

RICS Valuation – Global Standards 2017: UK national supplement

Issued November 2018, effective from 14 January 2019

Published by the Royal Institution of Chartered Surveyors [RICS]

Parliament Square

London

SW1P 3AD

www.rics.org

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Produced by the RICS Valuation Professional Group

ISBN 978 1 78321 327 6

This *RICS Valuation – Global Standards 2017 – UK national supplement* was previously published as *RICS Valuation – Professional Standards UK* [ISBN 978 1 78321 105 0]

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Part 1 Introduction

This UK national supplement sets out specific requirements, together with supporting guidance, for *members* on the application of the *RICS Valuation – Global Standards 2017* (the Global Standards) to valuations undertaken subject to UK jurisdiction.

It places fresh emphasis on the fact that the content is supplemental to that in the Red Book Global Edition, and not in substitution for it. This removes the need for an overall Introduction reproducing that in the Global Edition.

Application to members of RICS

- 1 Taking effect from 1 July 2017, the Global Standards adopt and apply the International Valuation Standards (IVS) 2017 and also place a number of additional requirements on RICS *members*, designed to provide *valuation* users with the highest levels of assurance regarding professionalism and quality. It is, however, recognised that within individual jurisdictions statutory, regulatory or other authoritative requirements (see **PS 1 section 4**) may affect how a *member* complies with the Global Standards – hence this national supplement. It reflects *valuation standards* and other authoritative requirements that are specific to the UK jurisdiction, and provides additional valuation applications guidance accordingly.

Application to members of IRRV

- 2 RICS and IRRV (The Institute of Revenues, Rating and Valuation) have agreed that these standards will be adopted and applied by members of IRRV who are also RICS *members* practising in the UK. The enforcement of these standards in relation to IRRV members is the responsibility of the IRRV Professional Conduct Committee. However, IRRV and RICS may request each other to deal with alleged breaches of these standards by those who are *members* of both bodies and may share information with a view to ensuring compliance.

The following conventions are adopted throughout:

- **Mandatory** requirements in this national supplement are set out in **bold type** – the remaining material is advisory.
- Terms defined in the Global Standards *Glossary* are shown in italics.
- References to the Global Standards use the relevant global section identifier only, e.g. **PS 1**, **VPS 1**, VPGA 1, etc. Internal cross-references within this supplement can be recognised by the inclusion of 'UK' in the title, e.g. **UK PS 1**, UK VPGA 1, etc.

Effective date

- 3 The RICS material included in this UK national supplement edition takes effect from 14 January 2019 and applies to all *valuations* where the *valuation date* is

on or after that day. Any amendments issued to take effect after that date will be clearly labelled accordingly.

Currency of the text

- 4 The definitive RICS Red Book Global Edition and UK national supplement text current at any given date is that on the RICS website www.rics.org/redbook. Any users of this publication should take care to ensure that they have had proper regard to any subsequent amendments.

Part 2 UK Professional and Valuation Standards – mandatory

1 UK Professional Standards (UK PS)

UK PS 1 Compliance with valuation standards within the UK jurisdiction

Members must take care to ensure compliance with UK law – including measures enacted by, or specific to, the devolved administrations – and any other authoritative requirements when providing valuation services (as defined in PS 1 of the Global Standards), which are subject to UK jurisdiction.

For the avoidance of doubt, the requirements and supporting guidance set out here modify or supplement the Global Standards, with which *members* undertaking or supervising valuation services must otherwise continue to comply at all times.

Implementation

- 1 It is important that *members* are aware not only of their general obligations under UK law, but also alert to specific requirements that may arise according to the particular *valuation* assignment on which they are engaged, under secondary legislation or regulation such as Rules and Codes (e.g. in connection with company takeovers) or other authoritative requirements (e.g. preparing *financial statements* under UK GAAP).
- 2 Compliance with such requirements will often be a matter for a valuer's client in the first instance, but the valuer is expected to provide the necessary professional advice to support the client in the discharge of that responsibility. Occasionally, however, a responsibility or duty may be placed directly on the valuer (e.g. under Rule 29 of the Takeover Code). Such instances are highlighted in the text that follows.

2 UK Valuation Technical and Performance Standards [UK VPSs]

UK VPS 1 Terms of engagement [scope of work] and reporting: Red Book compliance

For the purpose of VPS 1 section 3 paragraph 3.2(n) and VPS 3 section 2 paragraph 2.1(k) of VPS 3 in the Global Standards (on or after the effective date of this national supplement), a *valuation* report declared simply as issued 'in accordance with the RICS Red Book' without further reference to the edition or year of issue will – for UK jurisdictions – be taken to mean in accordance with the 2017 Global Standards plus this UK national supplement.

In some instances, it may be necessary or desirable for the benefit of valuation users (including others such as auditors) to make explicit which edition of the Red Book has been used. Valuers are reminded of the importance of ensuring that they are aware of, and familiar with, all updates to the Red Book (both to the Global Standards and to this UK supplement) relevant to the *valuation* assignment they are engaged on.

UK VPS 2 Terms of engagement (scope of work): supplementary provisions in Scotland

These supplementary provisions address the situation where, due to time restrictions sometimes created by the traditional and accepted procedures for buying residential property in Scotland, it is not possible to issue *terms of engagement* to clients, or those acting for clients, prior to the issue of a report.

Implementation

- 1 The expectation is that, wherever possible, *terms of engagement* will be issued to clients in accordance with the requirements of **PS 2** and **VPS 1**, including the specific requirement that the *terms of engagement* are settled prior to the issue of the report.
- 2 Where, exceptionally, this is not possible then the *member*, or their *firm*, must proceed as follows:
 - a) Where the *member* or their *firm* has a website openly accessible to the public, their standard *terms of engagement* must be published on it, and the client's, or their representative's, attention drawn to it. Great care must be exercised by the member if any modification to the standard terms is necessary in any individual case.
 - b) A written copy of the *terms of engagement* must then be sent to the client, or their representative, within 24 hours of receipt of the instruction. This may be by post or electronic means as appropriate.
- 3 It is considered to be good practice for the *member* or their *firm* to furnish their standard *terms of engagement* to referring parties (e.g. local solicitors, lenders, etc.), with their *valuation* commissions once received. A note of receipt of these terms should be sought.

UK VPS 3 Regulated purpose valuations: supplementary requirements

The requirements below are supplementary to PS 2 section 5 and apply to regulated purpose *valuations*, namely:

- *valuations* for financial reporting under UK VPGA 1 and UK VPGA 2
- *valuation* reports for inclusion in prospectuses and circulars to be issued by UK companies under UK VPGA 2.1
- *valuations* in connection with takeovers and mergers under UK VPGA 2.2
- *valuations* for collective investment schemes under UK VPGA 2.3 and
- *valuations* for unregulated property unit trusts under UK VPGA 2.4.

UK VPS 3.1 Exclusion of certain properties

- 1 Where a regulated purpose *valuation* (as defined above) includes:
 - a) one or more properties acquired by the client within the 12 months preceding the *valuation date* and
 - b) the valuer, or the valuer's firm, has in relation to those properties:
 - received an introductory fee or
 - negotiated that purchase on behalf of the client,

the valuer must not undertake that regulated purpose *valuation* of the property (or properties) unless another firm unconnected with the valuer's firm has provided a *valuation* of the property for the client at the time of, or since, the transaction was agreed.

Implementation

- 2 There are many circumstances where conflicts of interest may potentially arise (see **PS 2 section 3** and RICS global professional statement, **Conflicts of interest**, 1st edition). These RICS professional standards deal with, among other things, the conflict that may arise where the valuer or firm could be involved in the introduction and acquisition of property by the client and in the provision of a regulated purpose *valuation* of the same property.
- 3 Where the particular circumstances specified occur, the valuer must ascertain whether an unconnected firm, which should be identified, has undertaken such a *valuation* for the client and must include a reference to that fact in the report.

UK VPS 3.2 Disclosures

Where a *valuation* is a regulated purpose *valuation*, the valuer must state all of the following in the report and any draft published reference to it:

- a) in relation to the firm's preceding financial year the proportion of the total fees, if any, payable by the client to the total fee income of the

valuer's firm expressed as either less than 5% or, if more than 5%, an indication of the proportion within a range of 5 percentage points and

- b) where, since the end of the last financial year, it is anticipated that there will be a material increase in the proportion of the fees payable, or likely to be payable, by the client, the valuer must include a further statement to that effect, in addition to (a).

Implementation

- 1 In complying with this *valuation standard*, the valuer is not required to provide a comprehensive account of all work ever undertaken by the firm for the client. A simple, concise statement that discloses the nature of other work done and the duration of the relationship is all that is required. If no relationship exists other than the current *valuation* instruction, a statement to that effect should be made.
- 2 It may be both impractical and immaterial to establish and evaluate every relationship between the firm and every party connected with the instructing party. However, it is the valuer's responsibility to make reasonable enquiries to identify the extent of the fee-earning relationship with all parties having a material connection with the client, and to ensure that the principles of this standard are followed. Where there is a material connection or relationship, the disclosures required by this standard relate to the relationship of the valuer's firm with all the parties involved and the aggregate fees earned from those parties.
- 3 The information required under item (a) of **UK VPS 3.2** should be expressed, when required, in the form of 'between [x]% and [y]%', with the difference between the two figures being no more than 5 percentage points.
- 4 The purpose of item (b) of this standard is to recognise that there may be circumstances where a significant increase in the proportions of fees is anticipated between the end of the previous financial year and the *date of the report*. Because detailed information on the proportion will probably not be readily available, the valuer will need to make enquiries and form a judgement as to the likely proportions to be disclosed.
- 5 Where a reference to a report is to be published, the statement for inclusion in the publication (see **VPS 3 section 2 paragraph 2.2(j)**) should refer to all the information given in complying with this *valuation standard*. A note of the enquiries made and the source of the information used in complying with this *valuation standard* must be retained in the file.

Part 3 UK Valuation Practice Guidance Applications (UK VPGAs) – advisory

UK VPGA 1 Valuation for financial reporting: general matters

Introduction

- 1 *Valuations* for the purpose of financial reporting, in other words *valuations* provided to clients for inclusion in *financial statements*, require particular care as the statements have to comply strictly with the current financial reporting standards adopted by the reporting entity. Although the *International Financial Reporting Standards* (IFRS) are nowadays widely adopted, other financial reporting standards may still apply in individual jurisdictions.
- 2 In the case of the UK, and also the Republic of Ireland, company law recognises two financial reporting frameworks:
 - a) IFRS and
 - b) UK and Ireland Generally Accepted Accounting Practice (UK GAAP).

The Financial Reporting Council (FRC) is the body having statutory responsibility for issuing the relevant accounting standards under UK GAAP – these are designated Financial Reporting Standards (FRSs).

- 3 Publicly listed companies are required to apply IFRS in the preparation of their group accounts but may choose between IFRS and UK GAAP for the preparation of their individual parent accounts. Other entities have a free choice between the two frameworks, though in practice many larger unlisted entities also now adopt IFRS. While valuers may increasingly find that they are asked to provide *valuations* for companies and other entities reporting under IFRS, this is by no means universal.
- 4 Although the guidance that follows focuses primarily on the application of UK GAAP, the FRSs under UK GAAP have much in common with their equivalents under IFRS. Where appropriate, the commonalities as well as the detail differences are expressly signalled. Although the valuer's role will typically be focussed on the provision of advice on '*fair value*' (as defined in the applicable accounting standard), some knowledge of the broader context is likely to be helpful.
- 5 The objective of *financial statements* is to provide information about the financial position and performance of a reporting entity, not only to satisfy the requirements of the UK *Companies Act* 2006 and subsequent amendments (including regulations made under it), but also to inform the decision-making process for a wide range of end users. Therefore, financial accounting information needs to be assembled and reported objectively. Third parties who rely on such information have a right to be assured that the data is free from bias and inconsistency.
- 6 The objectives set out in paragraph 5 are supported in relation to certain specialised industries or sectors through the issue of Statements of

Recommended Practice (SORPs) by duly authorised UK bodies. Developed in the public interest, SORPs set out current best accounting practice and are intended to supplement the relevant accounting standards and certain other legal and regulatory requirements. While reference is made to SORPs where relevant both in this section and in other parts of this national supplement, their detailed content generally lies outside its scope. The **FRC website** holds full details of all current SORPs.

- 7 It should be noted that accounting standards speak of ‘measurement’, namely the ‘process of determining the monetary amounts at which the elements of the financial statements are to be recognised’; the term ‘valuation’ is not used. For the sake of clarity, the material in this national supplement uses the term ‘valuation’ unless the particular context requires otherwise.
- 8 Valuers are strongly advised to clarify at the outset with their clients (and where appropriate with the client’s auditors) which accounting regime applies and the level and degree of valuation work and disclosure required to accompany the *valuation* in order to ensure that their client’s precise accounting needs are addressed. Valuers should refer as necessary to the standards current at the date to which the *financial statements* relate – the guidance here is not a substitute for the source material (in relation to which all references are as at July 2018) – but they are reminded that decisions on the categorisation of an asset and on the ‘measurement’ basis to be used in any particular case are matters for the reporting entity’s management.
- 9 Valuers should be aware that the auditor is required to consider the valuation report prepared for the purposes of estimating a *fair value* for inclusion in the *financial statements*. The auditor will evaluate the relevance and reasonableness of the source data and valuation methods used and any *assumptions* adopted or conclusions reached by the valuer when preparing the *valuation*. It is likely that the auditor will make enquiries of the valuer in this respect.
- 10 In certain specific contexts, e.g. takeover situations, there are special rules and regulations that apply that extend to the role of valuers. *Members* are reminded of the general requirement in **UK PS 1** to observe and comply with such obligations.

UK VPGA 1.1 Overview

- 1 UK VPGA 1 provides overall guidance to valuers who furnish advice to clients for the purpose of financial reporting. While focussing on the requirements of UK GAAP, the same general principles apply to financial reporting under IFRS and for convenience the corresponding International Accounting Standard (IAS) references are included where applicable.
- 2 Although the financial reporting regime to be followed is a decision for the reporting entity, the accounting standards to be adopted and the manner in which they are to be applied will be affected by whether the assets to be valued are ‘private sector’ or ‘public sector’. In the case of public sector assets, generally the reporting regime is based on IFRS, with further refinements to the

detailed requirements depending on whether the assets are held by central government, local government or the wider public sector. These issues are addressed in more detail in UK VPGA 4 and 5. Financial reporting in relation to registered social housing providers is covered in UK VPGA 7 and charity assets is covered in UK VPGA 8.

UK Generally Accepted Accounting Practice [UK GAAP]

- 3 UK GAAP applies in the UK and the Republic of Ireland and does so in relation to *financial statements*, including any valuations that support them, in accordance with the **Financial Reporting Standards** issued by the Financial Reporting Council (FRC).
- 4 There are six Financial Reporting Standards in total:
 - i) **FRS 100** *Application of Financial Reporting Requirements*
 - this sets out and provides guidance on the overall reporting framework.
 - ii) **FRS 101** *Reduced Disclosure Framework*
 - this permits disclosure exemptions from the requirements of EU-adopted IFRSs (as amended for the requirements of UK law) for certain qualifying entities.
 - iii) **FRS 102** *The Financial Reporting Standard applicable in the UK and Republic of Ireland*
 - this introduces a single standard that seeks consistency with, but is not necessarily the same as, IFRS.
 - iv. **FRS 103** *Insurance Contracts*
 - this consolidates existing financial reporting requirements for insurance contracts.
 - v) **FRS 104** *Interim Financial Reporting*
 - vi) **FRS 105** *The Financial Reporting Standard applicable to the Micro-entities Regime.*
- 5 As noted in paragraph 6 of the introduction to this section, the Financial Reporting Standards are in some instances supplemented by Statements of Recommended Practice (SORPs). As of July 2018 they cover financial reporting in relation to:
 - Authorised funds.
 - Charities.
 - Further and higher education.
 - Investment trust companies and venture capital trusts.
 - Limited liability partnerships.
 - Pension schemes.
 - Registered providers of social housing.

