel consumption used for combustion in the building sector.
  
- 3.4.8. The new Emissions Trading System applies to regulated entities defined as *“any natural or legal person, except for any final consumer of the fuels, that engages in the activity referred to in Annex III”* (Article 3(ae)). This activity referred to in Annex III is the *“[r]elease for consumption of fuels which are used for combustion in the buildings, road transport and additional sectors”*. As a result, the regulation applies to persons liable to pay excise duties on energy (such as tax warehouses and fuel suppliers) and not on the end consumers of fuels used for combustion in buildings.
  
- 3.4.9. As of 1 January 2025, regulated entities will no longer be allowed to release for consumption fuels that are used in the buildings sector without a permit (Article 30b). As of 1 January 2028, regulated entities will have to surrender an amount of allowances that is equal to the regulated entity's total emissions, corresponding to the quantity of fuels released for consumption during the preceding calendar year (Article 30e(2)). From 2027 onwards, these allowances shall be auctioned (Article 30d(1)).
  
- 3.4.10. **Promotion of energy from renewable sources** – The Renewable Energy Directive 2018/2001, as amended by Directive 2023/2413, establishes a common system to promote energy from renewable sources across different sectors. In the building sector, Member States shall determine an indicative national share of renewable energy in 2030 that is consistent with an indicative target of at least a 49% share



of energy from renewable sources in the Union's energy consumption in buildings in 2030 (Article 15a(1)). Member States may count waste heat and cold up to a limit of 20% of that share (Article 15a(2)).

- 3.4.11.** To this end, Article 15a(3) obliges Member States to *“introduce appropriate measures in their national regulations and building codes and, where applicable, in their support schemes, to increase the share of electricity and heating and cooling from renewable sources produced on-site or nearby as well as renewable energy taken from the grid in the building stock”*. Therefore Member States shall *“require the use of minimum levels of energy from renewable sources [...] in new buildings and in existing buildings that are undergoing major renovation or a renewal of the heating system, in accordance with Directive 2010/31/EU, where that is economically, technically and functionally feasible”* (15a(3)).
- 3.4.12. Impact on property valuation** – These EU laws have transformative impacts on the building stock, property markets and valuation. Predictable events are accelerated depreciation of non-renovated properties, significant EU and national subsidies for the renovation of the owner-occupied housing stock and renovation obligations at certain trigger points in the life-cycle of a building. For further description, see EVS 6 Valuation and Energy Efficiency.

## Legislation

Article 194(1) of the Treaty on the Functioning of the European Union

Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

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

Communication of 11 December 2019 from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640

Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

Directive (EU) 2023/959 of the European Parliament and of the Council of 10 May 2023 amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814

concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading system

Directive (EU) 2023/1791 of the European Parliament and of the Council of 13 September 2023 on energy efficiency and amending Regulation (EU) 2023/955 (recast)

Directive (EU) 2023/2413 of the European Parliament and of the Council of 18 October 2023 amending Directive (EU) 2018/2001, Regulation (EU) 2018/1999 and Directive 98/70/EC as regards the promotion of energy from renewable sources, and repealing Council Directive (EU) 2015/652

Directive (EU) 2024/1275 of the European Parliament and of the Council of 24 April 2024 on the energy performance of buildings (recast)

## 4. Valuation of property and taxation

### 4.1. Value Added Tax (VAT)

#### 4.1.1. General Overview

- 4.1.1.1. **VAT Directive** – The current EU legislation on VAT is laid down in the VAT Directive 2006/112/EC. The VAT Directive provides a common framework regarding the way VAT is to be applied in the Member States (Articles 31 to 92), the standard rates (Articles 93 to 105b) and the exemptions (Articles 131 to 166) and deductions (Articles 167 to 192).
- 4.1.1.2. **Taxable persons and transactions** – In principle, VAT is applied to all transactions carried out in the EU for consideration (payment) by a taxable person, i.e. any individual or body that supplies taxable goods and/or services in the course of business (Articles 12 and 13). Taxable transactions include supplies of goods or services within a Member State, intra-EU acquisitions of goods (goods supplied and dispatched or transported by a business in one Member State to a business in another) and imports of goods into the EU (Articles 14 to 30).
- 4.1.1.3. **Transfer of rights, shares and interests** – Member States may consider the transfer of the following interests, rights and shares as a transfer of goods: (i) certain interests in immovable property, (ii) rights in rem giving the holder thereof a right of use over immovable property and (iii) shares or interests equivalent to shares giving the holder thereof de jure or de

facto rights of ownership or possession over immovable property or part thereof (Article 15(2)).

