Valuology

Comments on Supplement to RICS Practice Alert
Impact of Covid 19 on Valuation

issued 21 July 2021

The Practice Alert Supplement replaces the very similar supplement issued by RICS in September 2020. There are no fundamental changes in the guidance provided, but rather a subtle updating to reflect the continuing evolution of the impact on markets of the virus. The underlying theme of the changes is that the need to advise that a valuation is subject to Material Valuation Uncertainty is now relatively uncommon but that nevertheless valuers still need to be alert to sudden changes in the situation and also provide appropriate cautionary advice to their clients.

The principal changes are:

1. The introduction has been changed to acknowledge the fact that a substantial period has now passed since the pandemic was declared by the WHO in March 2020 but that the interventions applied in different jurisdictions have had a varying degree of impact on the markets. This emphasises that there is no single approach that valuers have to adopt , other than being aware of the current position in respect of the location and purpose to which their valuation advice applies.
2. The advice on inspections now acknowledges that in some locations government restrictions no longer prevent full internal inspection. Rather than advising that dispensing with an inspection is “**almost always** not voluntary” it now says in is “**usually** not voluntary”, one of the subtle changes in tone to reflect the differing responses to the virus between jurisdictions. It still recognises that inspecting property may be challenging because of a firms' own internal procedures, government-imposed restrictions, or the unwillingness of occupants to grant access. Apart from implying a minor change in the frequency in which mandatory restrictions will apply, there is no material change in what the valuer should do.
3. A paragraph has been added to emphasise that VPGA 10 of the Red Book indicates that market disruption that may cause Material Valuation Uncertainty will be “relatively unique” and usually where there are an unprecedented set of circumstances. It goes on to remind valuers that this needs to be borne in mind in considering the impact of further “waves” of the virus compared to the initial outbreak. In other words, if the market has adjusted to the existence of the virus and the added uncertainty this has created among buyers and sellers reflected in current prices, this is not a reason for declaring a current valuation as being materially uncertain.
4. In the previous Practice Alert there was wording suggested for situations where either Material Valuation Uncertainty due to the pandemic was still deemed to exist or where markets had adjusted but there was still need for cautionary advice. Many valuers have chosen to adopt these in their reports as appropriate. They need to be aware that both of these model clauses have been changed. Again, the changes do not make any significant changes from the previous alert, although additional advice is included to make it clear that the use of the sample declaration of Material Valuation Uncertainty due to the pandemic should now the exception rather than the rule.

The above comments are intended as a quick guide to the new RICS Practice Alert Supplement. It must not be relied on in isolation and must be read in conjunction with the actual supplement.

Our thoughts

The timely initial advice to valuers on how the effects of the pandemic on property markets should be reported, and the updates issued since, are a model for how RICS can use its convening power and resources to provide support to its members faced with unforeseen problems that are outside the professional experience of many current practitioners. It has also clarified some of the ambiguities and filled in the gaps in the current Red Book guidance in VPGA 10. Overall this has been an excellent initiative.

There are a few additional points we feel would benefit from amplification. These are:

5. Although not in either VPGA 10 or the Practice Alerts, the term "material valuation uncertainty" is often being contracted to the initials MVU. While a convenient shorthand this brings the risk of giving the impression that this is a distinct attribute of a valuation that can be turned on and off at will. It must always be remembered that there is uncertainty in every valuation estimate, just as there is uncertainty as to whether any bid or offer will be accepted until a deal is agreed. This is understood and therefore making specific reference to this uncertainty when reporting the valuation will only serve to unnecessarily undermine it. However, if the valuer has unusual difficulty in finding relevant evidence, then it becomes prudent to disclose this so that anyone relying on the valuation is aware that the valuer has less confidence in the figure than would normally be the case. This difficulty can arise from:
   - a recent unexpected event which has disrupted markets and the data on which they rely, of which the rapid onset of the pandemic in early 2020 was an example,
   - reliance on a method where the valuation is unduly sensitive to relatively small changes in the inputs used, the classic example being the residual method being used as the sole means of estimating the value of a development project,
   - valuing specialised property for which there are no direct comparables.

   There is therefore no fixed line as to when the inevitable uncertainty becomes material – in every case it will depend on the facts and circumstances. As confirmed in the Practice Alert, whether material uncertainty exists remains the decision of the valuer.
6. The Practice Alert has recommended wording for where COVID-19 is still a relevant issue but the property market is properly functioning. This includes the words "…our valuation is not reported as being subject to material valuation uncertainty…". This does beg the question why it is deemed necessary to confirm that you have not said something you haven't. We believe the explanation lies in the recently introduced regulations for property funds in the UK which requires a fund manager to suspend dealing in the fund's units if the standing independent valuer indicates that 20% or more of the fund's assets are subject to material valuation uncertainty.[1] Since in the first few weeks of the pandemic virtually all monthly fund valuations were subject to MVU, when this was no longer the case it was felt prudent to emphasise this. In the case of one off valuations being made where markets are now functioning there is an argument that the suggested wording is unnecessary and could cause confusion to clients unfamiliar with what "material valuation uncertainty" means.
7. Valuation uncertainty is only concerned with the degree of uncertainty in the reported value. It is not about "market risk" i.e. the risk of values being adversely affected by the eventual outcome of something that is known about or anticipated at the valuation date. This is explained more fully in our blog The future is uncertain – what's the problem? Although it is not a specific Red Book requirement to comment on market risk, many clients want this, and many firms include something in their report. It is clear that at the moment the future impact of the pandemic on different asset classes and different markets is

[1] Subject to conditions – see Non-UCITS Retail Schemes Investing in Illiquid Assets Instrument 2019 – FCA 2019/90

unknown. Buyers and sellers are aware of this risk and set prices in full knowledge of this. However, the current market consensus may prove to be wrong. Consequently where a valuation report includes commentary on potential risks looking forward from the valuation date, such as during the term of a loan, it would be prudent to include a warning of the potential for market conditions to move rapidly in response to changes in the control or future spread of COVID-19. This will apply regardless of whether the reported value is made subject to an MVU caveat or not.