- 6 Much of the detailed content of SORPs will not be relevant to the work of valuers, and so they are only lightly touched on in the guidance within this national supplement.
- 7 The material that follows provides an overview of the main financial reporting standards (with particular reference to FRS 102) but cannot cover all aspects of compliance by the reporting entity with them.

UK VPGA 1.2 Basis of 'measurement' for property, plant and equipment

Assets included in *financial statements* prepared in accordance with UK GAAP are measured on the basis either of the cost model, the revaluation model, or the fair value model as defined in FRS 102.

- 1 An entity is required to 'measure' (in the accounting sense – see paragraph 7 of the introduction) all items of property, plant and equipment after 'initial recognition' (meaning broadly, on first inclusion in its accounts as a discrete, quantifiable asset of the entity) using either:
 - the cost model in accordance with FRS 102 section 17 paragraph 15A (IFRS equivalent is IAS 16 paragraph 30) or
 - the revaluation model in accordance with FRS 102 section 17 paragraphs 15B–15F (IAS 16 paragraphs 31–42) or
 - in the case of *investment property* (see paragraph 3) the fair value model unless fair value cannot be measured reliably without undue cost or effort.

Where the revaluation model is selected, this is to be applied to all items of property, plant and equipment in the same class (i.e. having a similar nature, function or use in the business).

- 2 FRS 102 (Glossary) defines property, plant and equipment as tangible assets that:
 - a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and
 - b) are expected to be used during more than one [*accounting*] period.

FRS 102 section 17 paragraph 3 clarifies that property, plant and equipment does not include:

- a) 'biological assets' related to agricultural activity or 'heritage assets' (see UK VPGA 1.4 in both cases) or
- b) mineral rights and mineral reserves, such as oil, natural gas and similar non-regenerative resources.

For the IFRS definition of property, plant and equipment see IAS 16. While similar overall, there is no reference to heritage assets, and a distinction is

drawn in relation to biological assets where 'bearer plants' are included in the definition but their produce is not.

- 3 FRS 102 (Glossary) defines 'investment property' as property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:
 - a) use in the production or supply of goods or services or for administrative purposes or
 - b) sale in the ordinary course of business.

A property held under an operating lease may also be so classified in specified circumstances – see FRS section 16 paragraph 3. (For the IFRS definition of investment property see IAS 40.)

- 4 Further detail concerning asset classification for financial reporting is contained in UK VPGA 1.4, which also includes further guidance in relation to plant and equipment.
- 5 In terms of accounting treatment:
 - a) The cost model uses cost less subsequent depreciation and impairment losses (both accumulated) – FRS 102 section 17 paragraph 15A (IAS 16 paragraph 30). It should be emphasised that this is quite different from the *cost approach* as understood in valuation terms and should not be confused with it.
 - b) The revaluation model uses the fair value less subsequent depreciation and impairment losses (both accumulated) – FRS 102 section 17 paragraph 15B (IAS 16 paragraph 31).
 - c) The fair value model under FRS 102 section 16 paragraph 7 is for investment property whose fair value can be measured reliably without undue cost or effort and is then to be so measured at each reporting date.
- 6 The valuer's role will normally be confined to providing advice on *fair value* for the purpose of paragraph 5b and 5c. This may involve the *market approach*, the *income approach* or the *cost approach* according to the facts and circumstances of the case.

UK VPGA 1.3 Fair value

While the UK GAAP and IFRS definitions of *fair value* differ in detail, nevertheless in the majority of cases the figure to be reported will be the same.

- 1 Under UK GAAP, FRS 102 defines fair value as 'the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction' – FRS 102 section 2 paragraph 34(b). Under IFRS, *fair value* is defined as 'the price that would be received to sell an asset or paid to transfer

- a liability in an orderly transaction between market sector participants at the measurement date' (see **VPS 4 section 7**).
- 2 But while *fair value* for financial reporting, whether under IFRS or under UK GAAP, is defined using slightly different language from that in the IVS *market value* definition (see **VPS 4 section 4**), the underlying concept is essentially the same. In most cases the figure to be reported as the *fair value* of an asset is also that which would be reported as its *market value*.
 - 3 FRS 102 section 17 paragraph 15C specifies that in the case of land and buildings, fair value is usually determined from 'market-based evidence by appraisal that is normally undertaken by professionally qualified valuers'. Similarly, for items of plant and equipment fair value is usually their 'market value determined by appraisal'. Paragraph 15D provides that if there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an entity 'may need to estimate fair value using an income or a *depreciated replacement cost approach*'.
 - 4 Where items of property, plant and equipment are revalued using the revaluation model, the following disclosures are required under FRS 102 section 17 paragraph 32A:
 - the effective date of the revaluation
 - whether an independent valuer was involved
 - the methods and significant *assumptions* applied and
 - for each revalued class of property, plant and equipment, the 'carrying amount' that would have been recognised had the assets been carried under the cost model.
 - 5 Similarly, for *investment property* 'measured' using the fair value model, the *financial statements* must disclose (FRS 102 section 16 paragraph 10):
 - the methods and significant *assumptions* applied and
 - whether the *valuation* is based on a *valuation* by an independent valuer holding a recognised and relevant professional qualification with recent experience in the location and class of the *investment property* being valued.
 - 6 Valuers may be asked to assist by providing information for such disclosures, which could include key *assumptions* such as discount rates (yields), estimated rental values, void periods and future development costs. It is emphasised that a valuation report provided in accordance with **VPS 3** will normally include sufficient information concerning the methods used and any significant *assumptions* made to satisfy the disclosure requirements.
 - 7 FRS 102 section 17 paragraph 15B permits some flexibility in the frequency of valuations using the revaluation model – they must be carried out with 'sufficient regularity' but this does not necessarily mean annually. However, for *investment property* 'measured' using the fair value model, a fair value is required at each reporting date (section 16 paragraph 7).

- 8 The unit of account will usually be an individual property. However, if the valuer is requested to value an entity within which the property is owned (a special purpose vehicle for example), this should be disclosed in the valuation report and the *valuation* should take account of all aspects of the entity being valued, such as any debt and other assets/liabilities in the entity and the taxation implications.
- 9 In the limited circumstances where a *special purchaser* other than the reporting entity can be identified, it is recommended that the client's attention is also expressly drawn to this and the *special value* separately reported or clearly identified and disclosed when reporting the fair value, as would be the case when reporting *market value* generally.

UK VPGA 1.4 Property categorisation

Valuers should look to the entity to specify the categories of property that should be valued. They should then either report each of those values separately or provide a breakdown where an aggregated figure is reported.

- 1 Assets need to be categorised according to the accounting policies required or permitted by the applicable accounting standard. It is for the reporting entity to undertake that categorisation – the valuer will need to establish what categorisation has been determined, and also what *assumptions* (if any) need to be made.
- 2 The following table illustrates the different categories of asset, with additional explanation.

Financial statement classification	Examples of asset types – <i>certain additional information is below</i>	Accounting policies available
Property, plant and equipment [other than <i>investment property</i> – see below]	<ul style="list-style-type: none"> • Owner-occupied property • Own use plant and equipment • Property fully-equipped as an operational entity and used by the owner 	Cost or revaluation model
<i>Investment property</i>	<ul style="list-style-type: none"> • Land and buildings held, or in the course of development, for rental income and/or capital appreciation 	<i>Fair value</i> model [unless undue cost or effort]

Financial statement classification	Examples of asset types – certain additional information is below	Accounting policies available
Inventories	<ul style="list-style-type: none"> Assets held for sale in the ordinary course of business; in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services 	Cost [see paragraph 11 below]
Other [to be categorised according to the facts and circumstances]	<ul style="list-style-type: none"> <i>Specialised property</i> Options and other contractual rights that may be saleable and of value Mineral resources 	According to classification

Table 1: Different categories of asset

Owner-occupied property

- Owner-occupied property measured using the revaluation model will usually be valued on the basis of *fair value*. It may be necessary to apportion the total value reported between freehold, long leasehold (over 50 years) and short leasehold properties. This should be agreed with the entity at the outset.

Specialised activities

- FRS 102 section 34 sets out the financial reporting requirements for entities involved in certain 'specialised activities', which for this purpose include:
 - agriculture
 - extractive activities and
 - heritage assets.

a) Agricultural property

- Reporting entities engaged in agricultural activity must determine an accounting policy for each class of biological asset (defined as 'a living animal or plant') and its related agricultural produce – this can be either the *fair value* model or the cost model. If the entity chooses the former, it cannot then change to the latter.
- Farming livestock is within the definition of biological asset. It should be noted that the treatment for *financial statements* will not necessarily accord with the treatment for taxation purposes.
- Reference should be made to FRS 102 for further detail.

b) Extractive industries

- 6 Entities engaged in the exploration for and/or evaluation of mineral resources (extractive activities) will need to apply the requirements of *IFRS 6 Exploration for and Evaluation of Mineral Resources*. In doing so, references made to other IFRSs shall be taken to be references to the corresponding relevant section or paragraph within FRS 102.
- 7 Exploration and evaluation assets are initially measured at cost. They are classified as tangible or *intangible assets*, according to the nature of the assets acquired. After recognition, the exploration and evaluation assets are measured using either the cost model or the revaluation model.
- 8 As soon as technical feasibility and commercial viability are established, the assets are no longer classified as exploration and evaluation assets. IFRS 6 therefore does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral reserves (such as activities before an entity has acquired the legal right to explore, or after the technical feasibility and commercial viability to extract resources have been demonstrated). Activities and assets outside the scope of IFRS 6 are accounted for according to the applicable standards set out in FRS 102. For example, mineral bearing land or land suitable for waste disposal purposes will be measured in accordance with the cost model or revaluation model in accordance with FRS 102.

c) Heritage assets

- 9 It should be noted that the definition of heritage assets for this purpose excludes *investment property*, property, plant and equipment or *intangible assets* that fall within the scope of sections 16, 17 or 18 of FRS 102.

Inventories

- 10 FRS 102 section 13 covers inventories defined (FRS 102 Glossary) as assets that are:
 - a) held for sale in the ordinary course of business
 - b) in the process of production for such sale or
 - c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

This does not however include biological assets related to agricultural activity and agricultural produce at the point of harvest.

- 11 Inventories are measured at the lower of cost and estimated selling price less costs to complete and sell.

Property operating under statutory consents, permits or licences

- 12 Certain operations can be carried out only under statutory consents, permits and licences. Any *assumption* that operations will continue should be stated specifically in the report.
- 13 Where a business has been closed down and the property stripped of fixtures, fittings and furniture, it will normally be available for redevelopment, refurbishment or change of use. In such cases, it should be valued accordingly. If it is intended that the property will be reopened for the purposes of the business, its value for balance sheet purposes should reflect the additional costs that would be incurred compared with an existing, fully-operational property, and this should be explained in the report.

Land and buildings in the course of development

- 14 Where land and buildings in the course of development are to be revalued, they are to be included in the *financial statements* at their *fair value*.

Plant and equipment

- 15 Subject to the particular accounting policy of the reporting entity concerned, the valuer may be requested to consider the value of the plant and equipment assets as an integrated package of assets, as may be used by market participants, rather than just the sum of individual asset values. Therefore, any incompatibility of particular plant assets, imbalances between the capacity of different production sections, underutilisation, poor plant layout and similar functional obsolescence factors that may affect the overall efficiency of the manufacturing facility should be recognised and taken into account.
- 16 In the context of *fair value*, the assembled subject plant and equipment assets' core draft value (a term applied to an investment that, when added to the core assets of a diversified portfolio, can potentially increase the overall return of the portfolio with minimum exposure to risk) needs to be tested/adjusted (if necessary) for economic obsolescence (often as part of/in conjunction with a wider business valuation/impairment study). In the event that the valuer does not wish to test/adjust core draft values for economic obsolescence, this should be explicitly agreed as such with the client and referenced in the *terms of engagement*.
- 17 In the absence of relevant and meaningful market evidence, the replacement *cost approach* is usually adopted. Net current replacement cost is normally established by depreciating the gross current replacement cost to reflect age and obsolescence to arrive at the value attributable to the remaining portion of the total useful economic working lives of the assets.
- 18 Gross current replacement cost is the total cost of replacing an existing asset with an identical, or substantially similar, new modern equivalent asset that has a similar production or service capacity, including costs of transport, installation, commissioning, consultants' fees and non-recoverable taxes and duties.

- 19 The depreciation applied on a systematic basis over the economic life of the asset should take account of the age, condition, functional and economic obsolescence of the asset.
- 20 Where suitable market evidence is available to the valuer, any cost based *fair value* should always be benchmarked with the cost of acquiring a similar assembled asset unit/facility (as defined by how market sector participants account for subject assets) in the open market, taking due account of the costs of transport and installation, etc.
- 21 Although the *market approach* is usually considered prime under *fair value* measurement, the *income approach* should also be considered where appropriate. However, as it is usually difficult to identify and/or allocate an *income approach* to individual assets, adoption of this approach is usually the exception for plant and equipment assets.
- 22 Reference may be made to VPGA 5 for further guidance.

Options and other contractual rights that may be saleable and of value

- 23 In the case of options and other contractual rights, the valuer should discuss with the client the actual terms of the options or rights and the accounting classification to establish the precise nature of the *valuation* required.

UK VPGA 1.5 Valuations based on depreciated replacement cost

- 1 The *depreciated replacement cost* (DRC) method of valuation is used where there is no active market for the asset being valued – that is, where there is no useful or relevant evidence of recent sales transactions due to the specialised nature of the asset.
- 2 It is important to understand that the word 'depreciation' is used in a different context for valuation than at the accounting stage of financial reporting. In a DRC valuation, 'depreciation' refers to the reduction, or writing down, of the cost of a modern equivalent asset to reflect the subject asset's physical condition and utility together with obsolescence and relative disabilities affecting the actual asset. In financial reporting, 'accounting depreciation' refers to a charge made against a client's income to reflect the consumption of an asset over a particular accounting period (see UK VPGA 1.10).
- 3 For detailed guidance on the *depreciated replacement cost* (DRC) method of valuation for financial reporting, including the various matters that need to be taken into account as part of the valuation process, *members* should refer to RICS UK guidance note *Depreciated replacement cost method of valuation for financial reporting*, 1st edition.
- 4 For inclusion in accounts prepared under UK GAAP or IFRS, the value is reported as being on the basis of *fair value* (or current value where that is the basis applicable to parts of the UK public sector – see UK VPGAs 4 and 5).

- 5 In order to comply with **VPS 3 section 2 paragraph 2.2 (l)**, a statement is required explaining that because of the specialised nature of property, the value is estimated using a DRC method and is not based on the evidence of sales of similar assets in the market. This statement matches a requirement in FRS 102 or IAS 16 for the client to include a similar statement in the published accounts.

In the private sector

- 6 A *valuation* of a property in the private sector using a DRC method should be accompanied by a statement that it is subject to the adequate profitability of the business paying due regard to the total assets employed. This is especially important in the context of DRC valuations, which may ultimately be provided for accounting statements under UK GAAP or IFRS, and which will require adjustments for economic viability/obsolescence and wider market metrics.

In the public sector

- 7 A *valuation* of a property in the public sector using a DRC method should be accompanied by a statement that the *valuation* is subject to the prospect and viability of the continued occupation and use, but attention must be paid to any wider public sector IFRS-related accounting regulations (see UK VPGAs 4, 5 and 6).