- 4.1.1.4. **Reduced rates and exemptions** — Annex III of the VAT Directive provides a list of supplies of goods and services to which the reduced rates and the exemption with deductibility of VAT referred to in Article 98 of the Directive may be applied (see 4.1.4. below).
- 4.1.1.5. **Interpretation of VAT rules and concepts** — The rules and notions in the Directive constitute independent concepts of EU law which are to be interpreted solely under EU law (see, for instance, *Sequeira Mesquita* (C-278/18)), unless stipulated otherwise in the Directive. While a Member State's land and property law may be relevant in understanding the nature of the property transactions, it is irrelevant to the interpretation of the applicable VAT rules. Exemptions provided for in the Directive must be interpreted strictly (see, for instance, *Leichenich* (C-532/11)).
- 4.1.1.6. **Impact on property valuation** — VAT can be a significant factor in property transactions. This is especially the case in markets where some buyers are not able to fully recover the VAT. In particular, it will be important for a valuer to know whether the property is exempt or whether the exemption has been waived and, if it is subject to tax, what VAT rate applies to the property transaction at issue.

#### 4.1.2. The Supply of Land and Buildings

- 4.1.2.1. **New buildings and building land** — In line with Article 12(1) of the VAT Directive, the supply, before first occupation, of a building or parts of a building and of the land on which the building stands and the supply of building land are subject to VAT. Member States may apply criteria other than that of first occupation, such as the period elapsing between the date of completion of the building and the date of first supply, provided that this period does not exceed five years.
- 4.1.2.2. **Existing buildings and other types of land** — The supply of existing buildings or parts thereof, land on which a building stands and land which has not been built on is exempted from VAT (Article 135(1)(j) and (k)). However, Member States may allow taxpayers to opt for VAT on these transactions (Article 137(1)(b) and (c)). If the taxpayer opts for this, VAT will be chargeable on the supply of property but the taxpayer can recover the VAT on its inputs. The CJEU clarified that, for the purposes of this VAT exemption waiver, buildings and the land on which they stand cannot be dissociated from each other (see *Breitsohl* (C-400/98)). Therefore, a taxable person

who supplies both buildings and the land on which they stand may either use the VAT exemption for the buildings and the land taken as a whole, or opt for taxation of the whole.

- 4.1.2.3. The notion of “land”** – VAT rules for the supply of land depend on the type of land supplied. It is therefore important to clarify the three types of “land” that the Directive distinguishes: building land, land on which a building stands and land which has not been built on. Building land is defined as “*any unimproved or improved land defined as such by the Member States*” (Article 12(3)). The Directive leaves it entirely to the Members States to determine what is meant by the land on which a building stands (Article 12(2)) and does not specify what is meant by land which has not been built on. However, the CJEU clarified that land which has not been built on but is intended to be built on should be considered as building land even if at the time of the transaction the works have not yet started (see, for instance, *Woningstichting Maasdriel* (C-543/11) and *lcade Promotion* (C-299/20)).
- 4.1.2.4. The notion of “building”** – A building is defined as “*any structure fixed to or in the ground*” (Article 12(2)).
- 4.1.2.5. One single supply or multiple supplies** – Where the supply of immovable property is accompanied by the supply of services or movable property linked to the immovable property, one should verify whether these supplies should be assessed separately from the point of view of VAT. For VAT purposes, every supply must in principle be regarded as distinct and independent. However, if a transaction comprises several elements, the question arises whether it is to be regarded as one single supply or as several distinct and independent supplies which must be assessed separately.
- 4.1.2.6.** According to settled case-law of the CJEU, a transaction entailing several supplies must be regarded as one single supply if the supplies (i) form a single, indivisible economic supply, which would be artificial to split or (ii) consist of one principal supply in relation to which the other supplies are ancillary, i.e. when these supplies do not constitute for customers an end but a means of better enjoying the principal supply.
- 4.1.2.7.** Accordingly, where there is a single supply involving land on which a building stands and the supply of that land predominates, the whole transaction may be VAT exempt. Conversely, if the sale of land or buildings is ancillary to a taxable supply, it may be treated in accordance with the VAT status of that supply.

