RICS Valuation Global Standards 2017 - UK National Supplement

(aka the UK Red Book)

An overview of the consultation draft and our initial thoughts

The Headlines

- A change of title to make it clear that the UK Red Book is not an alternative to the Global Red Book for RICS members in the UK but is supplementary to it.
- The titles for each category of content are being changed. As in the existing UK Book there will be three - UK Professional Standards (UK PS), UK Valuation Technical and Performance Standards (UK VPS), and UK Valuation Applications Guidance (UK VPGA). While the last two titles seem unnecessarily verbose and have curiously dissonant abbreviations, they follow the designations introduced last year in the Global Standards.
- There is now greater clarity between what is mandatory and what is guidance. The UK PS and UK VPSs are mandatory, and the UK VPGAs are guidance. The amount of mandatory material is very much reduced, with just one very short UK PS (telling valuers they must comply with the RICS Global Standards and UK law) and three short UK VPSs. The bulk of the proposed book (117 of 127 pages in the draft) is guidance in the form of UK VPGAs.
- The current UK VPSs, Appendices and GNs have not just been retitled. Considerable shuffling of the current material is proposed so if something you are familiar with in the current book looks as though it has disappeared, you need to check as it may have just been relocated.
- Some current UK GNs have been "retired", namely UKGN 1 Lease Classification, UKGN 4 Inspections and Material Considerations and UKGN 6 Analysis of Commercial Lease Transactions. Another UKGN 2 on Depreciated Replacement Cost is being taken out of Red Book but will be separately issued as a standalone GN, with a parallel consultation taking place on proposed amendments.

Our Initial Reaction:
We are aware that there has been confusion ever since the Red Book was split into a Global and UK version, with more than a few UK based RICS members wrongly thinking that they only needed to be concerned with the UK Red Book. The changes should help dispel this misconception, although it remains to be seen if the branding of the final version is also better differentiated so that the two publications do not continue to look superficially identical.

Having attempted to solve one source of confusion, RICS has introduced another with the verbose new titles and mismatched abbreviations. However, since these were adopted last year in the Global Red Book, there is now little alternative but to accept them in the UK supplement as adopting logical designations now would create inconsistency.

While the brevity of the mandatory provisions is welcome, it does beg the question as to the criteria for including the guidance on various subjects that make up the rest of the UK Red Book. There are many RICS Guidance Notes issued outside of the Red Book on subjects of as much importance to valuers as the UK VPGNs included within it.

Section by Section

UK Valuation Technical and Performance Standards (UK VPSs)

There are currently four UK VSs but three of these, Financial Reporting under UK GAAP, Financial Reporting for Specific Applications, and Residential Property have now been redesignated as guidance. The three proposed UK VPSs are:

- **UK VPS1 Terms of Engagement:** This simply states that any reference to the RICS Red Book in the Terms of Engagement or Report within UK jurisdictions shall be deemed to include the Global Standards and UK Supplement.
- **UK VPS2 Terms of Engagement (Supplementary provisions in Scotland):** This deals with the permitted exception to issuing ToE before issuing the report, currently covered in UK Appendix 12.
- **UK VPS3 Regulated Purpose Valuations, Supplementary Provisions:** This contains the additional requirements for the UK regarding "fire break" valuations and fee disclosures for regulated purpose valuations. These are currently in UK VPS4. There are no material changes.

Our Initial Reaction:
The new UK VPS 1 does not require any action by the valuer but is a technical provision to reinforce the point that complying with the Red Book means the Global Standards and the UK Supplement.

The new UK VPS 2 concerns a national exception to the provisions in the Global Standards that arises because of the legal system for property transactions in Scotland.

There is little to comment on as the proposed new mandatory VPSs do not change anything that a valuer should have been doing already under the current UK Red Book.

UK Valuation Applications – Guidance (UK VPGAs)

There are fourteen proposed UK VPGAs divided into three parts.

