Red Book Global: Proposed additions and updates for 2022

The material below is selectively extracted from *RICS Valuation – Global Standards effective from 31st January 2020* (Red Book Global), showing proposed additions and updates to take effect from 31st January 2022 highlighted in yellow.

Title page

Effective from 31st January 2022

Preface

This updated global edition of the *RICS Valuation – Global Standards*, or the RICS 'Red Book Global' as it has become widely known, reflects, among other things, the recent changes made and incorporated into the *International Valuation Standards* (IVS), as well as continuing progress in the development of international standards for ethics and for measurement. Other refinements include:

- articulating in more detail the need for clear, unambiguous and documented terms of engagement when members apply any exceptions to VPS 1-5 under **PS 1 section 5**, *Exceptions*
- more detailed commentary on matters relating to sustainability/resilience and environmental, social and governance (ESG) in VPGA 8, *Valuation of real property interests*
- improving and/or clarifying some of the existing Red Book Global text in the light of feedback, experience and evolving needs.

Part 1: Introduction

3 With its focus on practical implementation, this updated edition of the *RICS Valuation – Global Standards*, commonly referred to as the RICS Red Book Global, applies the latest international standards and supplements them with additional requirements and best practice guidance that, when combined, provide the highest levels of assurance to promote and maintain public trust in valuation professionalism and quality.

At its heart this volume adopts and applies the *International Valuation Standards* (IVS) published by the International Valuation Standards Council (IVSC). The IVS consist of mandatory requirements that *must* be followed in order to state that a *valuation* was performed in compliance with it. Some aspects of the standards do not direct or mandate any particular course of action, but provide fundamental principles and concepts that must be considered in undertaking a *valuation*.

Effective date, duration and amendments to the International Valuation Standards

26 The International Valuation Standards reproduced with kind permission from IVSC in full in Part 6 are those approved by the IVSC Standards Board with an effective date of 31st January 2022.

Part 2: Glossary

basis of value – A statement of the fundamental measurement *assumptions* of a *valuation*. In some jurisdictions, the basis of value is also known as the 'standard of value'.

environmental, social and governance (ESG) – The criteria that together establish the framework for assessing the impact of the sustainability and ethical practices of a company on its financial performance and operations. ESG comprises three pillars: environmental, social and governance, all of which collectively contribute to effective performance, with positive benefits for the wider markets, society and world as a whole. Although ESG principally refers to companies and investors, ESG-related factors are also used to describe the characteristics and, where relevant, operation of individual assets. It is used throughout these standards in this context.

sustainability – *Sustainability* is, for the purpose of these standards, taken to mean the consideration of matters such as (but not restricted to) environment and climate change, health and well-being, and personal and corporate responsibility that can or do impact on the *valuation* of an asset. In broad terms, it is a desire to carry out activities without depleting resources or having harmful impacts.
There is as yet no universally recognised and globally adopted definition of '*sustainability*'. Therefore, *members* should exercise caution over the use of the term without additional appropriate explanation. In some jurisdictions, the term 'resilience' is being adopted to replace the term 'sustainability' when related to property assets.

Sustainability may also be a factor in environmental, social and governance (ESG) considerations.

PS 1 Compliance with standards where a written valuation is provided

4 Compliance with jurisdictional or other valuation standards

4.6 Departures from the IVS to comply with legislative and regulatory requirements that are in conflict with the standards are allowed. In such circumstances, a valuer may still state that the valuation has been performed in accordance with the IVS.

VPS 1–5 exceptions

5.5 The circumstances in which valuers are instructed to provide valuation reports and advice vary widely and may, in some cases, take several years to reach a conclusion. During this time, the instruction may be significantly amended – resulting in an instruction that began as an 'exception' ceasing to be so. Valuers should always focus on the actual task in hand at a specific point in the valuation process. If a valuer's role changes during this process, it is imperative that their actions are transparent, the application of Red Book Global at any given point in time is fully documented and the client is made aware of any change to the valuer's role or undertaking.

5.6 Even though the content of VPS 1 may not be mandatory in 'exception' cases, it cannot be too strongly emphasised that terms of engagement are still required and that they must be clear, unambiguous and appropriately documented (PS 2 section 7 paragraphs 7.3

and 7.4). This is as much in the interests of the valuer as of the client, as it ensures that there is no ambiguity about what is being requested and what is being supplied.