### 4.1.3. Leasing or Letting of Immovable Property

- 4.1.3.1. **VAT exemption** – As a general rule, the VAT Directive requires the Member States to exempt from VAT the leasing or letting of immovable property under conditions that they have to determine. However, according to Article 137(d) of the Directive, Member States may allow taxpayers to opt for VAT on these transactions.
- 4.1.3.2. **Scope of application** – Although the concepts of immovable property, letting and leasing are not defined by the Directive, they have to be analysed under EU law and not under the Member State's national laws.
- 4.1.3.3. The CJEU clarified that the concept of “*immovable property*” does not require that the property be indissociably incorporated into the ground. It is sufficient that the property not be mobile or easily movable, even where it is to be removed at the end of the lease. For instance, the CJEU considered as immovable property prefabricated buildings used as temporary housing which were bolted onto a concreted area, even though the buildings could be dismantled by eight persons in ten days and then re-erected elsewhere (*Maierhofer*, C-315/00). In the same vein, the CJEU decided that a houseboat without any propulsion system should be qualified as immovable property, on the grounds that it was immobilised on a river for many years and could not be removed without effort and considerable cost, was rented exclusively for the permanent operation of a restaurant discotheque and was connected to the water and electricity mains (*Leichenich* (C-532/11)).
- 4.1.3.4. In order for there to be “*letting*” of immovable property within the meaning of the Directive, the transaction must satisfy the following characteristics: the conferring by a landlord on a tenant, for an agreed period and in return for rent, of the right to occupy that property as if that person were the owner and to exclude any other person from enjoyment of such a right (see *Sequeira Mesquita* (C-278/18)).
- 4.1.3.5. The condition that the agreement be concluded for an agreed period is interpreted rather broadly. As a general rule, the agreement may not be occasional and temporary (*Régie communale autonome du stade Luc Varenne* (C-55/14) and *Leichenich* (C-532/11)). Nevertheless, it is not necessary that the period of the lease be fixed at the time the contract is concluded. Consequently, granting a license to several businesses to share premises, with no set duration and a rent partly linked to the passage of time may be considered to be a lease (*Temco Europe* (C-284/03)).

- 4.1.3.6.** A lease transaction in the meaning of the Directive also implies that the lessee has the exclusive right to occupy the property as if it was the owner. An agreement which grants only limited rights of possession or control on the immovable property concerned should therefore not be considered as a leasing agreement (*Sinclair Collins* (C-275/01)). On the other hand, the mere fact that the tenant does not have the right to make changes to the property does not preclude an agreement from being qualified as a lease agreement (*Sequeira Mesquita* (C-278/18)). As regards the exclusive nature of the tenant's right to occupy the property, it has been clarified that a restriction to this right does not preclude the occupation from being exclusive as regards all other persons not permitted to exercise a right over the property. A lease could therefore also relate to transactions where certain parts of a property must be used in common with other occupiers (*Temco Europe* (C-284/03)). The same holds true where the property is occasionally occupied by another when the lessee is not using it for itself. For instance, the CJEU ruled that the lease of mooring berths for boats fell within the scope of the exemption for leasing even though the berths were occasionally used by others when the lessee's boat was away (*Fonden Marselisborg Lystbådehavn* (C-428/02v)). In another case, the CJEU ruled that an agreement whereby the owner grants a fishing club the right to fish in its ponds does not fulfil the condition of exclusivity if the owner reserves the right to fish in those waters for her/himself or one guest per day (*Walderdorff* (C-451/06)).
- 4.1.3.7. Exceptions** – Article 135(2) of the Directive provides the following four exceptions to this VAT exemption:
- (a) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites;*
  - (b) the letting of premises and sites for the parking of vehicles;*
  - (c) the letting of permanently installed equipment and machinery;*
  - (d) the hire of safes."*
- 4.1.3.8.** Member States may limit the scope of the exemption further but may not broaden it (Article 135(2) of the Directive). For example, the CJEU confirmed that Member States may decide to make all leasing and letting of immovable property liable to VAT except for residential property (*Amengual Far* (C-12/98)).

- 4.1.3.9. **One single supply or multiple supplies** – If a lease transaction comprises several elements, the question may arise whether it is to be regarded as one single supply or as several distinct and independent supplies.
- 4.1.3.10. In this context, the CJEU ruled that the lease of a restaurant together with the equipment and kitchen appliances constitutes one single supply (*Mailat* (C-17/18)). In the same vein, the CJEU decided that the transfer of the use of vineyards which also entailed the transfer of certain assets and intangible rights was to be considered as one single supply (*Sequeira Mesquita* (C-278/18)).
- 4.1.3.11. Conversely, the qualification of letting does not apply if the transaction essentially concerns the supply of services rather than simply making property available. In this respect, the CJEU observed that making available sport facilities such as a golf course or a football stadium generally entails not only the passive activity of making the course available but also a large number of commercial activities. In such cases, the use of the facilities will only qualify as a lease if it constitutes the main service supplied in the transaction (*Pula Parking* (C-551/15) and *Stockholm Lindöpark* (C-150/99)).

#### 4.1.4. Works to Property

- 4.1.4.1. **Optional reduced rates** – Directive 2022/542 amended the VAT Directive to allow Member States to adopt reduced VAT rates on certain transactions. These rates may in principle not be less than 5 per cent (Article 98). As this is an option which each Member State can take up or not, and only for a limited number of goods or services covered in Annex III of the Directive, valuers should verify the applicable rate in the Member State in which the works are carried out.
- 4.1.4.2. **Scope of application** – In particular, Member States may apply a reduced VAT rate in relation to the *“supply and construction of housing, as part of a social policy, as defined by the Member States; renovation and alteration, including demolition and reconstruction, and repairing of housing and private dwellings; letting of immovable property for residential use”* (Annex III(10) of the Directive). Likewise, a reduced VAT rate may be applied to the *“construction and renovation of public and other buildings used for activities in the public interest”* (Annex III(10a) of the Directive).