Comparison with alternative use values

Value materially higher

- 8 As part of the process of valuing any property, the valuer needs to consider if there is potential for an alternative use that would be reflected in the *fair value*. In the case of *specialised property* that can only be valued using the *DRC* method, any alternative use value is likely to relate only to the land because the buildings or other improvements may be unsuitable for any alternative use.
- 9 Where it is clear that a purchaser in the market would acquire the property for an alternative use of the land because that use can be readily identified as generating a higher value than the current use and is both commercially and legally feasible, the client should be alerted and further instructions sought as necessary.
- 10 Realising a *fair value* based on an alternative use may be inconsistent with the going concern *assumption* upon which *financial statements* are normally prepared and, for the wider public sector, with its IFRS related accounting regulations. In addition, the costs that an entity might incur in closure or relocation could exceed any additional value that could be realised by an alternative use. Accordingly, an entity may request advice on the value derived from the *DRC* method, which assumes the existing use will continue, and on the value on the basis of the alternative use to assist it in quantifying the extent of any redevelopment potential.

- 11 Frequently, the potential for an alternative use in the event of the specialised use being discontinued can be broadly identified, but the value for that use may not be reliably determined without significant research. For example, it may require the valuer to research into the prospects of obtaining statutory consents, the conditions that would be attached to those consents, the costs of clearance, the cost of new infrastructure, etc. In such cases a simple statement that the value of the site for a potential alternative use may be significantly higher than the value derived from using the *DRC* method will be sufficient, leaving the client to issue further instructions if it requires the more detailed work to be undertaken. If *valuations* are required on alternative *assumptions* these should be clearly stated.

Value materially lower

- 12 If the valuer considers that the value of the asset would be materially lower if it ceases to be part of the going concern, this should be drawn to the attention of the client. However, there is no requirement to report that figure.

Assessing the implications of possible closure

- 13 If the client wishes to establish the impact of possible closure of a specialised facility on the value of the assets employed, it may commission valuations to reflect the 'break-up', salvage or alternative use value of the asset. This would be a separate exercise and not part of the *DRC* valuation for inclusion in the *financial statements*. Any *valuations* provided would need to be on the *special assumption* that the client had ceased operations (see **VPS 4 section 9**).

UK VPGA 1.6 Costs to be excluded

The owner's directly attributable acquisition costs or disposal costs should not be included in the *valuation* of an asset on a *fair value* basis. Where asked by the client to reflect such costs, these should be stated separately.

- 1 In determining the initial figure to be entered into the balance sheet on the acquisition of a property (the 'carrying amount'), FRS 102 requires that directly attributable acquisition costs (such as legal costs and stamp duty) where material, be added to the cost of the property itself. However, on subsequent *valuation*, such costs are not relevant to the *valuation*.
- 2 Similarly, an owner's disposal costs are not taken into account in *fair value*. Such costs may separately be taken into account if the asset is measured with reference to its *fair value* less costs to sell (if an impaired fixed asset) or at estimated selling price less costs to complete and sell (if an impaired inventory asset).
- 3 If requested to advise on these costs, the valuer should report them separately and not amalgamate them with the *fair value*, or existing use value. This is because the *valuation* should reflect the valuer's opinion of the consideration that would appear in the hypothetical sale and purchase contract (see **VPS 4**).

UK VPGA 1.7 Valuation date

Valuations for inclusion in *financial statements* are to be stated at the reporting date of the financial statement.

- 1 The *valuation date* for *valuations* prepared for inclusion in *financial statements* should be the reporting date of the financial statement.
- 2 Where a preliminary *valuation* is reported in advance of the *valuation*, it should be clearly marked as a draft and *members* are reminded that **PS 2 section 3**, particularly **paragraphs 3.10 to 3.15**, will apply.
- 3 For the treatment of events after the end of the reporting period, see UK VPGA 1.8.

UK VPGA 1.8 Events after the end of the reporting period

Where a *valuation* may be materially affected by events after the end of the reporting period, the valuer is required to refer to those events in the report and distinguish between 'adjusting' events (those that provide evidence of conditions that existed at the end of the reporting period) and 'non-adjusting' events (those that are indicative of conditions that arose only after the end of the reporting period).

- 1 Under FRS 102 section 32, an entity is required to adjust its statements to reflect adjusting events that occur between the end of the reporting period and the date when the *financial statements* are authorised for issue.
- 2 An adjusting event is one that provides evidence of conditions (favourable and/or unfavourable) that existed at the end of the reporting period. Examples might include the determination of a sale price of a property on the market or the settlement of a rent review.
- 3 Events occurring after the end of the reporting period that could not have been anticipated at that time (for example, if a property is destroyed by fire) are classified as 'non-adjusting events'. These are not to be reflected in any amendment to the *valuation* figure.
- 4 Where non-adjusting events could nevertheless influence the economic decisions of users taken on the basis of the *financial statements*, the entity is required to disclose the nature of the event and provide an estimate of its financial effect, or make a statement that such an estimate cannot be made.
- 5 Any request from a client to adjust a *valuation* prepared for inclusion in a financial statement to reflect new evidence needs to be treated carefully by the valuer. An adjustment should only be made if the valuer is satisfied that this evidence is truly reflective of a change in the market and/or is a matter that they had not already taken into account. The general principles set out in **PS 2 section 3** are relevant here.

UK VPGA 1.9 Leasehold interests and their classification

Where the interest to be valued is leasehold, it is vital that the exact nature of the interest is clarified with the client as appropriate and then confirmed and recorded in the *terms of engagement* and report.

- 1 It should be noted that UK GAAP and IFRS diverge on the treatment of leases. The changes being introduced under IFRS 16 (effective for annual reporting periods beginning on or after 1 January 2019) have not yet been taken up by UK GAAP. However, valuers should be aware that IFRS 16 will apply to FRS 101 – Reduced Disclosure Framework, which adopts the recognition, measurement and disclosure requirements of EU-adopted IFRS.

Classification of leases

- 2 FRS 102 section 20 paragraph 4 determines the classification of a lease. The overarching principle behind the determination of whether a lease is a ‘finance lease’ or an ‘operating lease’ is correctly establishing who bears the risks and rewards of ownership of the asset subject to the lease. It is therefore about the substance of the transaction and not the form of the contract.
- 3 When, substantially, all the risks and rewards incidental to ownership of the asset are transferred from the lessor to the lessee, this will give rise to a finance lease. The asset will appear on the company’s balance sheet (statement of financial position) together with a corresponding finance lease creditor. Where the risks and rewards of ownership remain with the lessor, the lease is classified as an operating lease and rentals are charged to profit or loss as incurred.
- 4 FRS 102 section 20 offers five examples (paragraph 5) and three indicators (paragraph 6) of situations that individually, or in combination, would normally lead to a lease being classified as a finance lease. However, it is important to understand that the indicators are not exhaustive.

Lessee accounting – finance leases

- 5 Once a lease has been determined as a finance lease, on initial recognition Section 20 requires a lessee to recognise an asset, with an equivalent liability, at an amount equal to the *fair value* of the leased asset or, if lower, the present value of the minimum lease payments, which are determined at the start of the lease.
- 6 The asset that is recognised is subsequently accounted for in the same way as an owned asset. That is to say, it may be measured using the cost model or a *fair value* model according to its nature.

Lessor accounting – finance leases

- 7 Lessors recognise assets that are subject to finance leases in their balance sheet (statement of financial position) as financial assets. These financial assets cannot typically be revalued for accounting purposes.

Operating lease accounting

- 8 Leases classified and accounted for as operating leases may not require *valuation*. One exception is where they are being valued as part of a purchase price allocation upon a business combination.
- 9 Where an operating lease interest is held at a rack rent, or has a short term before expiry or before a review date to full rental value, the value (or in certain cases, the liability or negative value) to the business may not be material.
- 10 The valuer should discuss with the reporting entity whether or not these specific leasehold interests are to be valued. If they are omitted from a *valuation* of an entire portfolio, the report needs to contain a reference to their omission on the grounds that their values are not material.

Group leases

- 11 Where a property is the subject of a lease or tenancy agreement between two companies in the same group, on arm's length terms and in accordance with normal commercial practice, it is acceptable to take account of the existence of that agreement when valuing the leased property.
- 12 However, on consolidation of the results and balance sheets of those companies into group accounts, the existence of the lease should be disregarded and the property valued as if occupied by the group company, but subject to other leases or licences to third parties.
- 13 If asked to produce a *valuation* that takes account of an inter-company agreement the valuer should disclose in the report the relationship between parties to the agreement, and should draw attention to the fact that a *valuation* taking full account of the lease would not be suitable for adoption in group accounts.

UK VPGA 1.10 Depreciation accounting

The following material provides information and guidance on the accounting concepts and practices governing the consideration of depreciation and associated apportionments for the purposes of *financial statements* prepared under UK GAAP. Similar accounting principles are also applied under IFRS.

Valuers should be aware that entities reporting under FRS 101 (Reduced Disclosure Framework) should in general follow the principles and *basis of value* of IFRS for accounting measurement.

Depreciation – an overview

- 1 Depreciation, in a financial reporting context, should not be confused with depreciation adjustments made in the course of *valuation*, for instance in a *depreciated replacement cost* valuation (see UK VPGA 1.5). Depreciation for accounting is the reduction of the stated value of an asset in a financial statement staged over its 'useful life'. Components of an asset that have a cost that is significant in relation to the whole are required to be depreciated

separately. Components that have a similar useful life and that are depreciated in a similar manner may be grouped. In order to establish the appropriate depreciation charge it is necessary to establish the useful life of the asset (or a component thereof) and the 'depreciable amount'. The depreciable amount is the difference (if any) between the 'carrying amount' and the 'residual value'. These terms are explained in detail in paragraph 19. While the valuer may be called on to provide input, it is the accountant who calculates the provision for depreciation based on the 'carrying amount' of the asset, or an apportionment if required. Impairment of the asset will also be considered by the accountant as appropriate (see UK VPGA 1.11).

- 2 More specifically, for the purpose of financial reporting depreciation refers to a charge made against income to reflect the use of the asset over its 'useful life' (defined in FRS 102 and IAS 16 as 'the period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity'). This may not be the same as the asset's economic life applied for valuation purposes, which is the number of years in which the asset returns more value to the owner (or successor for the same purpose) than it costs to own, operate, and maintain. A difference between the two can and will arise if the asset management policy of an entity involves the disposal of assets after a specified time or after the consumption of a specified proportion of the future economic benefits embodied in the asset.
- 3 While this guidance focusses particularly on land and buildings, the same general principles apply equally to plant and equipment.
- 4 FRS 102 (and IAS 16) requires that depreciation should be allocated on a systematic basis over the future useful life of a fixed asset. The depreciation method adopted should reflect, as fairly as possible, the pattern in which the asset's economic benefits are consumed by the entity.
- 5 The future useful life of an asset is described in terms of either time periods or production/other measurable units. All buildings have a limited life due to physical, functional and environmental changes that affect their useful life to the business. While routine servicing and repairs can be reflected, material extension of the useful life of the asset arising from capital expenditure on significant refurbishment or the replacement of components must be disregarded until such time as that expenditure is incurred.
- 6 As depreciation is normally only applied to the building element, an apportionment of the total value of the asset may or will be required – see paragraph 21.
- 7 In normal circumstances depreciation is not applicable to freehold land. Exceptions to this include land that has a limited life due to depletion (for example, by the extraction of minerals), or that will be subject to a future reduction in value due to other circumstances. One example would be where the present use is authorised by a planning permission for a limited period, after which it would be necessary to revert to a less valuable use.

- 8 Leasehold assets must, by their nature, have a limited life to the lessee although the unexpired term of a lease may exceed the life of the buildings on the land. Any contractual or statutory rights to review the rent, or determine or extend a lease, should also be considered.
- 9 The assessment of the remaining useful life of the asset and accounting depreciation are the responsibility of the directors of the entity (company), or their equivalent in other organisations. However, the valuer may expect to be consulted by the entity on matters concerning remaining physical and economic life, which are relevant to the assessment.
- 10 The valuer may also on occasion be asked to provide useful life figures for the entity's consideration subject to being supplied with information on future operational plans for the asset.

Useful life

- 11 As explained in paragraph 2, the future useful life of a tangible fixed asset is the period during which the entity in whose accounts the asset is carried expects to derive economic benefit from that asset, reflecting the remaining economic service delivery potential of its constituent components that are in situ on the relevant *valuation date*. As future replacement of components is not recognised, this is not the same as the total period of time an entity intends to remain in occupational use of an asset, sometimes referred to as 'service delivery lifespan' or 'design life'. If there is an expectation that the asset will be sold before the end of its physical or economic life, the useful life will be shorter. Useful life for accounting depreciation cannot normally be longer than the physical or economic life that is applied for valuation purposes and may well be shorter.
- 12 The limited circumstances in which the remaining useful life of an asset may exceed its remaining economic life is where the entity considers some of an asset's shorter life components to be not significant for accounting purposes and can be treated as immaterial to the overall asset for accounting depreciation purposes. Consequently, because subsequent expenditure on their replacement can be treated not as capital spend but instead charged to revenue in the year in which it occurs, these components can be given a longer useful life that reflects in advance their future replacement. However, the consequent impact on the asset's overall level of depreciation and overall remaining useful life will always be relatively small; if there were to be a substantial impact, it would indicate that those components were not in fact immaterial in terms of their individual or cumulative impact on the overall asset, either in cost or lifespan terms, and therefore should not have been so treated.
- 13 Many of the concepts used by a valuer to determine obsolescence adjustments when reaching a view as to the remaining economic life for valuation purposes are the same as those used to determine the remaining useful life for accounting depreciation purposes, but the exercises remain distinct. Only the latter will reflect the entity's policy on future disposals.

- 14** Where asked to provide information to assist the entity to determine the useful life of an asset, the valuer will need to take into account:
- Physical obsolescence – the age, condition and probable costs of future maintenance (assuming prudent and regular maintenance) but not capital expenditure – see paragraph 5.
 - Functional obsolescence – suitability for the present use, and the prospect of its continuance or use for some other purpose by the business. In the case of buildings constructed or adapted for particular uses, including particular industrial processes, the valuer will need to consult with the directors to ascertain their future plans.
 - Economic obsolescence – a loss in value to a property caused by factors external to the property itself.
 - Environmental factors – existing uses need to be considered in relation to the present and future characteristics of the surrounding area, local and national planning policies, and restrictions likely to be imposed by the planning authority on the continuation of these uses.
 - Information supplied by the entity on its policy for future disposals.
- 15** The policy on future disposals, and in particular whether there is any policy or intention to dispose of assets before the end of their natural economic benefits lifespan, is a matter for the reporting entity and not for the valuer, even though the valuer may provide input.
- 16** For most multi-block sites comprising a number of separate buildings, for example a school, hospital or military base, each building will usually have its own remaining useful life. This recognises that piecemeal redevelopment is usually possible and not unusual. In circumstances where there is a strong interdependency present, such as may occur in an industrial process factory complex, for example oil refinery buildings, they may be grouped and a single useful life allocated to all buildings within each group. Such an approach can be justified by the fact that it is normally uneconomic to carry out piecemeal redevelopment in these circumstances and the life of individual buildings can usually be extended within reasonable limits, by a higher standard of maintenance or minor improvement. It would not be appropriate to group buildings if they are used for different industrial processes with different accommodation requirements, or where the entity expressly requires each building to be considered individually.
- 17** If consulted on the remaining useful life of leasehold assets, the valuer will need to consider the duration of the lease, any options to determine or extend, the date of the next rent review and whether this is to the full, or a proportion of, market rental value.
- 18** Where the valuer is requested to provide advice on the remaining useful life of an asset for accounting depreciation purposes, the use of 'banding' will not normally be sufficient for the entity's purposes. Achieving appropriate accuracy can however be difficult and it may in some instances be useful to seek the assistance of a building surveyor.

