

RICS Consultation Draft

proposed changes to Global Red Book for 2025

VPS1 Terms of Engagement (Scope of Work):

A new paragraph has been introduced (1.3) to clarify that while some of the mandatory requirements may be covered in a master service agreement with a client, some matters have to be confirmed by the valuer on a case by case basis. In such cases the valuer should always confirm in writing and document any additional items required to meet the minimum requirements of VPS1.

Our Comment:

We agree with this change – an acknowledgement or confirmation letter should always be sent to cover matters that cannot be included in a master agreement because they are specific to each instruction. At a minimum this will include confirmation of the valuer responsible, that they have the necessary experience, that there is no conflict of interest, confirmation of the property and the interest to be valued. Any other matters not covered in the Service Agreement may also need to be addressed, for example, any limitations on your investigations, the assumptions you will make unless you find evidence to the contrary or any changes agreed to the master agreement for this specific instruction.

“Environmental, social and governance factors” have been added to the list of matters that have to be addressed in the Terms of engagement. Section 3.2 usually contains additional information on each of the listed items in 3.1 but in this case it simply says “*Any requirements in relation to the consideration of significant ESG factors.*”

We have a number of comments in relation to this change:

- A valuer meeting the requirements of PS2 2.1 should be aware of the potential relevance of environmental factors such as energy efficiency and flood risk in their area of practice. If a valuer did not consider these factors they would not be producing a compliant valuation unless they had agreed a special assumption to ignore them. To comply with VPS2 this could only be made if it can reasonably be regarded as realistic, relevant and valid for the particular circumstances of the valuation. As drafted “Any requirements....” suggests that consideration of ESG matters is an option.
- Obtaining information on relevant ESG factors should be part of the scope of the valuer’s investigation if following the RICS Guidance Notes on this subject. The limits that will apply to those investigations and the assumptions that they can make are listed in i), j) and k) of 3.1 and 3.2. If a specific reference to ESG investigations is felt necessary, this is where it should appear.
- RICS has a separate Guidance Notes on this subject, for example “Sustainability and ESG in Commercial Property Valuation”. These should be cross referenced in the “Implementation” narrative in 3.2.
- Linked to the above, it is inappropriate to simply add this at the end of the list of requirements. There are now 19 items and this list would be easier to follow if these were reordered to follow a logical sequence with related matters grouped together. As well as ESG investigations belonging with the other necessary investigations and required information there are other misplaced items. For

example, assumptions are related to the limits on a valuer's investigations and a special assumption changes the facts on which the value is based so while assumptions should be grouped with investigations, special assumptions should be grouped with the basis of value.

The following paragraph has been added to 3.2 b) identification of the client:

Clients may be internal (i.e. valuations performed for an employer) or external (i.e. when the valuer is engaged by a third-party client).

Our Comment:

We consider the recent inclusion of valuations undertaken for the valuer's employer as being within the scope of the Red Book to be a mistake, see our comments on exceptions in PS1 5. As is provided for all the listed exceptions, while compliance with VPS1- VPS6 may not be mandatory, it is still encouraged to the extent that this is practical. If our recommendation is accepted there is no need for this paragraph.

The following has been added to 3.2 d):

The client is responsible for the accuracy and completeness of clearly identifying the subject asset (s) and/or liability(ies) being valued in the valuation.

Our Comment:

The Red Book cannot and should not tell clients what they have to do. We see no purpose in this amendment. The duty of the valuer is clearly stated in the preceding sentence. Advice could be added indicating the valuer should ask the client to provide sufficient information to clearly identify the physical extent of the asset/liability and the interest to be valued if this is seen as not implicit in the existing requirement.

The following has also been added to 3.2 d):

Some higher value properties are held in special purpose vehicles (SPV) – corporate entities that are sometimes set up for the purposes of tax efficiency when transferring the interest in the property. If instructed to value a property that is held in an SPV, it is important that the valuer clarifies that they are instructed to value the interest in the property (rather than the SPV within which the property is held) on the assumption that it would be transferred by a sale of the SPV. If the client requires a valuation of the SPV within which the property is held, only valuers with the relevant experience and qualification in business valuation and holding any statutory registrations required for advising on corporate values, can accept such instructions.