## Legislation

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

Council Directive (EU) 2022/542 of 5 April 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax

## 4.2. Green Taxation

- 4.2.1. Taxation in support of green transition** – In order to reach the environmental policy goals set by the European Green Deal, the European Commission emphasises the importance of fostering Green Taxation. This means imposing taxes on inter alia energy, transport, pollution, resources and energy products. In its Report “Taxation in support of green transition” published in 2021, the European Commission recommended taxing greenhouse gas directly, giving taxes priority over tax incentives such as tax breaks on income or profit for the renovation of buildings, that, as stated in the Report, are common in the Member States.
- 4.2.2. Revision of the Energy Taxation Directive 2003/96/EC** – The European Commission has tabled a Proposal for a revision of the Energy Taxation Directive that it states is needed to *“overhaul the way in which energy products are taxed in the EU and to make sure that it better reflects the EU’s climate ambitions”*.
- 4.2.3.** The Proposal aims to introduce a new structure of tax rates to discourage the use of fossil fuels by setting higher rates for fossil fuels and lower rates for renewables products thereby decreasing the relative price advantage of fossil fuels over less polluting alternatives. In addition, the possibility of tax reductions and exemptions would be reviewed, to avoid lower taxation for fossil fuels, such as heating fuels used by households, while establishing transition periods to mitigate the economic and social costs of introducing taxation.

## Legislation

Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity

Taxation in support of green transition: an overview and assessment of existing tax practices to reduce greenhouse gas emissions, Final Report, 2021

Proposal of 14 July 2021 for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast)



## SCHEDULE OF EU LEGISLATION

### Valuation of Property for Statutory Needs under EU Company Law

Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)

Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees

Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)

Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law

Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law

Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions

### Valuation of Property for Company Accounts

Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions

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

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

Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings

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

Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

Commission Recommendation of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities

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

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC

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

Commission Regulation (EU) 2023/1803 of 13 August 2023 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

## **Valuation of Property for Credit Institutions**

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010

EBA Guidelines of 29 May 2020 on loan origination and monitoring

ECB Phase 2 Manual for Asset Quality Review of May 2023

Regulation (EU) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor

EBA Single Rulebook

### Valuation of Property for Insurance and Reinsurance Institutions

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

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

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

EIOPA Guidelines of 14 September 2015 on recognition and valuation of assets and liabilities other than technical provisions (EIOPA-BoS-15/113)

### Valuation of Property for Investment Funds

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

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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

Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with

regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision

Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds

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

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

Communication from the Commission of 26 March 2009 on the treatment of impaired assets in the Community banking sector

Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union

### **Environmental Assessments**

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

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

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

### **Water**

Council Directive 91/271/EEC of 21 May 1991 concerning urban wastewater treatment

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

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

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

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

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

Communication of 11 December 2019 from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640

Directive (EU) 2020/2184 of the European Parliament and of the Council of 16 December 2020 on the quality of water intended for human consumption

Communication of 12 May 2021 from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Pathway to a Healthy Planet for All, EU Action Plan: “Towards Zero Pollution for Air, Water and Soil”, COM/2021/400

Report of 15 December 2021 from the Commission to the Council and the European Parliament on the implementation of the Water Framework Directive (2000/60/EC), the Environmental Quality Standards Directive (2008/105/EC amended by Directive 2013/39/EU) and the Floods Directive (2007/60/EC)

Proposal of 26 October 2022 from the Commission for a Directive of the European Parliament and of the Council concerning urban wastewater treatment

## **Biodiversity, Nature Conservation and Nature Restoration**

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

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

Regulation (EU) 2024/1991 of the European Parliament and of the Council of 24 June 2024 on nature restoration and amending Regulation (EU) 2022/869

## Asbestos

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

Directive (EU) 2023/2668 of the European Parliament and of the Council of 22 November 2023 amending Directive 2009/148/EC on the protection of workers from the risks related to exposure to asbestos at work

## Energy

Article 194(1) of the Treaty on the Functioning of the European Union

Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

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

Communication of 11 December 2019 from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640

Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

Directive (EU) 2023/959 of the European Parliament and of the Council of 10 May 2023 amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading system

Directive (EU) 2023/1791 of the European Parliament and of the Council of 13 September 2023 on energy efficiency and amending Regulation (EU) 2023/955 (recast)