5.7 Terms such as 'quasi–Red Book' or 'partial Red Book' – or even 'non-Red Book' – must not be used in terms of engagement or reporting. Any appropriate exceptions to VPS 1–5 should be explicitly stated and explained in the terms of engagement and valuation report.

6 Departures

6.5 The circumstances in which a valuer can make a departure from the IVS are as described in Section 60 of the IVS Framework.

PS 2 Ethics, competency, objectivity, and disclosures

2. Member qualification

2.1 Members and firms must ensure that services are provided by competent individuals who have the necessary expertise. The test of whether an individual is appropriately qualified to accept responsibility for, or supervise the inputs into, a *valuation* involves satisfying the following criteria:

VPS 2 Inspection

1.5 VPGA 8 provides detailed commentary on matters evident or to be considered during inspection of real estate, including those matters that fall within the general heading of 'sustainability and ESG matters'. Such factors are commonly important in terms of market and societal perception and influence, and valuers should have proper regard to their relevance and significance in relation to individual valuation assignments.

2.3 The valuer must obtain from the client information of current or anticipated changes in rental and other relevant income from investment properties, and any material changes to the non-physical attributes of each property, such as other lease terms, planning consents, statutory notices and so on. The valuer must also consider whether any sustainability and ESG factors that affect the valuation are likely to have altered.

3.3 Valuers should collect and record appropriate and sufficient sustainability and ESG data for the valuation assignment.

VPS 3 Reporting

2.2 (l) 3 In the case of assets or liabilities that are interests in real estate, attention is drawn to VPS 2 paragraph 1.5 and the fact that, wherever appropriate, the relevance and significance of sustainability and ESG matters should form an integral part of the valuation approach and reasoning supporting the reported figure.

VPS 4 Bases of value, assumptions and special assumptions

1. Bases of value

The valuer must ensure that the *basis of value* adopted is appropriate for, and consist ent with, the purpose of the *valuation*.

If one of the *bases of value* defined in these global standards (including IVS-defined bases) is used, then it should be applied in accordance with the relevant definition and guidance, including the adoption of any *assumptions* or *special assumptions* that are appropriate.

If a *basis of value* not defined in these global standards (including IVS-defined bases) is used, it must be clearly defined and stated in the report, which must also draw attention to the fact that it is a departure if use of the basis in the particular valuation assignment is voluntary and not mandatory.

A valuer can only depart from the IVS as described in section 60 of the IVS Framework.

Part 5: Valuation applications

Introduction

Members are expressly reminded that the IVS include the following IVS Asset Standards, the full text of which is reproduced in Part 6 of these global standards:

- IVS 200 Businesses and Business Interests
- IVS 210 Intangible Assets
- IVS 220 Non-Financial Liabilities
- IVS 230 Inventory
- IVS 300 Plant and Equipment
- IVS 400 Real Property Interests
- IVS 410 Development Property
- IVS 500 Financial Instruments

VPGA 1: Valuation for inclusion in financial statements

2.2 In March 2021, the International Accounting Standards Board published the exposure draft *Disclosure Requirements in IFRS Standards—A Pilot Approach*. The exposure draft sets out a proposed new approach to developing and drafting disclosure requirements in IFRS standards, as well as new disclosure requirements for IFRS 13 *Fair Value Measurement*.

From the valuation community perspective, the most noteworthy potential change is the expectation or requirement that information will be provided to clients as a matter of course on what are described as 'reasonably possible alternative fair value measurements', to reflect the uncertainty that may exist regarding any significant inputs used to determine fair value.

2.3 IFRS 16 *Leases*, introduced in 2016, sets out the principles for the recognition, measurement, presentation and disclosure of leases. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

VPGA 2 Secured lending

6.1 Sustainability and ESG factors (see VPGA 8) can be a significant market influence and valuations for secured lending should always have appropriate regard to their relevance to the particular assignment.

6.2 (b) (i) Additional report contents should include: ...comment on maintainability of income over the life of the loan (and any risks to the maintainability of income), with particular reference to lease breaks or determinations and anticipated market trends – this may well need to be considered in a broader sustainability and ESG context, such as potential future cost liabilities related to meeting regulatory and investor requirements…

VPGA 4 Individual trade related properties

1. Background

1.1 Certain trade related properties are valued using the profits method (also known as the *income approach*) of *valuation*. The guidance below sets out the principles of this method of valuation but does not concern itself with the detailed approach to a *valuation*, which may vary according to the property to be valued.