The depreciable amount

19 The following definitions from FRS 102 are relevant:

- the carrying amount is ‘the amount at which an asset or liability is recognised in the statement of financial position’ (in IAS 16 ‘the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses’)
- the depreciable amount is ‘the cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value’ (in IAS 16 the explanatory words in brackets are omitted) and
- the residual value is the ‘estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life’ (in IAS 16, the definition is the same).

20 An entity may ask the valuer to provide an estimate of residual value in order to calculate the depreciable amount. It should be determined using a basis consistent with that used to determine the carrying amount of the asset. For example, where an asset is valued at *fair value*, the residual value should also be measured on a *fair value* basis. Where the residual amount is material, it should be reviewed at the end of each accounting period.

21 Where the ‘useful life’ of the asset is considered to be equal to the physical or economic life that is applied for valuation purposes, the valuer will need to consider whether the residual value will relate to a bare site value less relevant costs, or whether the existing buildings or other site improvements will have some continuing value, for example, for refurbishment.

22 In other cases, where the asset will become surplus or be disposed of before the end of its physical or economically useful life, the residual value will reflect the continuing life of the asset beyond the date at which the directors anticipated disposal.

Depreciation of a wasting asset

23 Provision of depreciation for a wasting asset is not primarily the concern of the valuer. Generally, the depreciable amount will be the difference between the present and the ‘after-use’ value, but associated costs, such as restoration costs, may also need to be taken into account. The future useful life will be assessed by the entity once it is advised of the life that the valuer has assumed for the purposes of the *valuation*.

Apportionment between land and buildings – general

24 FRS 102 section 17 paragraph 8 (and IAS 16 paragraph 58) requires land and buildings to be accounted for separately, whether or not they were purchased separately. Therefore, where a property is carried in the balance sheet at cost or has been the subject of a past or present *valuation*, the valuer will need

to ascertain the amount applicable to the buildings and to the land, by an apportionment of the cost or *valuation*.

- 25 The purpose of the apportionment – the removal of the land element from the *valuation* so as to depreciate only the building element – should be kept firmly in mind. Site works, such as roads, fences, paved areas and the like, are normally included in the value of the buildings and do not, therefore, feature in the apportioned land *valuation* figure.
- 26 At the end of the economic life of the buildings, the full potential of the site for redevelopment within the existing use would be realisable. However, allowance would have to be made for any material costs associated with demolition, site clearance or contamination treatment.
- 27 When providing figures for the purposes of accounting depreciation, the valuer will need to emphasise in the report that the resultant figures are apportionments derived solely for accounting purposes, and that they do not represent formal *valuations* of the individual elements.
- 28 The apportionment can be made in one of two ways:
- a) By deducting, from the cost or *valuation* of the asset, the value of the land for its existing use at the relevant date. In effect this calculates the residual value, unless the valuer believes that there is an additional residual value element in the buildings or site improvements. It is not appropriate to consider alternative uses unless they are reflected in the value at which the property has been included in the balance sheet.
 - b) Where there is little or no evidence of land values, greater reliance will have to be placed on making an assessment of the net current replacement cost of the buildings at the relevant date. This figure will be derived from the gross current replacement cost, which is then reduced to the written-down cost or net current replacement cost to reflect the value of the asset to the business. In effect this is a direct calculation of the depreciable amount.
- 29 Gross current replacement cost is defined as either:
- a) the actual cost of constructing the asset if this was incurred close to the relevant date or
 - b) the estimated cost of erecting the building, or a modern substitute building, at prices current at the relevant date. This figure may include fees, any irrecoverable VAT, finance charges appropriate to the construction period, if required by the accounting policy, and other associated expenses directly related to the construction of the building. A definition of the directly attributable costs can be found in FRS 102 section 17 paragraph 10 (and IAS 16 paragraphs 16-17).
- 30 Net current replacement cost is the gross current replacement cost, reduced to reflect the physical and functional obsolescence and environmental factors, in order to arrive at the value of the building to the business at the relevant date.
- 31 The relevant date is the effective *valuation date* or date of apportionment.

- 32 In the case of leasehold land and buildings, the total value will be the depreciable amount, except where the lease is likely to continue beyond the remaining useful life of the asset.
- 33 The valuer should make it clear that in assessing the depreciable amount, the availability of government grants should be ignored, leaving the entity to make any appropriate adjustments.
- 34 The inclusion or exclusion of plant and equipment in a *valuation* of land and buildings should normally follow VPGA 5, *Valuation of plant and equipment*.

Apportionments in respect of property that comprises only part of a building

- 35 Special care is recommended in dealing with the apportionment of value in respect of property that comprises only part of a building (of particular relevance in Scotland), with the remaining parts being separately owned by one or more other proprietors. This need for care is particularly relevant in considering the residual amount representing the value of land.
- 36 It is commonplace in Scotland for premises to be owned in perpetuity, even though those premises do not exclusively occupy the land on which they are situated. A building can contain various proprietors, and it is quite usual for this type of ownership to carry with it a common interest on the part of the various proprietors in certain sections of the building out with the actual premises occupied by them.
- 37 The presence (or otherwise) of other proprietors within the building, and the existence of common interest on their part, should be established as part of the examination of titles and other documentation prior to the completion of the *valuation*.
- 38 The valuer dealing with an apportionment of value in cases where common interest exists has to judge to what extent, if any, the apportionment and the residual amount in particular should be adjusted to allow for that common interest on the part of other owners in the building.
- 39 When dealing with property where there are other proprietors in the building, and where rights of common interest might exist, the apportionment of the *valuation* of the asset for depreciation purposes should be carried out by calculating the net current replacement cost of the building.
- 40 There might be cases where complications are encountered in defining or ascertaining the rights of the other proprietors in the building, but it is essential that if common interest exists, its effect is taken into account. If this is done, the valuer should be able to arrive at an apportionment where the depreciable amount fairly reflects the part of the *fair value* or cost of the whole property at the time it was acquired or valued. This can be expressed at that time as the value to the business of the buildings on the land. Similarly, the residual amount should properly represent the element of land value that could be realised.

Apportionments in relation to property valued as an operational entity

- 41 Where the *valuation* relates to property valued fully equipped as an operational entity, the *valuation* figures may need to be apportioned between:
- land
 - buildings and
 - fixtures and fittings.
- 42 In relation to trading potential, recognised accounting practice suggests that it would not be appropriate to treat that associated with the property as a separate component of the value of the asset if its value and life were inherently inseparable from that of the property (see also VPGA 4). The *valuation* of a property valued as an operational entity reflects the trading potential that the land and buildings, together with the trade inventory, can sustain in the hands of a reasonably efficient operator, assuming availability of licenses, etc. Trading potential is a property attribute that will exist within the land and buildings whether or not operational, though the impact on value will vary dependent on the facts (and whether trade has been established or not at such point). Trading potential included in the *valuation* is not an asset considered capable of separate identification or *valuation*. As a property attribute it is intrinsic to the land and the buildings and will be reflected in the values apportioned to those assets for UK GAAP purposes. The sums apportioned must comprise the total value.

Componentisation

- 43 FRS 102 section 17 paragraph 16 (and IAS 16 paragraphs 43-49) states: 'If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life. [Other assets shall be depreciated over their useful lives as a single asset].' Entities have a degree of flexibility as to their policy on what is termed componentisation, and although it will have no impact on the level of *valuation* reported by the valuer, the latter may be called on to assist in the componentisation process by apportioning on a cost basis their non-land *valuation* figures between components or component groupings and by recommending useful lives for each.
- 44 The mandatory requirements under FRS 102 (and IAS 16) are to depreciate separately each part of an asset with a cost that is significant in relation to the cost of the total asset. Those significant parts with similar remaining useful lives can then be grouped together. The remaining parts are also grouped together with approximation techniques applied to reflect the parts' differing economic benefit consumption patterns to arrive at a single overall estimate of appropriate useful life which can be applied to this remainder for accounting depreciation purposes.
- 45 As the extent of componentisation adopted by the entity may or will impact on what information is collected on *inspection*, when providing assistance a

dialogue with the entity at the outset is essential to establish their requirements as regards:

- their materiality threshold level, below which an asset need not be componentised and
 - their policy as to what constitutes cost significant.
- 46** It may usefully be noted that under IAS 16 paragraph 47, an entity can also elect to exercise their discretion and request componentisation of as many different parts of an asset as they wish, regardless of whether they are cost significant or have different remaining useful lives. This can give rise on occasion to requests for the depreciable amount to be fully apportioned between multiple different components, although it is questionable whether this has any material impact on improving the accuracy of the asset's total accounting depreciation figure.
- 47** For a non-specialised asset that has not been valued on a cost basis, an apportionment into two groupings, i.e. structure and services, may suffice. The particular request may be influenced by any additional use to which the entity intends to put out the figures, such as asset management or planned maintenance.
- 48** It is considered that where the discretionary approach is required by the entity, it will usually be sufficient to split the depreciable amount of a specialised asset into a maximum of perhaps five or six component groupings, such as:
- a substructure
 - superstructure
 - finishes
 - fittings and fixtures
 - engineering services and
 - external works.
- 49** In each instance, the resources devoted to componentisation could usefully have regard to the materiality of the effect on the accuracy of the overall asset depreciation and any additional use to which the entity intends to put the figures, such as asset management or planned maintenance.

UK VPGA 1.11 Impairment of assets

Overview

- 1** FRS 102 section 27 (and IAS 36) covers the 'impairment' of assets, a situation that arises where the 'carrying amount' (i.e. the figure at which the asset appears in the relevant financial statement) exceeds the 'recoverable amount' (i.e. the figure that could be recovered through the continuing use or sale of the asset). This could arise where, for whatever reason, an asset's *market value* has

declined significantly more than would be expected as a result of the passage of time or normal use or trading.

- 2 The impairment loss that the reporting entity must then recognise is the amount by which the 'carrying amount' of the asset exceeds:
 - in the case of inventories, its selling price less costs to complete and sell or
 - in the case of other assets, its recoverable amount (which is the higher of (1) the asset's *fair value* less costs to sell and (2) its value in use).
- 3 The 'value in use' is defined as the present value of the future cash flows expected to be derived from an asset. The use of the word 'value' in the expression 'value in use' does not mean that a valuer is necessarily competent to determine the figure as there are particular rules in FRS 102 that need to be applied. The term should therefore not be regarded as an alternative *valuation* basis for fixed assets and should not be used by valuers when preparing *valuations*.
- 4 It should be noted that *investment property* measured at fair value, and also biological assets related to agricultural activity measured at fair value less estimated costs to sell, are not covered by FRS 102 section 27.

UK VPGA 1.12 Publication statement

Valuers are reminded of the mandatory requirement in **VPS 3 section 2 paragraph 2.2(j)** that where the purpose of the report requires a published reference to it, the valuer has to provide a draft statement for inclusion in the publication.

- 1 The following examples are intended to be illustrative only of the degree of detail required for published references to *valuation* reports. The valuer will in all cases need to have due regard to the requirements of **VPS 3 section 2 paragraph 2.2(j)** and produce a statement that properly reflects the scope and nature of the asset valued.

2 Valuation by an external valuer

The company's freehold and leasehold properties were valued as at 1 December 2017 by an external valuer, John Smith, FRICS of Alpha Chartered Surveyors. The valuations were in accordance with the requirements of the *RICS Valuation – Global Standards 2017* (which incorporate the *International Valuation Standards 2017*) and the *UK national supplement* and FRS 102 *The Financial Reporting Standard* applicable in the United Kingdom and Republic of Ireland (and any other regulatory requirements).

The valuation of each property was on the following bases of value and *assumptions*:

- owner-occupied property: valued to fair value assuming that the property would be sold as part of the continuing business

- *investment property*: valued to fair value (FRS 102 section 16 or IFRS 13) assuming that the property would be sold subject to any existing leases

Note – measurement at fair value in FRS 102 is only required if this can be established ‘without undue cost or effort’, and if this is not possible the property is treated as if it were normal property, plant and equipment (that is, held at cost less depreciation) as set out in FRS 102 section 17.

- surplus property and property held for development: valued to *fair value* assuming that the property would be sold with vacant possession in its existing condition.

The valuer’s opinion of *fair value* was primarily derived using (include as appropriate):

- comparable recent market transactions on arm’s length terms
- *depreciated replacement cost approach*, because the specialised nature of the asset means that there are no market transactions of this type of asset, except as part of the business or entity
- an estimate of the future potential net income generated by use of the property, because its specialised nature means that there is no market-based evidence available.

Similar comments may be appropriate where the valuation is of plant and equipment or mineral bearing land.

A full and comprehensive statement regarding disclosures (agreed with the entity and recorded in the *terms of engagement*) should be made in accordance with **VPS 3** and **UK VPS 3.2**.

3 Valuation by an internal valuer

The statements will essentially be the same as those for *valuations* by an *external valuer*, except for the following variations of the first sentence:

- The company’s freehold and leasehold properties were valued by an internal valuer, John Smith FRICS, the company’s Property Director, as at 1 December 2017.
- The company’s freehold and leasehold properties were valued as at 1 December 2017, by the directors in conjunction with the company’s own professionally qualified staff.

Where appropriate, at the end of the statement, the following variation may be included:

- A representative sample of properties was also valued on the same basis by external valuer, ABC Chartered Surveyors, who confirmed that values proposed by the company’s professionally qualified staff are at level(s) consistent with its own figures.

UK VPGA 2 Valuations for other regulated purposes

UK VPGA 2.1 Valuation for listings and prospectuses

Valuation reports for inclusion in prospectuses and circulars to the shareholders of UK companies should be prepared in accordance with the guidance below.

Valuations for this purpose are regulated purpose *valuations* (see **UK VPS 3**) and the various disclosure requirements will apply.

Valuers are reminded that responsibilities to third parties, whether existing shareholders or potential investors, arise as described below and that in those circumstances they are precluded from capping or limiting their liability.

- 1 In the UK, the Financial Conduct Authority (FCA) is the competent authority for listing pursuant to Part VI of the *Financial Services and Markets Act 2000* and is responsible for:
 - the Prospectus Rules, which set out rules and guidance for companies seeking FCA approval to publish a prospectus, originally pursuant to EU Directive 2003/71/EC ('the Prospectus Directive' (PD)) and European Commission Regulation 809/2004 ('the PD Regulation') and
 - the Listing Rules, which set out rules and guidance applicable to companies admitted, or seeking admission, to the Official List of the FCA (UK-listed companies) and which include, among other things, rules governing the contents of circulars issued by UK-listed companies to their shareholders.

Valuers are reminded that the legislative and regulatory framework is extensive and will continue to evolve – the references above are not intended to be comprehensive.

- 2 UK VPGA 2 is supplementary to **VPS 3**. It does not replace **VPS 3**, but provides guidance on the content of reports prepared for this purpose. Where the *valuation* is of a portfolio of properties, VPGA 9 is relevant.
- 3 Where a company is issuing a publication under either the Prospectus Rules or the Listing Rules, there are specific requirements regarding the content of any valuation report included in that publication which derive from the 5th edition of the RICS Red Book. It is recognised that the reports in their entirety may be substantial documents and therefore in certain circumstances, and at the discretion of the UK Listing Authority, the key content may be published in a condensed form, though the full report must still be available on display for those wishing to access it. A condensed report must still provide sufficient information to enable potential investors to make an informed decision. It will also need to be distinguished from a publication statement under **VPS 3 section 2 paragraph 2.2(j)**.