Directive (EU) 2023/2413 of the European Parliament and of the Council of 18 October 2023 amending Directive (EU) 2018/2001, Regulation (EU) 2018/1999 and Directive 98/70/EC as regards the promotion of energy from renewable sources, and repealing Council Directive (EU) 2015/652

Directive (EU) 2024/1275 of the European Parliament and of the Council of 24 April 2024 on the energy performance of buildings (recast)

### Valuation of Property and Taxation

Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity

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

Taxation in support of green transition: an overview and assessment of existing tax practices to reduce greenhouse gas emissions, Final Report, 2021

Proposal of 14 July 2021 for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast)

Council Directive (EU) 2022/542 of 5 April 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax





# MEMBERSHIP OF TEGOVA

## Albania

SHOQËRIA E VLERESUESVE TE PASURIVE TE PALUAJTSHME (SVP)  
*Albanian Society of Property Appraisers*

## Argentina

TRIBUNAL DE TASACIONES DE LA NACIÓN ARGENTINA (TTN)  
*National Appraisal Agency of Argentina*

## Austria

ÖSTERREICHISCHER VERBAND DER IMMOBILIENWIRTSCHAFT (ÖVI)  
*Austrian Real Estate Association*

VERBAND ÖSTERREICHISCHER IMMOBILIENSACHVERSTÄNDIGER (VÖI)  
*Austrian Association of Real Estate Experts (ARE)*

## Belgium

BELGIAN ASSOCIATION OF PROPERTY VALUERS (BELGAVAL)

KAMER VAN VASTGOED-EXPERTEN (KAVEX)  
*Chamber of Real Estate Experts*

UNION DES GÉOMÈTRES EXPERTS DE BRUXELLES (UGEB-ULEB)  
*Union of Expert Surveyors of Brussels*

## Bosnia and Herzegovina

UDRUŽENJE NEZAVISNIH PROCJENITELJA (UNP)  
*Association of Independent Valuers*

UDRUŽENJE OVLAŠĆENIH PROCJENJIVAČA u BOSNI i HERCEGOVINI (UOPBiH)  
*Association of Certified Appraisers in Bosnia and Herzegovina*

## **Bulgaria**

КАМАРА НА ПРОФЕСИОНАЛНИТЕ ОЦЕНИТЕЛИ (КПО)

*Chamber of Professional Valuers (CPV)*

КАМАРАТА НА НЕЗАВИСИМИТЕ ОЦЕНИТЕЛИ В БЪЛГАРИЯ (КНОБ)

*Chamber of Independent Appraisers in Bulgaria (CIAB)*

## **Canada**

APPRAISAL INSTITUTE OF CANADA (AIC)

*Institut canadien des évaluateurs (ICE)*

## **Croatia**

HRVATSKO DRUŠTVO SUDSKIH VJEŠTAKA I PROCJENITELJA (HDSVIP)

*Croatian Association of Court Expert Witnesses and Valuers*

## **Cyprus**

ΣΥΝΔΕΣΜΟΣ ΕΠΙΣΤΗΜΟΝΩΝ ΕΚΤΙΜΗΤΩΝ ΑΚΙΝΗΤΩΝ ΚΥΠΡΟΥ

*Cyprus Valuers Association (CVA)*

## **Czech Republic**

ČESKÁ KOMORA ODHADCU MAJETKU (ČKOM)

*Czech Chamber of Appraisers (CCA)*

## **Denmark**

DANSK EJENDOMSMAEGLERFORENING (DE)

*Danish Association of Chartered Estate Agents*

## **France**

ASSOCIATION FRANÇAISE DES SOCIÉTÉS D'EXPERTISE IMMOBILIÈRE (AFREXIM)

*French Association of Property Valuation Companies*

CHAMBRE DES EXPERTS IMMOBILIERS DE FRANCE (CEIF-FNAIM)

*Chamber of the Real Estate Valuers of France*

COMPAGNIE NATIONALE DES EXPERTS IMMOBILIERS (CNEI)