Our Comment:

We welcome this addition. We are increasingly seeing valuations of properties held in SPVs based on the naïve conclusion that the value of the shares is simply the value of the real estate plus the difference in the transfer tax between a share transfer and a property transfer. This overlooks the fact that the value of the SPV can reflect matters other than the value of its asset, or assets.

Valuers also need to bear in mind:

- the comparable evidence used to determine the value of the real estate interest probably comes from similar property which is probably also held in SPVs.
- The method of sale in determining Market Value is deemed to be that most appropriate to obtain the best price in the market to which the seller has access. For IFRS Fair Value the transaction is deemed to be in the principal or most advantageous market to which the entity has access. Accordingly, if the most advantageous method of sale is to transfer through an SPV this should not be described as a “special assumption” as it is deemed to be the method that most market participants would use. It would be a special assumption to assume a method of transfer that was not the most advantageous.

VPS2 Bases of value, assumptions and special assumptions:

This is currently VPS4 but has been renumbered to match the sequence of standards in the new IVS. Most of the changes are just tidying up the previous wording and updating cross references to the IVS and other parts of the Red Book.

Our Comment:

Although this VPS has included bases of value, assumptions and special assumptions since 2014, this is not a logical grouping. While special assumptions can modify the basis of value reported, assumptions are related to the limits agreed on the valuer’s investigations and therefore would be better placed in VPS1. We often see confusion between an “ordinary” and a special assumption and also inputs into a valuation being incorrectly referred to as “assumptions”, which implies the valuer has accepted them as being true without verification! Clearly separating these two concepts would help avoid this confusion.

One material change is the inclusion of a new section 8 on Transaction Costs:

- 8.1 Most bases of value represent the estimated price of an asset without adjustment for the seller’s costs of sale or the buyer’s costs of purchase and any taxes payable by either party as a direct result of the transaction (IVS 102 section 70).*
- 8.2 The valuation must reflect the price that would be agreed, not the net receipt or the gross cost to the parties. If a client requires an estimate of such costs, these should be provided separately from the reported value.*
- 8.3 This does not mean that any costs (or taxes) that a prospective buyer or seller would incur in an actual transaction have to be ignored in the process of estimating market value or IFRS fair value. The costs that market participants would incur in a transaction are material in determining the price they would be prepared to agree. For example, if using an income approach, investment yields or discount rates are often calculated and quoted as the net return an investor would receive after deducting the costs of*

acquisition. If such net returns are used to estimate the price that would be agreed in a transaction, a similar deduction to allow for a typical buyer's costs has to be made otherwise the value will be overstated.

Our Comment:

We welcome this addition. 8.3 addresses the confusion sometimes caused to clients and even their auditors of reports indicating that the capitalisation rate used is net of purchaser's costs. This can lead to those costs being added back to the reported value on the grounds that Fair Value has to be reported without adjusting for transaction costs. This new section clarifies the principle that you must devalue (analyse) as you value. In other words if you are using input data that is expressed net of purchaser's costs then you must use the same to calculate the valuation.

Section 10.5 includes some illustrations of special assumptions. This is unchanged from the current edition.

Our Comment:

We consider the fourth point, "the property is vacant when in reality at the valuation date it is occupied" is not a good example. We have seen this being used for valuations of owner-occupied property. Since the definition of Market Value assumes a transfer of the current ownership rights this will include the right to possession. A special assumption is only needed of an owner-occupied property if, say, a sale and leaseback transaction was envisaged on the valuation date. A better example, and one commonly requested, would be:

- an existing lease of the property had been terminated on the valuation date

Section 12 amends the former section 11 by adding the sentence:

Where a projected value is essentially a form of property risk advice, PS 1 paragraph 1.9 must be followed.

Our Comment:

We have commented that we found the proposed PS1 1.9 confused, failing to make it clear that only if such advice included a valuation would the Red Book apply. If this is addressed as suggested this cross reference is unnecessary.