Reports for inclusion in prospectuses

- 4 Property companies seeking FCA approval, under the FCA Prospectus Rules for the publication of a prospectus, must include a property valuation report by an expert valuer in the prospectus. However, the report may be in a condensed form. Property companies are defined as those issuers whose principal activity is the purchase, holding and development of properties for letting and retention as an investment.
- 5 A condensed valuation report may also be included when the prospectus relates to a 'property collective investment undertaking', which is a collective investment undertaking whose investment object is the participation in the holding of property long term.

Reports for inclusion in circulars

- 6 When a UK-listed company proposes an acquisition or disposal of property, and the transaction is classified under the FCA Listing Rules as a class 1 transaction (where the size of the transaction is 25% or more of the value of the company), the company must seek shareholder approval. It must include a property valuation report by an expert valuer in the circular to shareholders. The company decides the classification of the transaction, but full definitions may be found in the FCA Listing Rules.
- 7 A UK-listed company must also include a property valuation report where it makes significant reference to the value of property in a class 1 circular to shareholders.

Status of the valuer

- 8 The valuation report is to be prepared by an independent expert. An *external valuer* as defined in the *RICS Valuation – Global Standards 2017 Glossary* meets this requirement.
- 9 The independent expert will need to disclose any material interest in the issuer. A material interest includes the following circumstances:
 - ownership of securities issued by the issuer or any company belonging to the same group, or options to acquire or subscribe for securities of the issuer
 - former employment of, or any form of compensation from, the issuer
 - membership of any of the issuer's bodies and
 - any connections to the financial intermediaries involved in the offering or listing of the securities of the issuer.
- 10 It is the issuer's responsibility to consider if the information provided will result in a material interest, taking into account the type of securities offered. The issuer is also responsible for clarifying that these securities have been taken into account, in order to fully describe the material interest (if any) of the expert, to the best of the issuer's knowledge.

- 11 The valuer and the valuer's staff will need to be aware of the *Criminal Justice Act 1993*, Part V – Insider dealing, and the valuer is responsible for ensuring compliance with the law. In cases of doubt, legal advice should be sought.
- 12 A valuer who attends meetings with clients and other advisers (such as lawyers, stockbrokers, accountants and investment bankers) should be aware of assuming any role that could be regarded as that of a 'financial adviser' within the provisions of the *Financial Services and Markets Act 2000*. If this were the case, the valuer would need to be a registered *member* of a relevant professional regulatory organisation. Although the role of a valuer would not normally fall within the definition, an extended involvement could lead to this – for example, in providing forecasts or commenting on them. If valuers have any doubt about their position, they should take legal advice, preferably before attending any meeting.

Valuation requirements: the Prospectus Rules

- 13 The *basis of value* for the FCA Prospectus Rules is *market value*.
- 14 Where the issuer is a property company resident in the UK, a valuation report must be included in the prospectus, but – as referred to in paragraph 3 – it can be in a condensed form.
- 15 The effective *valuation date* can be up to one year prior to the date of publication of the prospectus, provided that the issuer affirms in the prospectus that no material changes have occurred since the *valuation date*. If the valuer has previously provided a *valuation* for accounting purposes and the date of that *valuation* is within the time limit, the condensed report will relate to that valuation and no additional valuation is required.
- 16 Where the issuer is not able to affirm that no material changes have occurred, the effective *valuation date* must be at the latest practical date. Where the material change relates to only part of the issuer's portfolio, only that part needs to be valued at the latest practical date.
- 17 Where the report to be published includes information considered by the issuer to be commercially sensitive, the issuer may decide to delay disclosure of that information, which is acceptable, subject to compliance with the applicable provisions of the Market Abuse Regulation, provided its omission will not mislead the public. In such cases the valuer may amend the report appropriately, but will need to make a reference to the omission and state that this has been done on the express instructions of the issuer.

Valuation requirements: the Listing Rules

- 18 The *basis of value* for the FCA Listing Rules is *market value*.
- 19 Where the property holdings are very extensive, the valuation report to be included in the publication may be in a suitably condensed format.

- 20 The effective *valuation date* is required to be within 42 days of the date of the circular. The report is to be dated the same day as the circular is issued, or the same day as any other documents that will be incorporated.

Framework for condensed reports

- 21 A condensed report need not include descriptive details of the properties, but will need to include certain minimum information. Table 1 reproduces the minimum reporting requirements set out in **VPS 3** with which valuers will be familiar together with a number of additional matters specific to the preparation of reports under the Prospectus Rules and Listing Rules (referred to simply as the 'Rules'), with the intention of forming a 'checklist' that valuers may find useful:

VPS 3 heading	Comment
a) Identification and status of the valuer	<p>The report will need to confirm the valuer is acting as an <i>external valuer</i> and as an independent expert under the Rules.</p> <p>The statement that the valuer has the knowledge, skills and understanding to undertake the <i>valuation</i> competently should be made in this section.</p> <p>As this is a regulated purpose <i>valuation</i>, the disclosures highlighted in UK VPS 3 will need to be included.</p>
b) Identification of the client and any other intended users	The report will need to be addressed to the client, or its representatives; and as appropriate to the sponsor, underwriter[s], etc.
c) Purpose of the <i>valuation</i>	This may, where appropriate, include a comment that the report is a condensed version prepared for the relevant Rules.
d) Identification of the asset[s] or liability[ies] to be valued	A brief overview of the asset[s] being valued is required, i.e. the number of interests involved, whether freehold or leasehold, type [e.g. retail, industrial, leisure], location [e.g. throughout UK, in central London], address[es] and whether held as investment[s], for development or for owner occupation.
e) Basis[es] of value adopted	The basis of valuation is <i>market value</i> .
f) <i>Valuation date</i>	This needs to be within one year of the publication date for a prospectus and 42 days for a circular.
g) Extent of investigation	The report will need to record the date[s] and extent of the <i>inspection[s]</i> undertaken.

VPS 3 heading	Comment
h) Nature and source(s) of the information relied upon	<p>The report should be explicit as to what information has been provided [and best practice would be to record any information that was requested but not provided].</p> <p>Valuers should also include any additional information that has been available to, or established by, them that they believe to be crucial to the reader's ability to understand and benefit from the <i>valuation</i>.</p>
	<p>All <i>assumptions</i> need to be stated together with any reservations that may be required [see VPS 4 section 8]. Where property is located in more than one state, any variation of <i>assumptions</i> in each state must be made clear.</p> <p><i>Special assumptions</i> [VPS 4 section 9] will need to be clearly stated and confirmed as agreed with the client. In such instances, the value without such <i>special assumptions</i> must also be reported.</p> <p>Where the <i>valuation</i> reflects marketing constraints [VPS 4 section 10], restricted information [VPS 3 section 2 paragraph 2(h)] or limited <i>inspection</i> [VPS 3 section 2 paragraph 2(g)], the report will need to include full particulars.</p> <p>Any <i>departures</i> from the standards will need to be stated and explained [PS 1 section 6].</p>
j) Restrictions on use, distribution and publication of the report	<p>The condensed report will be published in its entirety, but it may be proper to reserve the valuer's rights to the material being reproduced or referred to in any other document.</p> <p>For prospectuses, the report should not include any disclaimer to the effect that liabilities to the <i>third parties</i> are excluded.</p> <p>For circulars, the report may include a disclaimer to the effect that liabilities to <i>third parties</i> are excluded but may not disclaim responsibility to the company, its directors or its shareholders.</p> <p>A statement that the report may not be used for any other purpose than that stated may be included, provided that the purpose of the valuation report is clearly stated in the report as being for inclusion in the issuer's prospectus.</p>
k) Confirmation that the <i>valuation</i> has been undertaken in accordance with the IVS	<p>Where the report is for inclusion in a prospectus and the company has adopted IFRS, confirmation is also required that the <i>valuation</i> accords with these standards and with International Valuation Standards.</p>

VPS 3 heading	Comment
l) <i>Valuation approach and reasoning</i>	No additional comment – this is as per VPS 3 section 2 paragraph 2(l) .

VPS 3 heading	Comment
<p>m) Amount of the <i>valuation</i> or <i>valuations</i></p>	<p>The <i>valuations</i> are to be summarised in the same categories determined under (d), identifying separately freeholds and leaseholds. Any negative values (liabilities) will need to be reported separately.</p> <p>The aggregate values and numbers of properties in each category are to be stated. Where the value of any individual property amounts to more than 5% of the aggregate <i>valuation</i>, the property will need to be specifically identified and the individual value disclosed.</p> <p>The currency that has been adopted must be clearly stated and, if translated into a currency other than that of the country in which the asset is located, the basis of the exchange rate.</p> <p>It may be appropriate to state that further details of individual properties are available for <i>inspection</i>, or on request, if this has been agreed with the client.</p> <p>Subject to any agreement that certain property information is to be kept confidential, the report should not omit information that would assist the reader to interpret the <i>valuations</i>. The following disclosures may therefore need to be made, as appropriate:</p> <ul style="list-style-type: none"> • inclusion of a statement about the extent to which the values are supported by market evidence, or are estimated using other <i>valuation</i> techniques (which should be disclosed) because of the nature of the property, limited transactions or any combination of these factors • where <i>special assumptions</i> have been made, alternative figures – such as a <i>valuation</i> without the <i>special assumption</i> – may be required to illustrate their effect and • for property in the course of development, making clear that the <i>market value</i> will reflect the value of the completed property, assuming that it had been completed at the <i>valuation date</i>, less the anticipated costs to complete, including the costs of finance and other holding costs. <p>Statements may also need to be made as to whether or not:</p> <ul style="list-style-type: none"> • any allowance has been made for liability for taxation that may arise on disposal, whether actual or notional • the <i>valuation</i> reflects costs of acquisition, disposal or reorganisation.
<p>n) Date of the valuation report</p>	<p>The <i>date of the report</i> is to be the same as the date of issue, or such other date that is the same as any other documentation to be published.</p>

VPS 3 heading	Comment
o] Commentary on any material uncertainty in relation to the <i>valuation</i> where it is essential to ensure clarity on the part of the valuation user	This requirement is mandatory only where the uncertainty is material. For this purpose, 'material' means where the degree of uncertainty in a <i>valuation</i> falls outside any parameters that might normally be expected and accepted.
p] A statement setting out any limitation on liability that have been agreed	See above. Great care is required to ensure that any limitations on liability within the report – summarised or otherwise – are compliant with the FCA Listing Rules and Prospectus Rules.

Table 1: Minimum reporting requirements

- 22 Valuers requiring further information about the regulatory requirements may access the full text of the rules through the **FCA website**.
- 23 Valuers may be requested to provide *valuations* for inclusion in an application for admission to the Alternative Investment Market (AIM). On initial application, the company is required only to reveal the value of property as shown in its latest accounts. The values do not have to be current unless they are shown as such in the accounts. Where the valuer is requested to provide current *valuations*, these will need to be provided in accordance with the particular accounting standards that the company has adopted. For that purpose, either VPGA 1 or UK VPGA 1 will apply. However, where the company has been listed on the AIM for at least 18 months, the publications will need to comply with the FCA Rules and these *valuation* guidelines.

UK VPGA 2.2 Takeovers and mergers

Valuations in connection with takeovers and mergers have to be provided in accordance with the Takeover Code (the Code) issued by the Takeover Panel.

Valuations for this purpose are regulated purpose valuations (see **UK VPS 3**), and accordingly the various associated disclosure requirements will apply. Valuers' attention is expressly drawn to the fact that certain requirements imposed by the Code apply directly to them.

- 1 The Takeover Panel (the 'Panel') is an independent body, established in 1968, whose main functions are to issue and administer the Takeover Code (the 'Code'), and to supervise and regulate takeovers and other matters to which the Code applies, in accordance with the general principles and rules it sets out. The Code is designed principally to ensure that shareholders are treated fairly and are not denied the opportunity to decide on the merits of a takeover, and that shareholders of the same class are afforded equivalent treatment. The Code provides an orderly framework within which takeovers are to be conducted and promotes, in conjunction with other regulatory regimes, the integrity of the financial markets.
- 2 Valuers providing valuation advice need to be alert to the fact that the Code imposes certain obligations on them, and should only agree to act where they fully understand the nature of the obligations and the potential consequences of failing to discharge them properly. This is because the Code applies to all who advise on matters to which the Code applies, and under Rule 29 the valuer is considered to be an 'adviser'. Furthermore, all the valuer's colleagues (professional, administrative and secretarial) who provide assistance may also be considered to be advisers; other partners and employees not involved are normally excluded.
- 3 Before accepting instructions, it is essential that the valuer checks the extant version of the Code to ensure that all its requirements are met (see www.thetakeoverpanel.org.uk).
- 4 A register of the holdings of securities that the valuer and colleagues have in the company, or companies, concerned will need to be maintained, including 'nil' returns and the holdings of spouses and dependent children. The valuer should advise the client of the totals or of any nil return.
- 5 No dealings in shares and other securities, or rights over these, may be made before or during the offer. The restrictions of the *Criminal Justice Act 1993* apply, as does Rule 4, Restrictions on Dealings, of the Code. The valuer and any colleagues involved in a takeover or merger will need to ensure they strictly observe the law, which also here embraces observance by spouses and dependent children. The Rules also cover acquisitions and realisations of shareholdings, and the value will again need to comply with them.
- 6 The valuer may consult the Executive of the Takeover Panel directly to seek advice. It is not necessary to do this through the company's advisers. In fact, the valuer may prefer not to involve them, particularly if subject to pressure to do something that is not in accordance with professional and ethical standards and these standards.

Status of the valuer

- 7 The *valuation* has to be provided by a named independent valuer. The Code states that an independent valuer means a corporate *member* of RICS who is an *external valuer* as defined in these standards, and who has no connection with other parties to the transaction.

- 8 The valuer will need to be able to demonstrate compliance with **PS 2 section 2**, and with any legal or regulatory requirements that apply.
- 9 The Code contains various provisions relating to the independence of advisers. Where potential conflicts are identified it may not be possible to resolve them by isolating information or assigning different personnel to the transaction. ‘Chinese walls’ may not be regarded as adequate (see **PS 2 section 4**). Where doubt exists, the compliance unit, or a similar disinterested unit of the valuer’s firm, will need to consult the Panel. Otherwise, legal advice should be sought.
- 10 A valuer who attends meetings with clients and other advisers, such as lawyers, stockbrokers, accountants and merchant bankers, should be wary of assuming any role that could be regarded as that of a ‘financial adviser’ within the provisions of the *Financial Services and Markets Act 2000*. A financial adviser must be a registered member of a professional regulatory organisation. Although the role of a valuer would not normally fall within the definition, any extended involvement could so fall, for example, in providing forecasts or commenting on them. If *members* have any doubt about their position, legal advice should be taken, preferably before attending any meeting.

Basis of value

- 11 The *basis of value* will normally be *market value* as defined in **VPS 4**. If the company’s accounts are prepared under UK Generally Accepted Accounting Practice (UK GAAP) with the consent of the Panel, the *basis of value* set out in UK VPGA 1 may be used.
- 12 The *basis of value* will need to be clearly stated in the valuation report. Only in exceptional circumstances should it be qualified, in which case the valuer will need to explain the meaning of the words used. Similarly, *special assumptions* (see **VPS 4**) should not normally be made in a *valuation*, but if *special assumptions* are permitted by the Panel, they should be fully explained (see **VPS 3**).
- 13 In the case of land currently being developed or with immediate development potential, in addition to giving the *market value* in the state as at the *valuation date*, the *valuation* should include:
 - a) the value after the development has been completed
 - b) the value after the development has been completed and let
 - c) the estimated total cost, including carrying charges, of completing the development, and the anticipated dates of completion and of letting or occupation and
 - d) a statement of whether planning consent has been obtained and, if so, the date thereof and the nature of any conditions attaching to the consent that affect the value.