- UK VPGAs 1-6 cover subjects relating to financial reporting valuations.
- UK VPGAs 7-10 cover valuations for residential and commercial secured lending.
- UK VPGAs 11-14 cover valuations for other purposes where the public interest is involved

By clicking on the links above you can navigate directly to our summary and comments on each section.

To see our overall conclusion, click here

PART 1 – Financial Reporting Valuations

The proposed new UK VPGA1 covers valuations under UKGAAP and contains much of the material that is currently in UKVS 1. It also incorporates the current UK Appendices 1,2,4 and 6. Some, but not all, material relevant to public sector valuations has been moved to the new UK VPGA2. It consists of a detailed "walk through" of the various accounting functions where valuation inputs may be required under UK Accounting Standards.

UK VPGA2 Valuations for financial statements – specific applications is effectively a merger of the existing UK VS2 with it supporting Appendices, 7, 8 and 9. As currently, the title is misleading as the subjects covered are not valuations for financial reporting but for valuations under the Listing Rules, the Takeover Code and the FCA rules for valuation of Collective Investment Schemes. However, somewhat curiously some material relating to financial reporting valuations for the public sector and social housing has been relocated from the current UKVS 1.

The proposed UK VPGA3 covers depreciation for accounting and is essentially the same as the current UK Appendix 4 with a few additional paragraphs. One change is that the guidance is no longer confined to depreciation requirements under UK GAAP but extends to IFRS in recognition that, from a valuation perspective, the requirements are identical.

Valuations required for the financial statements of local authorities are now to be covered in UK VPGA4. This updates the current guidance in UK Appendix 5 to reflect changes in the CIPFA Code, which is updated annually.

UK VPGA5 is a direct replacement for the current UKGN 7 covering valuations for the disposal or acquisition of property by charities and the requirements of the *Charities (Qualified Surveyors' Reports) Regulations* 1992.

The proposed UK VPGA 6 is a direct update of the current UK Appendix 3 on the valuer's relationship with an auditor. There are a number of detailed changes, mainly to the references to provisions in the International Auditing Standards that are applicable to the role of a valuer acting as an expert for either management or the auditor.

Our Initial Reaction:
The grouping together of these six VPGAs is curious. The little that UK VPGA 2 has to do with financial reporting is due to the proposed introduction of material on valuations of public sector assets and social housing, which has no logical connection with the other subjects covered. UK VPGA 5 has absolutely nothing to do with financial reporting.

There have been a few updates made to reflect changes in the standards or regulations governing the types of valuation discussed, and some shuffling of the content. However, we think an opportunity to greatly simplify this guidance has been missed. The contrast between the inadequate discussion of valuation requirements under IFRS in the global VPGA 1 and the overwhelming discussion of accounting detail in the UK VPGAs is stark. Valuers need to be alerted to the applicable accounting standards, where these can be found and provided with any guidance needed to clarify how valuations to support different accounting concepts are carried out. They do not need detailed discussion of the accounting concepts themselves or extensive extracts or paraphrasing of accounting standards or applicable statutory regulations. Almost 50% of the UK Red Book does not need to be taken up trying to teach valuers about accountancy.

Some of this material would also be better placed in the Global Standards, as the IFRS and International Auditing Standards are applicable in many countries outside of the UK. This also would enable significant simplification of the UK material.

PART 2 - Secured Lending Valuations

Commercial Secured Lending

UK VPGA 7 is a new addition having no equivalent in the current UK Red Book. It advises that different lenders may have different policies and requirements and that members undertaking valuations for this purpose must comply with the provisions in the Global Red Book. It mainly consists of cross references or paraphrasing of requirements in the global standards relating to competency, conflicts of interest, liability caps, terms of engagement and information to be relied upon. It does cross reference a recently issued RICS Guidance Note: *Risk, Liability and Insurance in Valuation* which is not specifically mentioned in VPS 1 of the global standards as it is UK specific.

