

FIVE COUNTIES CONFERENCE

High Wycombe

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Red Book Update

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These notes contain extracts from the RICS Valuation - Global Standards 2017 and the RICS Valuation - Professional Standards UK 2014 (revised April 2015). You should not act without first reading and understanding the relevant part(s) of the Standards and other publications

1. The RICS Red Book Overview

RICS Valuation – Professional Standards January 2014 (Global and UK)

- applies to valuations where the *valuation date* is on or after 6th January 2014
- the Global edition was reprinted in June 2015 to include a minor addendum and remove some references only applicable to the UK
- since then other national valuation standards have emerged and the Global and UK standards are now published separately.

RICS Valuation – Global Standards 2017

- this replaces the ***RICS Valuation – Professional Standards 2014*** (Global)
- was released on 15th June 2017
- aligns the Red Book with International Valuation Standard (IVS) 2017
- reflects recent progress in international standards for ethics and for measurement
- effective from 1st July 2017
- applies to all valuations where the *valuation date* is on or after that day

RICS Valuation – Professional Standards UK 2014 (revised April 2015)

- was updated in respect of Valuations under UK GAAP in December 2014
- the update is effective from 1st January 2015

Was revised in April 2015

- to include the update effective from 1st January 2015
- plus a few minor amendments

Currently under review

- a consultation draft was due late in 2017

2. The Red Book 2017: Contents and Summary of Changes

Part 1: Introduction

Part 2: Glossary

Part 3: Professional Standards (PS) (mandatory)

- must have regard to *International Property Measurement Standards* (IPMS)

Part 4: Valuation Technical and Performance Standards (VPS) (mandatory)

- was RICS Global Valuation Practice Statements

Part 5: Valuation Applications (VPGA) (advisory)

- retitled but still contains RICS Global Valuation Practice Guidance – applications (VPGAs)

Part 6: International Valuation Standards 2017

Part 3: Professional Standards (PS)

PS 1 Compliance with standards where a written valuation is provided

- retitled
- additional descriptive material on *Exceptions*
- *oral valuations* added in 1.1.6

PS 2 Ethics, competency, objectivity and disclosures

Part 4: Valuation Technical and Performance Standards

VPS 1 Terms of engagement (scope of work)

- retitled
- additional heading regarding limitations on liability

VPS 2 Inspections, investigations and records

- retitled: *valuation records* added to reflect requirement of IVS 2017

VPS 3 Valuation reports

- incorporates text moved from 2014 VPGA 9 (Valuation in markets susceptible to change: certainty and uncertainty)

VPS 4 Bases of value, assumptions and special assumptions

- *Fair Value* 2014 definition (b) removed and now retitled *Equitable Value*

VPS 5 Valuation approaches and methods

- new addition

Part 5: Valuation Applications (VPGA)

The RICS valuation practice guidance – applications (VPGAs)

- 10 in total the most pertinent being

VPGA 1 Valuation for inclusion in financial statements

VPGA 2 Valuation of interests for secured lending

- retitled

VPGA 8 Valuation of real property interests

- new

VPGA 9 Identification of portfolios, collections and groups of properties

- retitled

VPGA 10 Matters that may give rise to material valuation uncertainty

- retitled

3. The UK Red Book 2014 (revised April 2015)

This comprises:

UK Valuation Standards (**UKVS**) (mandatory)

UK Appendices (advisory)

UK Guidance Notes (**UKGN**) (advisory)

UK Valuation Standards

UKVS 1 Valuation of real property, plant and equipment for financial statements under UK GAAP (Re-titled from 1st January 2015)

UKVS 2 Valuations for Financial Statements – specific applications

UKVS 3 Valuations of Residential Property

UKVS 4 Regulated purpose valuations

UK Appendices

- 14 in total the most pertinent being

UK Appendix 5 Valuations of local authority assets

UK Appendix 10 RICS residential mortgage valuation specification

UK Appendix 11 Application of the RICS mortgage valuation specification to related purposes

UK Guidance Notes

- 7 in total the most pertinent being

UKGN 3 Valuations for capital gains tax, inheritance tax and stamp duty land tax

UKGN 4 Inspections and material considerations

UKGN 6 Analysis of commercial lease transactions

4. Purpose of the Red Book

Introduction

1. Consistency, objectivity and transparency
7. To assure users that a valuation provided anywhere in the world is in accordance with the highest professional standards
8. The standards set out procedural rules and guidance which:
 - (a) impose mandatory obligations regarding competence, objectivity and transparency
 - (b) establish a framework for uniformity and best practice
 - (c) expressly comply with the RICS *Rules of Conduct*
9. The standards do not:
 - (a) instruct on how to value
 - (b) prescribe a particular report format
 - (c) override specific mandatory standards in individual jurisdictions

5. RICS Professional Standards

PS 1 Compliance with standards where a written valuation is provided

All members, whether practising individually or within an RICS-regulated or non-regulated firm, who provide a written valuation are required to comply with the international standards and RICS global standards set out below.