1.2 This VPGA relates only to the *valuation* of an individual property that is valued on the basis of trading potential. **IVS 230 Inventory** focuses on the valuation of physical goods that are not real property and which will be used in future production processes (i.e. raw materials, parts, supplies, goods used in the production process and goods awaiting sale).

1.4 Other types of properties, such as car parks, garden centres, caravan parks and crematoria, fulfil the requirements at 1.3 and are valued in some jurisdictions with reference to trading potential using a profits approach. This list is not intended to be exhaustive. A further subset of properties includes those where the adaptation in use or restraint on flexibility is less marked, but a valuation based on an income approach, including many aspects of this VPGA, may still be regarded as the best indicator of value. A non-exhaustive list of examples includes self-storage, flexible workspace, purpose-built investment student housing and data centres. The choice of method will be a matter for valuer judgment having regard to the specific type, form and use of the property and market circumstances prevailing, and evolving, at the time.

VPGA 8 Valuation of real property interests

This guidance provides additional commentary on certain specific topics and issues that arise in relation to the valuation of real estate, and is supplemental to IVS 400 Real Property Interests, IVS 410 Development Property and VPS 2. It expressly covers inspections and investigations, and includes important material on sustainability and ESG issues, which can be a market influence in relation to real estate.

1.3 (c) where relevant, information on any substantial outgoings and running costs, and the level of recovery from the occupier – energy efficiency and carbon emissions may be among a number of relevant factors when considering sustainability and ESG issues (see below)

2.6 Sustainability and environmental, social and governance (ESG) - Potential or actual constraints on the enjoyment and use of property caused by ESG issues may result from natural causes (such as flooding, severe storms and wildfires), from non-natural causes (such as contamination) or sometimes from a combination of the two (such as subsidence resulting from the historic extraction of minerals). Despite the considerable diversity of circumstances, the key question is always the extent to which the factors identified affect value. Particular care should be taken when assessing or commenting on ESG factors, as valuers may not have the specialist knowledge and experience required. In appropriate cases, the valuer may recommend making further enquiries and/or obtaining further specialist or expert advice in respect of these matters.

The following paragraphs consider the matter in more detail.

a) Natural environmental constraints

i. Some property will be affected by environmental factors that are an inherent feature either of the property itself or of the surrounding area, and which have an impact on the value of the property interest. Examples include ground instability issues (such as swelling and shrinking clay, subsidence consequent on historic or current mineral extraction, etc.) and the risk of flooding from any mechanism. Resilience protection measures may alleviate the impact of the factor.

ii. Although detailed commentary on both the risks and the effects may be outside the realm of the valuer's direct knowledge and expertise, the presence, or potential presence, of these factors is something that can often be established in the course of a valuation inspection through normal enquiries or by local knowledge. Use of the relevant Property Observation Checklist from appendices A to C of the RICS guidance note *Environmental risks and global real estate*, 1st edition (2018), may be of assistance when undertaking inspections. It is not just the risk of a particular event occurring that needs to be considered, but also the various consequences. For example, if the property has suffered a recent event such as flooding this may affect the availability of insurance cover, which, if material, should be reflected in the valuation.

iii. The valuer should be careful to state the limits that will apply to the extent of the investigations and the assumptions that will be made in relation to environmental matters, and should state any sources of information relied upon.

b) Non-natural constraints (contamination and hazardous substances)

i. A valuer may not be competent to advise on the nature or risks of contamination or hazardous substances, or on any costs involved with their removal. However, a valuer who has prior knowledge of the locality and experience of the type of property being valued can reasonably be expected to comment on the potential that may exist for contamination and the impact that this could have on value and marketability.

ii. The nature and risks may of course be directly attributable to the use of the property itself. For example, a number of businesses depend on activities that involve the use of hazardous substances or operate waste management activities that may be regarded as a nuisance by third parties. Although detailed commentary on such effects may be outside the realm of the valuer's expertise, their presence, or potential presence, is something that can often be established in the course of a valuation inspection through normal enquiries or by local knowledge.
iii. The valuer should state the limits on the investigations that will be undertaken and state any sources of information or assumptions that will be relied on. Any historic or existing use matters observed can again be recorded on the relevant Property Observation Checklist from appendices A to C of the RICS guidance note Environmental risks and global real estate, 1st edition (2018).

c) Sustainability and ESG – assessing the implications for value

i. While not a term that has a universally recognised definition yet (see the RICS glossary in Part 2), in a valuation context sustainability encompasses a wide range of physical, social, environmental and economic factors that can affect value and of which valuers should be aware.