*National Company of Real Estate Experts*

**CONFÉDÉRATION DES EXPERTS FONCIERS (CEF)**

*Confederation of Land Valuers (CLV)*

**CONSEIL SUPÉRIEUR DU NOTARIAT (CSN)**

*High Council for the Notarial Profession*

**INSTITUT FRANÇAIS DE L'EXPERTISE IMMOBILIÈRE (IFEI)**

*French Institute of Real Estate Valuation*

**SYNDICAT NATIONAL DES PROFESSIONNELS IMMOBILIERS (SNPI)**

*National Association of Real Estate Professionals*

**UNION DES SYNDICATS DE L'IMMOBILIER (UNIS)**

*National Union of Property Professions*

## **Georgia**

**საქართველოს დამოუკიდებელ შემფასებელთა საზოგადოება**

*Independent Valuers Society of Georgia (IVSG)*

## **Germany**

**BUND DER ÖFFENTLICH BESTELLTEN VERMESSUNGSINGENIEURE e.V. (BDVI)**

*Association of Publicly Appointed Surveyors*

**BUNDESVERBAND ÖFFENTLICH BESTELLTER UND VEREIDIGTER SOWIE QUALIFIZIERTER SACHVERSTÄNDIGER e.V. (BVS)**

*Association of Publicly Certified and Qualified Experts*

**IMMOBILIENVERBAND DEUTSCHLAND IVD BUNDESVERBAND der IMMOBILIENBERATER, MAKLER, VERWALTER und SACHVERSTÄNDIGEN e.V. (IVD)**

*German Real Estate Professional Association*

## **Greece**

**ΣΥΛΛΟΓΟΣ ΕΚΤΙΜΗΤΩΝ ΕΛΛΑΔΟΣ (ΣΕΚΕ)**

*Association of Greek Valuers (AVAG)*

**PEOPLECERT HELLAS**

*Certification Body*

## **Ireland**

**INSTITUTE OF PROFESSIONAL AUCTIONEERS AND VALUERS (IPAV)**

## Italy

ASSOCIAZIONE SOCIETÀ DI VALUTAZIONI IMMOBILIARI (ASSOVIB)

*Association of Property Valuation Companies*

CONSIGLIO NAZIONALE GEOMETRI e GEOMETRI LAUREATI (CNGeGL)

*National Council of Surveyors*

ISTITUTO di ESTIMO e VALUTAZIONE (IEV)

*E-Valuations – Institute of Estimation and Valuation*

ISTITUTO ITALIANO di VALUTAZIONE IMMOBILIARE (ISIVI)

*Italian Institute for Real Estate Valuation*

## Kosovo

SHOQATES SE VLERESUESVE TE KOSOVES (SHVK)

*Kosovo Appraisers Association (KAA)*

## Latvia

LATVIJAS IPASUMU VERTETAJU ASOCIACIJA (LIVA)

*Latvian Association of Property Appraisers*

## Lithuania

LIETUVOS TURTO VERTINTOJŲ ASOCIACIJA (LTVA)

*Lithuanian Association of Property Valuers*

LIETUVOS VERTINTOJŲ RŪMAI (LVR)

*Lithuanian Chamber of Appraisers*

## Moldova

AGENȚIA GEODEZIE, CARTOGRAFIE și CADASTRU (AGCC)

*Agency for Geodesy, Cartography and Cadastre*

## Montenegro

INSTITUT OVLAŠĆENIH PROCJENJIVAČA CRNE GORE (IOPCG)

*Institute of Certified Valuers of Montenegro*

NACIONALNO UDRUŽENJE PROCJENITELJA CRNE GORE (NUPCG)

*National Association of Valuers of Montenegro*

**UDRUŽENJE NEZAVISNIH PROCJENJIVAČA CRNE GORE (CUP)**

*Association of Independent Valuers of Montenegro*

**Netherlands**

**NEDERLANDS REGISTER VASTGOED TAXATEURS (NRVT)**

*Real Estate Valuers Register of the Netherlands*

**NEDERLANDSE COÖPERATIEVE VERENIGING VAN MAKELAARS EN TAXATEURS IN ONROERENDE GOEDEREN (NVM)**

*Dutch Association of Real Estate Brokers and Valuers*

**Vastgoedpro**

*Association of Real Estate Agents and Valuers of the Netherlands*

**VBO**

*Dutch Association of Real Estate Agents and Valuers*

**WAARDERINGSKAMER**

*The Netherlands Council for Real Estate Assessment*

**North Macedonia**

**ASOCIJACIJA NA NEZAVISNI PROCENUVACI**

*Association of Independent Valuers*

**BIRO ZA SUDSKI VESTACENJA (BSV)**

*Bureau for Court Expertise*

**KOMORA NA PROCENUVACI NA REPUBLIKA SEVERNA MAKEDONIJA (KPRSM)**

*Chamber of Valuers of the Republic of North Macedonia*

**Norway**

**NORSK TAKST (NT)**

*Norwegian Surveyors and Valuers Association*

**Poland**

**POLSKA FEDERACJA STOWARZYSZEŃ RZECZOZNAWCÓW MAJĄTKOWYCH (PFSRM)**

*The Polish Federation of Valuers' Associations*

## Portugal

ASSOCIAÇÃO DAS SOCIEDADES DE AVALIAÇÃO E AVALIADORES DE PORTUGAL (ASAVAL)  
*Association of Valuation Companies and Valuers of Portugal*

ASSOCIAÇÃO NACIONAL DE AVALIADORES IMOBILIÁRIOS (ANAI)  
*National Association of Real Estate Valuers*