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

- 1.5 An estimated replacement cost is not a *written opinion of value*.
- 1.6 Where valuation advice is provided orally
 - the principles set out in this volume should be observed
 - oral advice is not without liability

International Property Measurement Standards (IPMS)

- 3.5 Members must have regard to the *RICS property measurement professional statement*

5. VPS 1- 4 Exceptions

5.1 PS 1 and PS 2 are mandatory for all written valuations

5.2 The mandatory application of VPS 1 to 5 may be unsuitable or inappropriate some purposes

- but the application of the relevant standards is encouraged

5.4 The areas of exception are where valuation is provided for:

Agency or brokerage work in anticipation of disposal or acquisition instructions

- acquisition or disposal where RICS global practice statement and guidance note, *Real estate agency and brokerage guidance, 3rd edition* (2016) applies
- the exception does not cover a purchase report that includes a valuation.

Acting or preparing to act as an expert witness

- an expert witness must follow the rules and directions laid down by the court, tribunal etc

Performing statutory functions

- where statutory provisions define the task and frequently govern the manner in which it is to be carried out
- a valuation provided in accordance or compliance with legislation is not the point
- the emphasis is on the word *function*

Note:

1. The RICS Guidance Note *Leasehold Reform in England and Wales, 3rd Edition*, August 2015 states in section 2.2 *The valuer needs to be aware that whereas leasehold reform valuations fall outside the 'Red Book', aspects of negotiations on price and premium and preparation and attendance for any tribunal or court fall within*
2. The Guidance Note *Dilapidations in England and Wales, 7th Edition*, September 2016 in respect of Diminution Valuations states *...the form and content of the advice / report is not covered by the requirements of the RICS Valuation - Professional Standards (Red Book)*

Purely for internal purposes

- without liability and without communication to a third party
- vital in Terms of Engagement that prohibition on disclosure to any other party is explicit
- the fact that a valuer is an *internal valuer* does not automatically bring a valuation within this exception

Preparation for or during negotiations or litigation

- including where acting as advocate

PS 2 Ethics, competency, objectivity and disclosures

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

2. Member Qualification**2.1 Must have**

- market knowledge
- the valuation skills to undertake the valuation competently
- compliance with the RICS Valuer Registration (VR) requirements

3. Independence, objectivity, confidentiality and the identification and management of conflicts of interest**3.1 Members must follow the mandatory requirements in the RICS *professional statement, Conflicts of interest***

- 1st Edition, March 2017: Effective from 1st January 2018

7. Terms of Engagement**7.1 All material matters must be brought to the client's attention prior to the issue of the report and documented. *This is to ensure that the report does not contain any revision of the initial terms of engagement of which the client is unaware.*****6. Terms of Engagement****VPS 1 Terms of engagement (scope of work)****3.1 *Terms of engagement must address the following matters.***

- (a) Identification and status of the valuer*
- (b) Identification of the client(s)*
- (c) Identification of any other intended users*
- (d) Identification of the asset(s) or liability(ies) being valued*
- (e) Valuation (financial) currency*
- (f) Purpose of the valuation*
- (g) Basis(es) of value adopted*
- (h) Valuation date*

- (i) Nature and extent of the valuer's work - including investigations - and any limitations thereon*
- (j) Nature and source(s) of information upon which the valuer will rely*
- (k) All assumptions and special assumptions to be made*
- (l) Format of the report*
- (m) Restrictions on use, distribution and publication of the report*
- (n) Confirmation that the valuation will be undertaken in accordance with the IVS*
- (o) The basis on which the fee will be calculated*
- (p) Where the firm is registered for regulation by RICS, reference to the firm's complaints handling procedure, with confirmation that a copy will be made available on request*
- (q) A statement that compliance with these standards may be subject to monitoring under RICS' conduct and disciplinary regulations.*
- (r) A statement setting out any limitations on liability that have been agreed.*

7. Inspections and Investigations

VPS 2 Inspections, investigations and records

Inspections and investigations must always be carried out to the extent necessary to produce a valuation that is professionally adequate for its purpose. The valuer must take reasonable steps to verify the information relied on in the preparation of the valuation and, if not already agreed, clarify with the client any necessary assumptions that will be relied on.

1.4 Regard must be had to the International Property Measurement Standards wherever applicable.

3 Valuation Records

A proper record must be kept of inspections and investigations, and of other key inputs, in an appropriate business format.

See also: UKGN 4 Inspections and material considerations

8. Valuation Reports

VPS 3 Valuation Reports

The report must:

- *clearly and accurately set out the conclusions of the valuation in a manner that is neither ambiguous nor misleading, and which does not create a false impression. If appropriate, the valuer should draw attention to, and comment on, any issues affecting the degree of certainty, or uncertainty, of the valuation under item (o) below*
- *deal with all the matters agreed between the client and the valuer in the terms of engagement (scope of work) - (see VPS 1).*

2. Report Content

This corresponds with the Terms of Engagement plus:

l) Valuation approach and reasoning

m) Amount of the valuation or valuations

n) Date of the valuation report

o) Commentary on any material uncertainty in relation to the valuation where it is essential to ensure clarity on the part of the valuation user

(1) Valuation Approach and Reasoning

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

.....