ii. The range of issues includes, but is not limited to, key physical risks such as flooding, heat, wildfires and severe storms, and transitional risks such as energy efficiency, carbon emissions and climate impact. The impact of these risks can be influenced by current and historic land use as well as matters of design, configuration, accessibility, legislation, management and fiscal considerations. Sustainability matters can impact occupier preferences and purchaser behaviour, and may also be a consideration for investors, secured lenders, insurers and public bodies.

iii. The pace at which sustainability and ESG is feeding directly or indirectly into value has jurisdictional variations. In order to respond appropriately as markets change, valuers should continuously seek to enhance their knowledge. The role of valuers is to assess value in the light of evidence normally obtained through analysis of comparable transactions. While valuers should reflect markets, not lead them, they should be aware of sustainability features and the implications these could have on property values in the short, medium and longer term. The issues may extend to:

- ESG matters (see above) including, where applicable, climate change and resilience to climate change
- configuration and design including use of materials and concepts increasingly associated with 'wellness'
- accessibility and adaptability, including access and use by those with disabilities
- carbon emissions, energy efficiency, building 'intelligence' and other 'costs in use'
- fiscal considerations.

iv. Valuers are actively encouraged to identify and collect sustainability and ESG-related data.

v. Only where existing market evidence would support this, or where in the valuer's judgement market participants would expressly reflect such matters in their bids, should sustainability characteristics directly influence value(s) reported.

vi. Valuers are often asked to provide additional comment and strategic advice. In these cases, the valuer should consult with the client on the use and applicability of sustainability and ESG metrics and benchmarks that are applicable in each case. For example, when preparing valuations on the basis of investment value or worth, sustainability and ESG factors that could influence investment decision-making may properly be incorporated, even though they are not directly evidenced through transactions.

vii. Where appropriate, in order to comply with best practice in reporting, valuers should:

- assess the extent to which the subject property currently meets the sustainability and ESG criteria typically expected within the context of its market standing and arrive at an informed view on the likelihood of these impacting on value, i.e. how a well-informed purchaser would take account of them in making a decision as to offer price
- provide a description of the sustainability-related property characteristics and attributes that have been collected
- provide a statement of their opinion on the relationship between sustainability factors and the resultant valuation, including a comment on the current benefits/risks that are associated with these sustainability characteristics, or the lack of risks, and
- provide an opinion on the potential impact of these benefits and/or risks to relative property values over time.

viii The RICS guidance note *Sustainability and ESG in commercial property valuation and strategic advice*, 3rd edition (2022) provides guidance on the identification, assessment and impact of sustainability and ESG issues for commercial real estate valuations.

Part 6: International Valuation Standards

The *International Valuation Standards* (IVS) are reproduced in full in this Part, with kind permission from IVSC. Effective from 31st January 2022, they are adopted and applied through these RICS Red Book Global Standards, being cross-referenced throughout Parts 3 to 5.

Members are reminded that IVSC reserves the right to make further amendments to IVS at any time. Any consequential amendments to this Red Book Global edition will be made in accordance with the arrangements described in paragraph 27 of Part 1: Introduction.

Summary of main changes to IVS 2020 – effective from 31st January 2022

Core Principles – A list of 'core principles' for standard setting and valuation has been added to the Introduction.

Glossary – The Glossary has been extended.

Framework – Two clauses have been added to explain what is meant by compliance with the standards and when a departure may be made. Other changes indicate that an individual or group of individuals responsible for preparing a valuation must be appropriately qualified, competent and unbiased, and act ethically.

IVS 101 Scope of Work – Valuers preparing valuations for their own employers are now referred to as 'employed valuers'. Valuers preparing valuations for a third-party client are called 'engaged valuers'.

IVS 104 Bases of Value – A section on ‘allocation of value’ has been added.

IVS 105 Valuation Approaches and Methods – wording has been reinstated to clarify that market, income and cost approaches are not exclusive and may be used in any combination.

IVS 200 Businesses and Business Interests – the Introduction has been amended to better describe the scope of the standard.

IVS 230 Inventory – This is a new standard and addresses the valuation of goods that will be used in future production, work in progress and goods awaiting sale. It excludes real estate and buildings under construction.

IVS 400 Real Property Interests – the Introduction has been amended to provide additional clarification of what this standard covers, including the valuation of agricultural land and unregistered land.