ASSOCIAÇÃO PORTUGUESA DOS PERITOS AVALIADORES DE ENGENHARIA (APAE)  
*Portuguese Association of Expert Engineering Valuers*

## Romania

ASOCIAȚIA NAȚIONALĂ A EVALUATORILOR AUTORIZAȚI DIN ROMÂNIA (ANEVAR)  
*National Association of Authorised Romanian Valuers*

## Russian Federation

ПАРТНЕРСТВО РОССИЙСКОГО ОБЩЕСТВА ОЦЕНЩИКОВ (ПРОО)  
*Partnership of the Russian Society of Appraisers*

РОССИЙСКАЯ КОЛЛЕГИЯ ИНЖЕНЕРОВ (РКО)  
*Russian Board of Appraisers*

РОССИЙСКОЕ ОБЩЕСТВО ОЦЕНЩИКОВ (РОО)  
*Russian Society of Appraisers*

## Serbia

NACIONALNO UDRUŽENJE PROCENITELJA SRBIJE (NUPS)  
*National Association of Valuers of Serbia*

## Slovenia

SLOVENSKI INSTITUT ZA REVIZIJO (SIR)  
*Slovenian Institute of Auditors*

## Spain

ASOCIACIÓN ESPAÑOLA DE VALORACIÓN INMOBILIARIA Y URBANÍSTICA (AEVIU)  
*Spanish Association of Real Estate and Urban Appraisal*

CONSEJO GENERAL DE LA ARQUITECTURA TÉCNICA DE ESPAÑA (CGATE)  
*Spanish General Council of Technical Architecture*

**SUSPENDED**

CONSEJO SUPERIOR DE LOS COLEGIOS DE ARQUITECTOS DE ESPAÑA (CSCAE)  
*High Council of the Orders of Architects of Spain*

## **Sweden**

SAMHÄLLSBYGGARNA-SFF  
*Swedish Professionals for the Built Environment*

## **Turkey**

TÜRKIYE DEĞERLEME UZMANLARI BİRLİĞİ (TDUB)  
*Turkish Appraisers Association*

## **Ukraine**

АСОЦІАЦІЯ СПЕЦІАЛІСТІВ БАНКІВСЬКОЇ ОЦІНКИ УКРАЇНИ (АСБОУ)  
*Ukrainian Association of Bank Valuation Specialists*

УКРАЇНСЬКЕ ТОВАРИСТВО ОЦІНЮВАЧІВ (УТО)  
*Ukrainian Society of Appraisers*

## **United Arab Emirates**

دائرة الأراضي و الأملاك دبي  
*Dubai Land Department*

## **United Kingdom**

CENTRAL ASSOCIATION OF AGRICULTURAL VALUERS (CAAV)  
INSTITUTE OF REVENUES RATING AND VALUATION (IRRV)

## **United States of America**

APPRAISAL INSTITUTE (AI)  
INTERNATIONAL ASSOCIATION of ASSESSING OFFICERS (IAAO)





# GLOSSARY OF TERMS

## A

### **Alternative use value**

The value of the property under a use other than the present one.

### **Assumption**

A fact or condition about the property assumed by the valuer (whether instructed or otherwise) which he or she does not or cannot know or reasonably ascertain.

## B

### **Basis of value**

A statement of the fundamental assumptions for undertaking a valuation for a defined purpose.

## C

### **Comparable**

A property deemed by the valuer to be similar to the one being valued.

### **Cost Approach**

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

### **Cost-benefit analysis**

A technique to assist in decision making when comparing alternative properties, sites or projects. The technique involves the consideration and measurement in financial terms of all costs and benefits.

## D

### **Date of inspection**

The date at which the inspection took place.

### **Date of report**

The date at which the valuer signs the report.

### **Date of valuation**

The date to which the opinion of value applies.

### **Departure**

Circumstances where the mandatory application of the valuation standards may be inappropriate or impractical.

### **Depreciable amount**

The cost of an asset, or other amount substituted for cost, less its residual value.

*(IAS 16)*

### **Development property**

Land and/or buildings undergoing works of construction, reconstruction or refurbishment or which are suitable for such works in the immediate future.

## E

### **Excess land (or surplus land)**

Land within the property that is not essential to the operational purposes of buildings.

**F****Fair value (for accounting purposes)**

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

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

**Fair value (general definition)**

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

**Financial statements**

Written statements of the financial position of a person or a corporate entity, and formal financial records of prescribed content and form. These statements carry a measure of public accountability within a regulatory framework of accounting standards and the law.

**Forced sale value**

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

**G****Gross development value**

The end value of a completed development envisaged under a residual method of valuation.