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

Note: Key Inputs / Comparables

See: RICS Information Paper:

Comparable Evidence in Property Valuation (1st Edition, 2012)

Page 11, Comparable Analysis Matrix

Note: Commentary on Valuation Uncertainty**VPGA 10 Matters that may give rise to material valuation uncertainty**

- 2.1 There are three common circumstances in which material uncertainty may arise (see 2.2, 2.3 and 2.4 below)
- 2.2 The asset or liability may have characteristics that make it difficult to value
 - it may be unusual or even unique
 - potential planning permission
- 2.3 Limited or restricted information
- 2.4 Disrupted markets
 - unforeseen financial, macro-economic, legal, political or natural events

9. Bases of Value**VPS 4 Bases of Value, Assumptions and Special Assumptions**

- 2.1 *A basis of value is a statement of the fundamental measurement assumptions of a valuation. (Basis must not be confused with Method of Valuation which is now not defined but in the 6th Edition was defined as: A procedure or technique used to arrive at the value described by a basis of value.)*

The following bases are included in the Red Book 2017:

- Market Value
- Market Rent
- Investment Value (or worth)
- Fair Value (under International Financial Reporting Standards)

4. Market Value

Defined in IVS 104 as:

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

- 4.1 The highest and best use of an asset
 - possible, legally permissible and financially feasible
- 4.2 Ignores price distortions caused by *special value* or *synergistic value*

5. Market Rent

Defined in IVS 104 as:

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

5.1 MR will vary significantly according to the assumed lease terms

- lease terms should reflect current practice

5.2 *Market Rent* is used to indicate the amount for which a vacant property may be let or a let property may re-let when the lease terminates

- (but please note S34 of Landlord and Tenant Act 1954)

Market Rent is not suitable for rent reviews

- where the actual *definitions* and *assumptions* have to be used

5.3 When providing *Market Rent*

- the assumed principal lease terms should be set out
- any payments or concessions should also be stated

6. Investment Value (Worth)

Defined in IVS 104 as:

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

7. Fair Value

7.1 **The definition adopted by the International Accounting Standards Board (IASB) in IFRS 13 is:**

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.

7.3 There would usually be no difference in the reported figure between *Fair Value* and *Market Value*

Note: Fair Value definition (b) in the 2014 Red Book has been retitled *Equitable Value* and is defined in IVS 104 Section 50:

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

There are four further Valuation Bases in the RICS UK Valuation Standards

- Existing Use Value (**EUV**) **UKVS 1.3**
- Existing Use Value for Social Housing (**EUV-SH**) **UKVS 1.13**
- Projected Market Value (**PMV**) of residential property **UKVS 3.3**
- Value of Plant and Equipment to the business (**VPEB**) **UKVS 1.11**

10. Valuation Approaches and Methods

VPS 5 Valuation approaches and methods (new addition in 2017)

Valuers are responsible for adopting, and as necessary justifying, the valuation approaches and the valuation methodologies used to fulfil individual valuation assignments. These must always have regard to

- *the nature of the asset (or liability)*
- *the purpose, intended use and context of the particular assignment*
- *any statutory or other mandatory requirements applicable in the jurisdiction concerned.*

3. The overall valuation approach is usually classified into one of three main categories:
 - the market approach
 - the income approach
 - the cost approach

11. Valuation Assumptions and Special Assumptions

VPS 4 Bases of Value, Assumptions and Special Assumptions

8. Assumptions

An assumption is made where it is reasonable for the valuer to accept that something is true without the need for specific investigation or verification.

8.5 See VPGA 8 for practical application

VPGA 8: Valuation of Real Property Interests

2. Information and guidance is given on the following Assumptions
 - 2.2 Title
 - 2.3 Condition of buildings
 - 2.4 Services
 - 2.5 Planning (Zoning)

- 2.6 Contamination and hazardous substances
- 2.7 Environmental matters distinguishing between:
- (a) Natural environmental constraints
 - (b) Non-natural constraints (contamination and hazardous substances).
 - (c) Sustainability – assessing the implications for value

VPS 4 Bases of Value, Assumptions and Special Assumptions

9. Special Assumptions

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

9.5 Illustrations of Special Assumptions are:

- planning consent has or will be granted
- proposed development has been completed in accordance with a defined plan and specification
- the property has been changed in defined way
- the property is vacant (when occupied at the valuation date)
- the property is let on defined terms (when vacant at the valuation date)
- that *synergistic value* is created where one or more parties has as *special interest*

10 Valuations reflecting an actual or anticipated marketing constraint, and forced sales

10.7 The term *forced sale value* must not be used

Note: Could be expressed as *Market Value on the Special Assumption of a sale after X days*

- 90 days / 3 months is usual for residential property
- 180 days / 6 months is usual for commercial property

Note: The marketing period in *Market Value* has already happened

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