Reporting the valuation

- 14 The effective date at which the assets were valued will need to be stated together with the professional qualifications and address of the valuer. If a *valuation* is not current, the valuer will need to be able to state that a current *valuation* would not be materially different. If this statement cannot be made, the *valuation* will need to be updated.
- 15 The Code requires of the entity that the opinion of value is contained in the offer document, and the valuation report must also be put on display (see **VPS 3 section 2 paragraph 2.2(j)**). Where the valuation report includes material that may be commercially sensitive, the Panel may allow publication in a summarised form.
- 16 In some exceptional cases, it will not be possible for a valuer to complete a full *valuation* of every property. The Panel may be prepared to regard the requirements of Rule 29 as met if the valuer carries out a *valuation* of a representative sample of properties and reports those *valuations*. In such case the directors must take sole responsibility for an estimate, based on the sample, to cover the remaining properties. This procedure will be available only where the portfolio as a whole is within the knowledge of the valuer, who will be required to certify the representative nature of the sample. Where this is done, the document should distinguish between properties valued professionally and those where the directors have made estimates on the basis of the sample *valuation*. The document should also compare such estimates with book values.

UK VPGA 2.3 Collective investment schemes

Valuations for collective investment schemes have to be in accordance with the requirements of the Financial Conduct Authority (FCA) Collective Investment Schemes Sourcebook, found at www.handbook.fca.org.uk/handbook/coll

Valuations for this purpose are regulated purpose *valuations* (see **UK VPS 3**), and the various disclosure requirements will apply.

- 1 Under Part XVII of the *Financial Services and Markets Act 2000* only certain collective investment schemes may be promoted to the public. These are:
 - investment companies with variable capital (ICVC) constituted in the UK
 - authorised unit trusts (AUTs) constituted in the UK, which are collective investment schemes authorised by the FCA and
 - collective investment schemes constituted outside the UK and recognised by the FCA.
- 2 To avoid confusion, valuers should be aware that the FCA Collective Investment Schemes Sourcebook (COLL) uses the term 'scheme property' in a very wide sense, which is not restricted to *real estate*. An 'immovable' is a freehold or leasehold interest in England and Wales, any interest or estate in or over land,

- or heritable right (including a long lease in Scotland) or, if not in either of those jurisdictions, an equivalent interest.
- 3 For more detailed information about collective investment schemes, the full text of the sourcebook is available at www.fca.org.uk
 - 4 Qualified investor schemes are authorised funds that are intended only for professional clients and for retail clients who are sophisticated investors. They have a more relaxed set of rules governing their operation than that for retail schemes, particularly regarding their investment powers. A qualified investor scheme is essentially a mixed asset type where different types of permitted asset may be included as part of the scheme property, depending on the investment objectives and policy of that scheme and any restrictions in the rules.

Basis of value

- 5 Any *valuation* by an appropriate valuer or a standing independent valuer will need to be on the basis of *market value* as defined in these standards and any special provisions within the instrument constituting the scheme.

The valuer

- 6 The COLL requirements for an appropriate valuer and for a standing independent valuer can be found at www.handbook.fca.org.uk/handbook/coll

Financial reporting

- 7 The Investment Managers Association has issued a statement of recommended practice (SORP) that provides guidance on the effective implementation of the accounting standards. Financial Statements of Authorised Funds is available from www.investmentfunds.org.uk

UK VPGA 2.4 Unregulated property unit trusts

Valuations for unregulated property unit trusts have to be on the basis of *market value*. *Valuations* for this purpose are regulated purpose valuations (see **UK VPS 3**), and the various disclosure requirements will apply.

- 1 Unregulated property unit trusts are a form of collective investment scheme where assets are held in trust for the participants that do not have day-to-day control over the management of those assets. They may not be marketed to the general public and are thus distinguished from authorised unit trusts (AUTs).
- 2 There is no regulatory requirement for an independent *valuation*, but in reality, most trust deeds require an independent valuer. If the trustee and/or the manager request an independent valuer, the valuer will need to check the criteria and confirm that he or she meets them (see **PS 2 section 4**).

- 3 *Valuations* of land and buildings are critical to the pricing of units and should be reviewed at frequent intervals. Every *valuation* should be as up to date as possible with regard to the valuer's judgement of the trends of the most recent transactions in the market, even if those trends may be short term.
- 4 In normal circumstances, the valuer is employed by, and reports to, the fund manager, but copies of the report should be provided for the trustees.

UK VPGA 3 Valuations for assessing adequacy of financial resources

UK VPGA 3.1 Adequacy of financial resources of insurance companies

Valuations for inclusion in the assessment of the adequacy of financial resources for insurance companies have to be in accordance with the Prudential Regulation Authority (PRA) sourcebook for insurers (INSPRU).

- 1 European Directives require financial institutions to make assessments of the adequacy of their financial resources. In the UK the PRA INSPRU provides that the value of assets for checking financial adequacy is to be the same as that adopted by the entity for its accounting purposes.
- 2 The value of assets is to be measured in accordance with:
 - a) the insurance accounts rules, or the *Friendly Societies (Accounts and Related Provisions) Order 1994*
 - b) FRS issued or adopted by the ASB and
 - c) statements of recommended practice (SORPs), issued by industry or sectoral bodies recognised for this purpose by the ASB or
 - d) IAS,

as applicable to the firm for the purpose of its external financial reporting (or as would be applicable if the firm were a company with its head office in the UK).

- 3 *Valuations* for this purpose will therefore be in accordance with the relevant IVS (see VPGA 1 or UK VPGA 1) and will need to include a statement that they comply with the provisions of the sourcebook.

The INSPRU sourcebook is available at www.handbook.fca.org.uk/handbook/INSPRU/pdf

UK VPGA 3.2 Adequacy of financial resources for financial institutions

Valuations for inclusion in the assessment of the adequacy of financial resources for banks, building societies and investment firms have to be in accordance with the Prudential Regulation Authority (PRA) sourcebook for banks, building societies and investment firms (BIPRU).

- 1 European directives require financial institutions to make assessments of the adequacy of their financial resources. In the UK the PRA BIPRU sets out detailed rules for which such assessments shall be made.

2 BIPRU 3.4 states:

3.4.66 (1) The requirements about monitoring of property values ... are as follows:

- a) the value of the property must be monitored on a frequent basis and at a minimum once every three years for residential real estate;
- b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
- c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
- d) the property *valuation* must be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
- e) for loans exceeding €3 million or 5% of the capital resources of the firm, the property *valuation* must be reviewed by an independent valuer at least every three years.

(2) For the purposes of (1), 'independent valuer' means a person who possesses the necessary qualifications, ability and experience to execute a *valuation* and who is independent from the credit decision process.

BIPRU 3.4.66, © The Prudential Regulation Authority

3.4.77 The property must be valued by an independent valuer at or less than the market value. In those EEA States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value.

BIPRU 3.4.77, © The Prudential Regulation Authority

Note that BIPRU states that 'necessary qualifications' need not be professional qualifications, but the valuer should be able to demonstrate that he or she has the necessary ability and experience to undertake the review.

- 3 The definition of *market value* is the same as adopted in these standards (see **VPS 4**).
- 4 Mortgage lending value is not normally used in the UK, but where appropriate, reference may be made to the RICS guidance note **Bank lending valuations and mortgage lending value**, 1st edition.
- 5 The full BIPRU is available at www.handbook.fca.org.uk/handbook/BIPRU

UK VPGA 4 Valuation of local authority assets for accounting purposes

Scope

- 1 The *financial statements* of local authorities need to be prepared in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom* (the 'Code'), published by the Chartered Institute of Public Finance and Accountancy (CIPFA), which is based on the *International Financial Reporting Standards* (IFRS). The Code is reviewed continuously and is issued annually. The edition of the Code that is applicable for any given financial year is based on accounting standards in effect on 1 January prior to the start of that financial year, e.g. for the 2018/19 Code, this means EU-adopted accounting standards with an effective date of 1 January 2018 or earlier.
- 2 The material in this UK VPGA has been developed in conjunction with CIPFA. Valuers are strongly advised to refer to the current Code for the financial period in which the *valuation* is undertaken and to ensure that their client's precise accounting prerequisites are addressed.
- 3 The general principles underlying the *valuation* of local authority assets are no different from those for any entities, but the Code incorporates additional guidance for public sector bodies and introduces the concept of service potential:
 - a) Local authorities in the UK are required to keep their accounts in accordance with 'proper (accounting) practices'. This is defined, for the purposes of local government legislation, as meaning compliance with the terms of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code).
 - b) The Code specifies the principles and practices of accounting required to prepare a Statement of Accounts that gives a true and fair view of the financial position and transactions of a local authority.
 - c) The Code applies formally in Great Britain to local authorities, fire authorities (England and Wales), joint committees and joint boards of principal authorities. In Northern Ireland it applies to all district councils. The Code also applies throughout the UK to police and crime commissioners and other police bodies, as relevant.
 - d) The local authority Code constitutes 'proper (accounting) practice':
 - i) In England and Wales, under the terms of section 21(2) of the *Local Government Act 2003*.
 - ii) In Scotland, under section 12 of the *Local Government in Scotland Act 2003*.
 - iii) In Northern Ireland, the status and authority of the local authority Code derives from regulation 4 of the *Local Government (Accounts and Audit) Regulations (Northern Ireland) 2006* and through

the relevant accounts direction issued by Department of the Environment (Northern Ireland).

- 4 Local authorities measure their assets and liabilities and provide disclosures in accordance with IFRS 13 *Fair Value Measurement*, where the Code requires or permits *fair value* measurement, except where adaptations to fit the public sector are detailed in the Code.
- 5 Valuers should note that the new international accounting standard for leases (IFRS 16) has been published and although it will not come into force until 1 January 2019, landlords and tenants are already giving consideration to its implications. Under this new international accounting standard, the current difference between finance leases and operating leases will be disapplied and *real estate* liabilities, i.e. full rents due under the entire lease term, will have to be shown on a tenant company's balance sheet. The right to use the property throughout the term of the lease will be shown as an asset and future payments under the lease will be shown as a depreciable capital asset liability.
 - CIPFA and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) adapt IAS 16 *Property, Plant and Equipment* within the Code to require items of property, plant and equipment that are operational and therefore providing service potential for the authority to be measured for their service potential either at existing use value, existing use value – social housing, or *depreciated replacement cost* and not at *fair value*. These measurement bases are described in the Code as current value (measurements).
- 6 Property, plant and equipment assets that do not provide service potential for the authority (that is those assets classified as surplus assets, and assets classified as Held For Sale) are not measured for their service potential but for the economic benefits inherent in the assets. Therefore, the current value measurement base for these assets is at *fair value* in accordance with the definitions and measurement requirements in IFRS 13.

UK VPGA 4.1 IFRS 13 Fair Value Measurement

IFRS 13 *Fair Value Measurement* was introduced to the 2015/16 Code, which impacts on the *valuation* of local authority assets. The Standard, IFRS 13, provides a single definition of *fair value*. It is designed to apply to assets and liabilities covered by those IFRS standards that currently permit or require measurement at *fair value* (with some exceptions).

The IFRS 13 definition of *fair value* is based on exit values and market prices for assets and liabilities. For property, plant and equipment the Code requires a *valuation* to be at the asset's highest and best use and is a measure of financial capacity. CIPFA/Local Authority (Scotland) Accounts Advisory Committee (LASAAC) Joint Board considers that the most appropriate measure of operational property, plant and equipment should be based on the service potential that the assets provide in support of the services of the authority.

This means that these assets will be measured at:

- existing use value (EUJ)
- existing use value – social housing (EUJ-SH) or
- *depreciated replacement cost* (DRC),

as appropriate to the property, plant and equipment asset in question. These measurement bases are described in the Code as current value (measurements) and should not be confused with the *bases of value* set out in **VPS 4**.

- 1 Apart from infrastructure, community assets and assets under construction, the Code sets out that the *basis of value* for all property, plant and equipment assets is to be current value. Valuers should note that the Code permits local authorities to measure community assets at '*valuation*' in accordance with the measurement requirements for heritage assets in section 4.10 of the Code. There are four measurement approaches to calculating current value in the Code:
 - For operational property, plant and equipment:
 - i) existing use value (EUJ) in accordance with the definitions in UK VPGA 6 and guidance in the Code
 - ii) existing use value – social housing (EUJ-SH); in accordance with the definition in UK VPGA 7 and guidance in the Code
 - iii) *depreciated replacement cost* (DRC) in accordance with UK VPGA 1.5 (see also RICS UK guidance note *Depreciated replacement cost method of valuation for financial reporting*, 1st edition) and
 - For surplus assets *fair value*:
 - iv) as defined under IFRS 13 and as adopted by the Code.
- 2 Leases of land and buildings are to be separated into land and building elements, and classified and accounted for separately (see section 4.4 of the Code).
- 3 *Investment property* is to be valued at *fair value* (with certain exceptions), including *investment property* under construction where its *fair value* can be reliably determined (see section 4.7).
- 4 Assets held for sale are to be valued at the lower of their carrying value and *fair value* less costs to sell as appropriate to the measurement requirements of the Code (see section 4.8).
- 5 Heritage assets are measured at *valuation* (or may be recognised at cost when it is not practicable to obtain a *valuation* at a cost that is commensurate with the benefits to users of the *financial statements*). Heritage asset *valuations* may be undertaken by any method that is appropriate and relevant (see section 4.10 of the Code).
- 6 For depreciation purposes assets are to be recognised on a component basis, where components have a significant cost in relation to the total cost of the asset. In practice this can be achieved by separately accounting only

for significant components that have materially different asset lives, or where different depreciation methods are used (see section 4.9).

- 7 Residual values are to be based on current prices at the balance sheet date.
- 8 The valuer's role is to provide assistance on the identification and classification of assets and, essentially, to provide the current value or *fair value* of those assets in accordance with the Code where such a value is required (see section 4.2).
- 9 The valuer will not normally be involved in any interpretation of the Code relating to the treatment of assets in the accounts once the values have been established.

UK VPGA 4.2 Classification of assets

- 1 Property assets are to be classified for measurement purposes into one of the following groups:
 - Property, plant and equipment: Authorities are required to account for all property, plant and equipment in accordance with International Accounting Standards (IAS) 16, *Property, Plant and Equipment*, except those more specifically listed in this UK VPGA or where the Code has detailed interpretations or adaptations to fit the public sector (see section 4.3). See UK VPGA 4.1 and section 4.1 of the Code for the *valuation* requirements for property, plant and equipment assets.
 - Leases and lease type arrangements: Authorities are required to account for leased assets in accordance with IAS 17, *Leases*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 4.4).
 - *Investment property*: Authorities are required to account for *investment property* in accordance with IAS 40, *Investment Property*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 4.7).
 - Assets held for sale: Authorities are required to account for assets held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, except where the Code has detailed interpretations or adaptations to fit the public sector (see section 4.8).
 - Heritage assets: are measured at *valuation* (or may be recognised at cost – see paragraph 1 of section 4.1). Heritage asset *valuations* may be made by any method that is appropriate and relevant (see section 4.10 of the Code).