**Guaranteed replacement cost**

The payable amount limited to the insured value as stated in the insurance policy, but if the damage exceeds the limits on the policy, the insurance company is obligated to fully replace or rebuild the property without any deduction for depreciation.

## H

### **Highest and best use**

Integral to Market Value, it is the use of a property that is physically possible, reasonably probable, legal or likely to become so, and that results in the highest value of the property at the date of valuation.

## I

### **Income Approach**

A form of investment analysis based on a property's capacity to generate net benefits (i.e. usually monetary benefits) and the conversion of these benefits into a present value.

### **Insurable value**

The cost of replacing the damaged property with materials of like kind and quality and without any deduction for depreciation.

### **Investment value**

The value of a property to an owner or prospective purchaser, calculated on the basis of their individual investment criteria.

## M

### **Market Approach**

A valuation approach where the valuation is produced by comparing the subject property with the evidence obtained from market transactions that fulfil the criteria for the relevant basis of value.

### **Market Rent**

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

## Market Value

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

**Due to diverging non-English language versions of the CRR definition, TEGOVA has a universally usable common guidance-definition:**

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

## Marriage value

*(see synergistic value)*

## Minimum Educational Requirements (MER)

A syllabus, divided into two levels of knowledge, required of all valuers who are members of TEGOVA Member Associations.

## Mortgage Lending Value

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

# P

## Price

The amount asked, offered or paid for a property.

## Property

Land and buildings on, below or above ground including pipes, cables and other equipment connected thereto.

## Q

### **Qualified valuer**

A natural person, whether self-employed or employed by a valuation company or other legal entity who is responsible for undertaking valuations, and who fulfils the requirements set out by TEGOVA.

## R

### **Recognised European Valuer (REV)**

A valuer recognised by TEGOVA for her/his qualification, knowledge and professional experience.

### **Residual value**

The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

## S

### **Special assumption**

An assumption made where instructions differ from the actual facts existing at the date of valuation.

### **Synergistic value**

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

## T

### **TEGOVA Residential Valuer (TRV)**

A valuer undertaking residential valuations who is recognised by TEGOVA for her/his qualification, knowledge and professional experience.

### **Terms of engagement**

The specific terms of the contract between the valuer or valuation firm and the client.

# V

## **Valuation approach**

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

## **Valuation method**

The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at a determination of value.

## **Valuation methodology**

The process by which a valuer undertakes the valuation of the property, including the selection by the valuer of the approach or approaches to be applied, the choice of method(s) and the use of models or techniques in order to interpret the valuation inputs and reach conclusions based on them.

## **Valuation model**

A specific technique of data treatment conducted within a valuation method.

## **Valuation report**

A document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment, providing a professional opinion of value supported by a recognised basis or bases of valuation within the framework of European Valuation Standards.

## **Other Publications**

European Business Valuation Standards

European Plant, Machinery & Equipment Valuation Standards







The European Group of Valuers' Associations unites 74 national valuers' associations from 38 countries representing 70 000 qualified valuers either self-employed or employed by specialist consultancies, private sector companies, government departments or financial institutions both local and international. Its European Valuation Standards (EVS) are cited as reliable standards for the valuation of residential immovable property for mortgage lending purposes in the EU Mortgage Credit Directive and have been given precedence over all other standards by the European Central Bank in successive editions of its Asset Quality Review manual for the updating of banks' real estate collateral values.

Profound EU-led mutations since the 2020 edition explain the many new aspects of EVS 2025:

- ▶ EVS 6 Valuation and Energy Efficiency now sets out in detail the methodology the valuer must follow to determine Market Value in an EU-legislated context of rapid mandatory renovation of the worst performing building stock. The essentially residual approach adopted has also been enhanced by a review of the residual methods in Part II Methodology.
- ▶ The revised Capital Requirements Regulation's valuation provisions – including a new 'property value' comprising 'prudently conservative valuation criteria' – are treated in depth in European Valuation Guidance Note (EVGN) 2 on Valuation for Mortgage Lending, a key tool for combining Market Value and 'property value' in the valuation of mortgage collateral.
- ▶ A new Guidance Note (EVGN 4) on Valuation of Agricultural Property covers all aspects including climate change and technology and data.
- ▶ Part VI Valuation and Sustainability has undergone an in-depth revision and expansion to take account of the vast changes brought to land and buildings by the European Green Deal.
- ▶ Part X European Union Legislation and Property Valuation covers the extremely rich legislative production since the last edition.

The Minimum Educational Requirements (Part IV) have been modernised and the entire Blue Book has been reviewed to enhance its use as an essential and didactic practice tool that is also intelligible to clients and the authorities. A highlight of this effort is the complementing of the very successful EVS Valuation Report for Residential Property with template reports for office property (EVGN 3. II) and agriculture (Annex to EVGN 4).