Our Initial Reaction:

It is difficult to see the purpose of this new UK VPGA. It consists of little more than a list of cross references to the global standards which, in addition to the generic requirements, has guidance specifically for secured lending in VPGA 2. The Introduction to these proposed UK standards and UK PS1 make it clear that members must comply with the global standards. Adding material that paraphrases requirements in the global standards serves no useful purpose and could be counterproductive. It actually undermines the point that a UK valuer should be using the global standards and may lead some to thinking that this document can be treated as an effective summary. Neither is it "supplementing" the global standards by adding guidance that is specific only to the UK. The only thing discussed which is not already covered in the global standards is the reference to the UK Guidance Note on risk and liability. This can and should be more effectively promoted by means other than a superfluous section in the UK Red Book.

Residential Mortgage Valuations

The material currently in UKVS 3 and Appendices 10, 11 and 13 is now found in UK VPGAs, 8, 9 and 10. However, the existing material has been rearranged so that the none of the new VPGAs is a direct replacement for the existing UKVS or any of its Appendices.

The most significant proposal is that use of the RICS Residential Mortgage Valuation Specification (the "Specification") currently found in UK Appendix 10 should no longer be mandatory. Although the proposed new UK VPGA 8 indicates RICS has agreed with UK Finance and the Building Societies Association that its provisions will be incorporated into requests for valuations from members of those organisations, there is no longer a requirement for the member to use the equivalent of the Specification. Its redesignation as guidance, means that the valuer will be "expected" to follow it unless otherwise agreed in writing, in advance, with the client. This, therefore, opens up the possibility that some lenders will issue instructions which vary from the current Specification and the guidance that is proposed in its place.

It also should be noted that the proposed new VPGA 8 differs from the current Specification. For example, provisions for valuations without a reinspection that currently appear in Appendix 11 are now included in the proposed VPGA 8. There are also some detailed changes to the list of assumptions that may be made, a notable one being that the current "default" assumptions for leasehold property, such as there being an unexpired term of at least 85 years, have effectively been discontinued, meaning that valuer and lender will have to agree these, if necessary on a case by case basis.

A change to the limits on the role of the valuer could have wider ramifications. The Specification is currently unequivocal in stating that the valuer **must not** accept instructions to make recommendations as to the length of the mortgage term, or the amount to be advanced. Neither must advice be given as to a lender's underwriting decisions. The proposed new UK VPGA 8 indicates that these are matters for the lender, although the valuer **may** highlight and report on specific risks, particularly if these are likely to have a material effect on value or are likely to prove critical to a lending decision. Changing a "must not" to a "may" is a significant change in policy and could have ramifications for valuers who fail to report on something that could impact on lending decisions which is not covered in the standard report questions asked by a lender.

The proposed UK VPGA 10 T*he Valuation of Registered Social Housing for Loan Security Purposes* is effectively an amalgamation of the existing UK Appendices 13 and 14 with some minor adjustments to the language to reflects its revised status as guidance.

Our Initial Reaction:
The redesignation of this material as guidance seems a welcome move at first sight as it gives clients and valuers greater flexibility to agree a service which is relevant to the type of property and lending involved. However, the reason why a mandatory Specification for residential mortgage valuations was agreed back in the 1990s was because having a standardised product across the market enabled valuers to produce abbreviated reports with the quick turnaround and low fee required by lenders. Moving towards a situation where bespoke services may be agreed puts greater onus on the valuer to ensure that the terms of engagement are clearly stated, particularly with regard to limitations, assumptions and reporting formats which potentially increases complexity and cost.

The equivocal language introduced around the valuer's responsibility to advise on lending decisions potentially extends their liability and is something that will need careful consideration when accepting or agreeing terms of engagement if it goes through.

PART 3 Other Public Interest Valuations

UK VPGA11 is the replacement for UKGN 3 *Valuations for capital gains tax, inheritance tax and stamp duty land tax.* It has been extended to include reference to the Annual Tax on Enveloped Dwellings and some additional advice on the responsibilities of a valuer advising a taxpayer.