UK VPGA 4.3 Valuation of property, plant and equipment

- 1 Infrastructure, assets under construction and (generally speaking) community assets are measured at historical cost, and the option given in IAS 16 to

- measure at *fair value* is withdrawn. Note however that although community assets may normally be measured at *valuation*, they may alternatively be recognised at cost – in such cases *valuations* may be made by any method that is appropriate and relevant in accordance with section 4.10 of the Code. Examples of this category of asset are given in UK VPGA 4.10.
- 2 All other assets in this category, i.e. those not covered by paragraph 1, are required by the Code to be measured at current value. Note that the definition of current value of property, plant and equipment includes surplus assets measured at *fair value*.
 - 3 The Code requires the following approach to reporting:
 - For operational land and buildings, current value is to be interpreted as the amount that would be paid for the asset in its existing use. This requirement is met by providing a *valuation* on the basis of EUV in accordance with UK VPGA 1.4, EUV-SH in accordance with the definition in section 4.1 or by adopting the DRC approach in accordance with UK VPGA 1.5 and the RICS UK guidance note *Depreciated replacement cost method of valuation for financial reporting*, 1st edition.
 - Surplus assets are to be measured at *fair value* in accordance with IFRS 13, as adopted by the Code.
 - 4 Where the existing use value and *market value* are significantly different (higher or lower), *market value* (that is, the *valuation* does not disregard alternative uses) is to be reported in addition to the existing use value. A statement should be made that no account has been taken of issues such as reducing the service potential or disruption, and the associated costs that would be incurred in achieving that alternative use.
 - 5 The role of the valuer is to provide relevant *valuations* and discuss with authorities the reasons for the differences in the values provided. Authorities will decide the appropriate accounting treatment.
 - 6 The use of DRC is recognised in appropriate circumstances. The valuer will need to have regard to the requirements of UK VPGA 1.5. In addition, UK VPGA 1.5 and the RICS UK guidance note *Depreciated replacement cost method of valuation for financial reporting*, 1st edition, contain detailed information on the use and application of DRC when valuing for *financial statements*. Attention is also drawn to the use of the ‘instant build’ approach (which aligns the *valuation* of both the land and the buildings at the same date) for local authority property assets.
 - 7 In England, Scotland and Wales the current value of council dwellings is measured using EUV-SH (see section 4.1). Guidance on this is available in *Stock Valuation for Resource Accounting: Guidance for valuers – 2016*, published by the Department for Communities and Local Government in November 2016. In Scotland the Local Authority Scotland Accounts Advisory Committee (LASAAC) has issued guidance on dwelling *valuation* methodology stating that by 2015/16 at the latest the *valuation* of council dwellings is to be achieved using a Beacon Approach (Adjusted Vacant Possession) methodology.

In Wales the *basis of value* is also EUV-SH, but there is no specific *valuation* guidance covering the housing revenue account. In Northern Ireland the District Councils are not responsible for social housing.

- 8 The detailed requirements with regard to private finance initiative (PFI) and public private partnership (PPP) arrangements are in section 4.3 of the Code. In broad terms the arrangement is initially recognised under IAS 16 and measurement is at *fair value* based on estimations of cost. Subsequent measurement of the infrastructure (PFI asset) is the same as other property under IAS 16, and the detailed requirements are set out in the Code in chapter 4 paragraphs 4.3.2.8 to 4.3.2.11.

UK VPGA 4.4 Leases and lease type arrangements

- 1 Leases are recognised, measured and accounted for in accordance with IAS 17 Leases subject to the interpretations in the Code. Leases that are held as *investment property* by lessees, or investment property held by lessors under operating leases, are measured under IAS 40, *Investment Property*.
- 2 The new international accounting standard for leases (IFRS 16) has been published and although it will not come into force until 1 January 2019, landlords and tenants are already giving consideration to its implications.
- 3 Under the new international accounting standard, the current difference between finance leases and operating leases will be disapplied and *real estate* liabilities, i.e. full rents due under the entire lease term, will have to be shown on a tenant company's balance sheet.
- 4 The right to use the property throughout the term of the lease will be shown as an asset and future payments under the lease will be shown as a depreciable capital asset liability.
- 5 The amounts to be recognised in the balance sheet where a lease is a finance lease are calculated in accordance with IAS 17. In summary this states that lessees should recognise assets acquired under finance leases as such and the associated lease obligations as liabilities. The assets and liabilities should be recognised at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments.
- 6 The valuer may be requested to provide the fair value of the leased property. This is not the value of the interest in the lease, but the underlying fair value of the property reflecting the presumption of a finance lease that transfers all risks and rewards incidental to ownership of the asset.
- 7 The Code provides specific rules for the recognition of leases and distinguishes between those held as lessee and those held as lessor.

UK VPGA 4.5 Leases held as a lessee

- 1 Operating lease: Lease payments are recognised as an expense on a straight-line basis over the lease term, unless another systematic basis is more representative of the benefits received by an authority. No *valuation* is required as assets are not held on the balance sheet of a lessee under an operating lease.
- 2 Finance lease: Initial recognition as assets and liabilities in the balance sheet is at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease.
- 3 After initial recognition, leased assets are measured in the same way as any other assets under IAS 16 and are subject to impairment review under IAS 36, *Impairment of Assets* as adopted by the Code.

UK VPGA 4.6 Leases held as lessor

- 1 Operating lease: Initial recognition as assets in the balance sheet is at cost. After initial recognition, leased assets are measured in the same way as any other assets under IAS 16 and are subject to impairment review under IAS 36. Income is recognised on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which the benefit derived from the leased assets is diminished.
- 2 Finance lease: The asset is recognised as a receivable at an amount equal to the net investment in the lease. The Code provides that the finance income is calculated so as to produce a constant periodic rate of return on the net investment. The valuer is not involved in this calculation.
- 3 Leases of land and buildings are classified as finance or operating leases in the same way as leases of other assets. However, the land and building elements of a lease of land and buildings are considered separately for the purposes of lease classification, therefore an apportionment is required between the land and the building elements. An apportionment for this purpose should not conflict with any apportionment required for the calculation of depreciation.

UK VPGA 4.7 Valuation of investment property

An *investment property* is one that is used solely for rentals or capital appreciation, or both. Property that is used to facilitate service delivery, as well as for rentals or capital appreciation, is not *investment property* and should be recognised and measured under IAS 16.

- 1 *Investment property* is to be accounted for in accordance with IAS 40 at *fair value* and the option to measure at cost model is not permitted (other than in exceptional circumstances outlined in the Code (see paragraph 4.4.2.13)).

- 2 The Code requires the valuer to provide the *fair value* of the property reflecting any current leases, current cash flows and reasonable *assumptions* about future rental income or outgoings.
- 3 Property held by a lessee under an operating lease may be accounted for as an *investment property* only if the property would otherwise meet the definition of *investment property*. In such cases the lease shall be accounted for as if it were a finance lease.
- 4 The *fair value* of *investment property* held under a lease (that is, where the authority is the lessee) is in respect of the lease interest, not its underlying *market value*.

UK VPGA 4.8 Valuation of assets held for sale

An authority is required to identify and separately account for assets where they meet the strict criteria, as set out in the Code (also see IFRS 5), for classification of assets as held for sale.

- 1 Assets held for sale are measured at the lower of the carrying value and *fair value* less costs to sell. Where the valuer makes an adjustment for the costs to sell, this will need to be made clear in the report to avoid double counting.

UK VPGA 4.9 Accounting for depreciation

General guidance on depreciation for accounting purposes is given in UK VPGA 1.

- 1 IAS 16 recognises that, with a few exceptions, land does not depreciate and therefore requires land and the buildings erected on it to be recognised as separate assets. The allocation of the value between these two constituent elements has been a requirement for many years.
- 2 The Code provides that:
 - ‘each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item must be depreciated separately’ (Code paragraph 4.1.2.43).

However, the Code also states:

- ‘Where there is more than one significant part of the same asset which has the same useful life and depreciation method, such parts may be grouped in determining the depreciation charge’ (Code paragraph 4.1.2.43) and

IAS 16 states:

- ‘to the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant’ (IAS 16 paragraph 46).

- 3 In practice, IAS 16 requirements can be satisfied by separately accounting for only those significant components that have different useful lives and/or where different depreciation methods are applied to the remainder of the asset. However, an authority may choose to depreciate separately the parts of an asset that do not have a cost considered significant in relation to the total cost of the asset.
- 4 For this purpose the 'asset' is the non-land element recognised in the accounts. An explanation of the principles and the accounting requirements is set out in the CIPFA Local Authority Accounting Panel (LAAP) Bulletin 86 (Updated), *Componentisation of Property, Plant & Equipment under the 2010/11 IFRS-based Code*, originally published in June 2010 and subsequently updated. Valuers should ensure that they take into account the requirements of the updated LAAP Bulletin.
- 5 This UK VPGA does not cover the derecognition and recognition of components (that is, when enhancement expenditure takes place). This is discussed in detail in LAAP Bulletin 86 (Updated), in paragraphs 60.1 to 60.14, which complies with the requirements of the Code in chapter 4 paragraphs 4.1.2.50 to 4.1.2.51.

UK VPGA 4.10 Examples of asset categories measured at cost

The asset categories that follow are where, in the circumstances described, the Code provides that historic cost is to be used with the consequence that *valuations* will not be required for financial reporting purposes.

Assets under construction

- 1 The Code requires that an *investment property* under construction is measured at *fair value* once an authority is able to measure reliably the *fair value* of the *investment property* and at cost before that date (see Code paragraph 4.4.2.12).

Infrastructure assets

- 2 Examples of infrastructure assets to be measured at cost include:
 - roads
 - street furniture
 - bridges
 - permanent ways
 - water supply and drainage systems and
 - sea defences.

Community assets

- 3 Community assets are described in the Code as 'assets that the local authority intends to hold in perpetuity, that have no determinable useful life, and that may have restrictions on their disposal'. If the asset is used for a specific operational purpose, it does not qualify as a community asset and should be valued accordingly.
- 4 Examples of community assets include:
 - parks (but not a golf course within a park)
 - cemeteries and crematoria (land only) and
 - allotments (where there are restrictions on alternative uses).
- 5 The following questions can be used to test for community assets:
 - a) Is the intent to hold the asset forever?
 - b) Does the asset have an indeterminable useful life?
 - c) Are there restrictions on disposal?
- 6 To qualify as a community asset, the answers for questions (a) and (b) have to be 'yes', while an affirmative answer to question (c) is not obligatory but a helpful contributory factor.

UK VPGA 5 Valuation of central government assets for accounting purposes

Valuations of central government assets for *financial statements* are to be prepared in accordance with the *Government Financial Reporting Manual* (FReM), prepared by HM Treasury and the devolved administrations.

For National Health Service (NHS) bodies in England, Scotland and Wales, the Department of Health's Group Accounting Manual (GAM) essentially mirrors the FReM provisions.

- 1 The *Government Financial Reporting Manual* (FReM) is the technical accounting guide to the preparation of *financial statements* and sets out the detailed requirements that entities are required to follow when dealing with accounting for tangible fixed assets.
- 2 FReM complements guidance on the handling of public funds published separately by the relevant authorities in England and Wales, Scotland and Northern Ireland. The Manual is prepared following consultation with the Financial Reporting Advisory Board (FRAB). In addition to the FReM, HM Treasury provides illustrative *financial statements* and supporting guidance on accounting matters helpful to those preparing *financial statements*.
- 3 The Manual applies EU-adopted *International Financial Reporting Standards* (IFRS) and is kept under constant review, inter alia to reflect developments in IFRS. The use of IFRS in general text in the Manual should be taken to include International Accounting Standards (IAS) and interpretations of IAS and IFRS issued by the Standards Interpretations Committee (SIC) or the International Financial Reporting Interpretations Committee (IFRIC).
- 4 With regard to operational property, plant and equipment, FReM currently adopts IAS 16 *Property, Plant and Equipment*, interpreted and adapted for the public sector.
- 5 For in-use, non-*specialised property* assets (operational assets), FReM requires assets that are held for their service potential (i.e. operational assets used to deliver either front line services or back office functions) should be measured at their current value in existing use. For non-specialised assets current value in existing use should be interpreted as *market value* in existing use, which is defined in UK VPGA 6 as existing use value (EUV). For specialised assets current value in existing use should be interpreted as the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential. Where a DRC approach is used to value specialised assets, the 'instant build' approach (which aligns the *valuation* of both the land and the buildings at the same date) is applied.
- 6 Assets that were most recently held for their service potential but are surplus should be valued at current value in existing use if there are restrictions on the entity or the asset which would prevent access to the market at the reporting

date. If the entity could access the market, the surplus asset should be valued at *fair value* using IFRS 13.

- 7 The authoritative version of the Manual for any financial year is available by the start of the financial year to which it relates. The valuer should check the version applicable to the relevant financial year before preparing *valuations*.
- 8 FReMs and the guidance are available at:
www.gov.uk/government/collections/government-financial-reporting-manual-frem

UK VPGA 6 Local authority and central government accounting: existing use value (EUV) basis of value

Neither IFRS 13 nor FRS 102 make reference to 'existing use value' (EUV) as a basis of *valuation*.

However, when instructed to value operational property plant and equipment for local authorities and assets for *financial statements* for central government, valuers should be aware that the Code of Practice on Local Authority Accounting (CIPFA 'Code') – see UK VPGA 4 – and the Government Financial Reporting Manual (FRoM) – see UK VPGA 5 – require that the *basis of value* is existing use value as appropriate to the property, plant and equipment asset in question and not *fair value* as defined in FRS 102 and IFRS 13.

Valuers should be aware that non-operational 'surplus' property, plant and equipment is measured at *fair value* arrived at in accordance with IFRS 13.

Therefore, *valuations* based on EUV should adopt the following definition:

'The estimated amount for which a property 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 acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the asset required by the business, and disregarding potential alternative uses and any other characteristics of the asset that would cause its *market value* to differ from that needed to replace the remaining service potential at least cost.'

1 Existing use value (EUV) is to be used only for valuing property that is owner-occupied by an entity for inclusion in *financial statements*. The definition of EUV is taken from the wording of the *market value* definition with one additional *assumption* and a further requirement to disregard certain matters. In practical terms, the definition of existing use value can be seen generally to accord with the conceptual framework of **VPS 4**, but with the following supplementary commentary:

2 '**...the buyer is granted vacant possession ...**'

The *assumption* that vacant possession would be provided on acquisition of all parts of the property occupied by the business or 'reporting entity' does not imply that the property would be empty, but simply that physical and legal possession would pass on completion. Any parts of the property occupied by *third parties* should be valued subject to those occupations. Properties occupied by employees, ex-employees, or their dependants should be valued with regard to the circumstances of their occupation, including any statutory protection. This assumption also means that it is not appropriate to reflect any possible increase in value due to special investment or financial transactions (such as sale and leaseback), which would leave the owner with a different

interest from the one that is to be valued. In particular the covenant of the owner-occupier must be ignored.

3 ‘...of all parts of the property required by the business ...’

If parts of the property are unused and are surplus to the operational requirements of the business, their treatment will depend on whether they can be sold or leased separately at the *valuation date*. If they can be occupied separately, they should be allocated to a separate category as surplus property and valued on the basis of *market value*. If separate occupation is not possible, any surplus parts would have no more than a nominal EUUV, as they would contribute nothing to the service potential of the property and would not feature in a replacement at least cost.

4 ‘...disregarding potential alternative uses ...’

‘Existing use’, in the context of EUUV, means that the valuer should disregard uses that would drive the value above that needed to replace the service potential of the property. An entity seeking to replace this potential at least cost will not buy a property if its value has been inflated by bids from other potential occupiers for whom the property has greater value because of alternative uses or development potential that are irrelevant to its own requirements.