UK VPGA12 provides completely new guidance on valuations for compulsory purchase and statutory compensation. The purpose of introducing this subject into the Red Book is far from clear. Reference is made at the start to the 2017 RICS Professional Statement *Surveyors Advising in Respect of Compulsory Purchase and Statutory Compensation* and also the possible relevance of the Practice Statement *Surveyors Acting as Expert Witnesses.* It states that the provisions of PS1 and PS2 in the global Red Book are applicable. Since PS1 states that the standards are mandatory subject to exceptions, two of which are providing valuation advice in preparation for negotiations and acting as an expert witness the only applicable part of PS1 seems to be the Valuer Registration requirements, although since registration is only required for valuations to which the Red Book applies this is far from clear. PS2 is concerned with competency and ethics, including conflicts of interest, which are already covered in the 2017 Professional Statement which is referenced. It appears that this VPGA has been introduced purely to draw attention to the dedicated Professional Statement.

The proposed UK VPGA 13 is a direct replacement for the current UKGN 5 *Local authority disposal of land for less than best consideration*, and there are no material changes.

The proposed UK VPGA14 *Affordable rent and market rent in a regulatory context* is a replacement for the current UK Appendix 14. However, since all the material content of UK Appendix 14 has already been incorporated into the proposed UK VPGA 10 (see above) this is a needless duplication.

Our Initial Reaction:
Guidance on the specific considerations for tax valuations is useful, and the depth of the analysis in both the current and proposed in UK VPGA11 only serves to illustrate the unnecessary detail in the earlier financial reporting guidance. Like the proposed UK VPGA7, UK VPGA12 only acts as a billboard for more specific requirements or guidance already issued by RICS, which is hardly a valid criterion for Red Book exclusion. An Appendix giving a comprehensive list of other current professional statements or guidance notes issued separately by RICS and which could be of relevance to valuers would be more useful.

Our Conclusions

The clarification that the UK Red Book is a national standard that supplements the Global Standards is to be welcomed, as is the improved clarity as to what is a mandatory requirement and what is guidance or advice. However, there may be unintended consequences from the removal of the mandatory status of the Residential Mortgage Specification, not least the suggestion that a valuer may now be expected to give advice on the lending decision or terms under certain circumstances.

Less welcome is the organisation. Unrelated topics have been mashed together in some of the VPGAs, especially in the group that purports to cover financial reporting valuations. For example, why has it been decided that guidance on the valuation of public sector assets for financial reporting belongs in the same VPGA as guidance on the Takeover Code?

While the detailed discussion of accounting concepts in the various VPGAs concerned with financial reporting may be of relevance or interest to a small minority of RICS valuers, it is misplaced in a document this is supposed to focus on actions that a valuer should take or consider. The inclusion of this material increases the length and complexity of the overall document, which does not help accessibility or comprehension. This over concentration on financial reporting may be due to the original Red Book having been produced solely for this purpose, but in 1995 it was made applicable to most valuations. Twenty three years and five editions later a better balance should have been reached.

The haphazard nature and apparently random topics covered by the proposed VPGAs does lead us to question why these subjects are included in the “Red Book”. There are at least twenty RICS Guidance Notes of relevance to valuers which are published separately. According to the latest preamble to these GNs, they are treated as a professional standard for the purpose of the RICS Rules of Conduct, so have the same status as VPGAs. A sensible approach would be to include guidance which is relevant to the widest spectrum RICS valuers in the Red Book, with more specialist subjects available as separate standalone guidance. As things stand we have guidance on arcane subjects such as prudential banking regulations in the Red Book but guidance that is relevant to most property valuers on contamination or analysing comparable evidence sitting outside it.

What Next?

We have prepared this summary to help RICS valuers understand some of the proposed changes and to find their way around the unnecessarily long draft. It reflects only points we have noticed and which we feel may be of general interest because they affect a significant number of valuers. We have not checked all the detail, especially of the documents referenced in the various UK VPGAs, and the fact that we have not mentioned something does not mean that we agree with it.

We will be submitting our own comments to RICS. If you feel that something we have highlighted could impact your business, we urge you to inspect the draft and submit an appropriate comment to RICS yourself.

The draft can be found here:

https://consultations.rics.org/consult.ti/system/listConsultations?type=O