The valuer should therefore ignore any element of ‘hope value’ for alternative uses that could prove more valuable. However, it would be appropriate to take into account any value attributable to the possibility of extensions or further buildings on undeveloped land, or redevelopment or refurbishment of existing buildings, providing that these would be required and occupied by the entity, and that such construction could be undertaken legally and without major interruption to the current operation.

5 ‘...disregarding ... any other characteristics of the property that would cause its market value to differ from that needed to replace the remaining service potential at least cost.’

There are circumstances where it may be appropriate for the valuer to ignore factors that would adversely affect the *market value*, but would not be characteristic of a replacement. Examples include:

- where an occupier is operating with a personal planning consent that could restrict the market in the event of the owner vacating
- where the occupier holds the property under a lease and there are lease covenants that impose constraints on assignment or alternative uses
- where a property is known to be contaminated, but the continued occupation for the existing use is not inhibited or adversely affected, provided there is no current duty to remedy such contamination during the continued occupation
- where an industrial complex is overdeveloped, and the extra buildings have either limited the *market value* or detracted from it, but would need to be replaced to fulfil the service potential to the business

- where the existing buildings are old and so have a limited *market value*, but would have a higher replacement cost to the business
 - where the property is in an unusual location, or is oversized for its location, with the result that it would have a low *market value*, but where the cost of replacing the service potential would be significantly greater and
 - where the market is composed solely of buy-to-let investors, but the valuer believes that the replacement cost (the price agreed between a willing vendor and willing owner-occupier purchaser) would be higher.
- 6 Any value attributable to *goodwill* should normally be ignored.
- 7 The fact that a large property may be in single occupation does not necessarily mean that it has to be valued on the *assumption* that only bids from other potential occupiers for the whole can be taken into account. If the property is one where a higher value would be generated by the potential to divide it into smaller units for the existing use, this should be reflected in the *valuation*.
- 8 Many market *valuations* are based on the existing planning use of the property, which often, but not invariably, generates the highest value. Such *valuations* have sometimes been described as 'existing use valuations'. However, this is incorrect and they should properly be expressed as *market values*.

It is emphasised that EUV is only to be used when valuing property that is occupied by the owners of the interest being valued for the purpose of their business, for inclusion in *financial statements*.

UK VPGA 7 Valuation of registered social housing providers' assets for financial statements

Valuations of social housing for *financial statements* of registered social housing providers are undertaken on a basis of either:

- a) existing use value for social housing (EUV-SH) for housing stock held for social housing or
- b) fair value in accordance with IFRS 13 for housing stock that is classified as surplus assets.

Existing use value for social housing (EUV-SH) is an opinion of the best price at which the sale of an interest in a property would have been completed unconditionally for a cash consideration on the *valuation date*, assuming:

- a) a willing seller
- b) that prior to the *valuation date* there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest for the agreement of the price and terms and for the completion of the sale
- c) that the state of the market, level of values and other circumstances were on any earlier assumed date of exchange of contracts, the same as on the *date of valuation*
- d) that no account is taken of any additional bid by a prospective purchaser with a special interest
- e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion
- f) that the property will continue to be let by a body pursuant to delivery of a service for the existing use
- g) the vendor would only be able to dispose of the property to organisations intending to manage their housing stock in accordance with the regulatory body's requirements
- h) that properties temporarily vacant pending re-letting should be valued, if there is a letting demand, on the basis that the prospective purchaser intends to re-let them, rather than with vacant possession and
- i) that any subsequent sale would be subject to all the same *assumptions* above.

- 1 *Financial statements* for registered social housing providers are prepared broadly in accord with UK GAAP but are subject to the provisions of a specific Housing Statement of Recommended Practice (SORP) 2014, which applies to all registered social housing providers in the UK and provides essential guidance on, and interpretation of, accounting standards (including the *basis of value*) for the sector.

- 2 A registered social housing provider is a social landlord that is registered in one of the registers by the Homes England or the Welsh Assembly Government under the *Housing Act 1996* (as amended), the Scottish Housing Regulator under the *Housing (Scotland) Act 2001* and the Department for Social Development (Northern Ireland) under the *Housing (Northern Ireland) Order 1992*.
- 3 Valuers will need to ensure that they are familiar with the latest publication when undertaking any *valuation* work in this area.

Basis of value

- 4 EUV-SH is similar to market value, but with additional assumptions reflecting the continued use of the property for social housing. Although it shares some of the characteristics of EUV, it should not be confused with this basis. The essential similarity is that both are aimed at establishing the service potential of the properties, but in the case of EUV-SH it is specifically for the delivery of the registered social housing provider's objectives. Therefore, any value that may attach to a sale of property with vacant possession for use other than social housing is to be ignored.
- 5 Properties owned by a registered social housing provider may be shown in their accounts at historic cost, net of housing association grant (HAG), or at *valuation*. Where the properties are shown at *valuation*, the figure should be the lower of replacement cost (the expense of purchasing at the least cost the remaining service potential of the asset at the balance sheet date) less HAG, or the recoverable amount (the higher of an asset's or cash generating unit's *fair value* less costs to sell and its value in use) less any HAG recovery.
- 6 If a registered social housing provider has embarked on a policy of disposing of properties with vacant possession, or has declared an intention to do so, those properties will be surplus to requirements and should be valued to *fair value*. Any properties valued on this basis will need to be separately identified in the report.
- 7 The report will need to show the values of completed schemes separately from those for properties under construction. Where properties in the course of development are valued, the *valuation* should be in accordance with UK VPGA 1 on land and buildings in course of development.
- 8 *Valuations* will also need to be split between properties held for letting, shared ownership properties and properties for outright sale. In the case of shared ownership properties, 'under construction' would include properties where the initial tranche of equity remains unsold.
- 9 Where a discounted cash flow (DCF) method has been used to derive EUV-SH, the valuer will need to state the key *assumptions* made, together with the discount rate(s) used.

- 10 A registered social housing provider may request *valuations* on alternative bases, for example, *fair value*, or *fair value* with vacant possession, and these alternative figures may be disclosed in the notes to the accounts.
- 11 The registered social housing provider's portfolio may include properties not used for housing purposes, for example, lock-up shops. These properties should be valued to *fair value* in accordance with IFRS 13.

UK VPGA 8 Valuation of charity assets

Overview

There are various statutory provisions that apply to charities. These include:

- the *Companies Act 2006*
- the *Charities Act 2011*
- the *Trusts of Land and Appointment of Trustees Act 1996* and
- the *Trustee Act 2000*.

In addition, the Charity Commission publishes various booklets giving advice on specific topics that are available on its website (www.charitycommission.gov.uk/detailed-guidance/land-and-property/). Booklets CC33 *Acquiring Land*, and CC28 *Sales, leases, transfers or mortgages*, together with their operational guidance, are particularly useful.

Members who require more information about the powers of trustees or any other matter related to charities should seek advice from the charity's own professional advisers.

UK VPGA 8.1 Acquisitions

Where trustees propose to acquire land, there is no requirement for them to obtain professional advice, unless such a requirement is in the trust deed. However, the Charity Commission strongly recommends that they obtain a report from a 'qualified surveyor' (as defined in CC33 and given in paragraph 2.2) who is acting solely for the trustees.

- 1 Where the proposed transaction requires the trustees to obtain an order of the Charity Commission before acquiring land (for example, acquiring land other than freehold land, buying land from one of the trustees or where there is no power to acquire land), it is anticipated that the Commission will expect such an application to be accompanied by a surveyor's report.
- 2 A 'qualified surveyor' is defined in CC33 as 'a fellow or professional associate of the Royal Institution of Chartered Surveyors (RICS)'. Pending any review of this publication, the reference with regard to RICS may be read as referring to any 'member' of RICS, as defined in the Rules of Conduct.
- 3 When considering the purchase of land, the trustees must take all reasonable steps to ensure that, among other matters:
 - the property is suitable for its intended use and, in particular, is not subject to any legal or planning restrictions or conditions that might conflict with that use, or with which it may be difficult for the trustees to comply
 - any necessary planning permission is obtained

- the price or rent is fair compared with similar properties on the market and
- when acquiring a lease, they understand the obligations to which they will be subject under the lease and ensure that the terms of the lease are fair and reasonable.

Basis of value

- 4 Although there is no *basis of value* specified in the Charity Commission guidance, the presumption is that it will be *market value* or *market rent*.
- 5 There may be circumstances where a charity is in a special position – for instance, where it has the benefit of certain tax exemptions or is a *special purchaser* – and therefore may be able to justify paying more than *market value*. Such circumstances, which are assessments of *worth*, are not to be reflected in the *valuation* but should be referred to in the general advice as to what the trustees should offer to pay or bid at auction.

Matters to be included in the report

- 6 While complying with the general requirements of **VPS 3**, the valuer will need to have regard to the Commission's recommendation to include:
 - a description of the land
 - details of any planning permission needed
 - a *valuation* of the land
 - advice on the price that the trustees ought to offer to pay, or the maximum bid they ought to make at auction
 - a description of any repairs or alterations the trustees would need to make and their estimated cost
 - a positive recommendation (with reasons) that it is in the interests of the charity to purchase the land and
 - anything else the surveyor thinks is relevant, including a description of any restrictive or other covenants to which the land is subject.

UK VPGA 8.2 Disposals

Where a charity wishes to dispose of an interest in land exceeding a term of seven years, a report must be obtained from a 'qualified surveyor' (section 119 of the *Charities Act 2011*).

- 1 For these purposes, as explained in UK VPGA 8.1 paragraph 2, the requirement to use a 'qualified surveyor' means engaging a *member* of RICS. The trustees of the charity must also reasonably believe the surveyor concerned has the necessary ability in, and experience of, the *valuation* of land of the particular kind and in the particular area in question.

Matters to be included in the report

- 2 As well as complying with the general requirements of **VPS 3**, the report should include a range of information laid down in the *Charities (Qualified Surveyors' Reports) Regulations 1992* (SI 1992/2980).
- 3 A description of the relevant land and its location, by reference to a plan if convenient, is to include:
 - the measurements of the relevant land
 - its current use
 - the number of buildings (if any) included in the relevant land
 - the measurements of any such buildings and
 - the number of rooms in any such buildings and their measurements.
- 4 Details of whether the relevant land, or any part of it, is leased by or from the charity trustees should be included and, if it is, so should details of:
 - the length of the lease and the period of this that is outstanding
 - the rent payable under the lease
 - any service charge payable
 - the provisions in the lease for any review of the rent payable under it, or any service charge payable and
 - the liability under the lease for repairs and dilapidations and any other provision in the lease that, in the opinion of the surveyor, affects the value of the relevant land.
- 5 The report should contain information on whether the relevant land is subject to the burden, or enjoys the benefit, of any easement or restrictive covenant. In addition, it should state if the land is subject to any annual or other periodic sum charged on, or issuing out of, the land, except rent reserved by a lease or tenancy.
- 6 Information on any buildings included with the relevant land and whether they are in good repair should be subject to appropriate comment. If they are not in good repair, the surveyor should give advice on:
 - whether it would be in the best interests of the charity for repairs to be carried out prior to the proposed disposition
 - what those repairs, if any, should be and
 - the estimated cost of those repairs.
- 7 Advice should be given on whether it would be in the best interests of the charity to alter any buildings included in the relevant land prior to disposition (because, for example, adaptations to the buildings for their current use will not command the best market price on the proposed disposition). An estimate of the outlay required for any alterations should be suggested.

- 8 Advice should be given on the manner of disposing of the relevant land so that the terms on which it is disposed of are the best that can reasonably be obtained for the charity, including:
- where appropriate, a recommendation that the land should be divided for the purposes of the disposition
 - the period for, and the manner in which, the proposed disposition should be advertised (unless, exceptionally, the surveyor's advice is that it would not be in the interests of the charity to advertise the proposed disposition)
 - where advised that it would not be in the best interests of the charity to advertise the proposed disposition, the reasons for that advice (for example, that the proposed disposition is the renewal of a lease to someone who enjoys statutory protection, or belief that a *special purchaser* will pay considerably more than the market price for it) and
 - any view the surveyor may have on the desirability or otherwise of delaying the proposed disposition and, if it is reasonable to believe that such delay is desirable, what the period of that delay should be.
- 9 The report should include the surveyor's opinion of:
- the current value of the relevant land, taking account of its current state of repair and current circumstances (such as the presence of a tenant who enjoys statutory protection) or, where the proposed disposition is a lease, the rent that could be obtained in its current state
 - the value of the relevant land, or what the rent under the proposed disposition would be if advice under paragraph 6 has been given and followed; or where an opinion expressed under paragraph 7 has been acted on; or if both such advice and opinions has been acted on
 - the increase in the value of the relevant land or rent if a recommendation made under paragraph 8 had been followed and
 - the amount by which the price that could be obtained by not advertising exceeds the price that could be obtained if the proposed disposition were advertised (where the advice is that it would not be in the best interests of the charity to advertise the proposed disposition because it is believed a higher price can be obtained by not doing so) or where a delay is advised in the proposed disposition under paragraph 8, the amount by which the surveyor believes the price that could be obtained due to such a delay exceeds the price that could be obtained without it.
- 10 In cases where it is relevant, and the surveyor is competent to do so, advice may be given on whether VAT may arise on the proposed disposition, and the effect it would have on the *valuations* given in paragraph 9. In cases where either the surveyor does not feel able to give such advice, or believes that such advice is not relevant, a statement should be made to that effect.
- 11 The surveyor may be of the opinion that the proposed disposition is not in the best interests of the charity because it does not make the best use of the relevant land. If so, the reasons for this opinion, together with advice on the type

of disposition that would constitute the best use of the land are to be given. For example, this would include any relevant advice on the prospect of buying out a sitting tenant, or of succeeding in an application for a change in the use of the land under the laws relating to town and country planning or similar.

UK VPGA 8.3 Financial statements

- 1 The Charity Commission and the Office of the Scottish Charity Regulator are the joint SORP-making body for charities – see UK VPGA 1.1 paragraph 5. For reporting periods starting or after 1 January 2016 all charities must follow the Charities SORP (as periodically updated) that applies the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102). An October 2018 bulletin effects changes for reporting periods on or after 1 January 2019.

UK VPGA 9 Relationship with auditors

Auditors have a statutory obligation, for UK incorporated entities, to express an opinion on whether the accounts:

- have been properly prepared in accordance with the *Companies Act 2006* (in particular, in accordance with its disclosure requirements)
- have been prepared in accordance with applicable accounting standards and
- give a true and fair view.

In order to express this opinion, auditors may need to obtain reasonable assurance from valuers that *valuations* prepared for *financial statements* under UK GAAP are correct at the *date of valuation* and further information may be requested.

- 1 The International Standards on Auditing (UK) (ISAs (UK)) and International Standard on Quality Control (UK) (ISQC (UK)) are based on the International Standards on Auditing (ISAs) and International Standard on Quality Control (ISQC) of the same titles that have been issued by the International Auditing and Assurance Standards Board (IAASB). The latest editions can be accessed via **the Financial Reporting Council website**. It is important that valuers acting as experts as described in this guidance have a working knowledge and understanding of their content so far as it applies to them. As they are revised and updated from time to time, they are not reproduced here.
- 2 An independent auditor may look to an expert for information or assistance in determining whether the values of assets or liabilities included in *financial statements* are reasonable and well supported. Where this is so, it is important for the valuer to be clear about the exact nature of their role and the responsibilities involved.
- 3 The valuer may be either:
 - a) engaged by the reporting entity to supply a *valuation* figure for inclusion in the relevant financial statement (management's expert) or
 - b) engaged by the auditor to assist with independent review of the relevant entity's report (auditor's expert).

The role of the independent auditor

- 4 Turning firstly to the role of the auditor, their responsibility is to design and perform audit procedures to obtain sufficient appropriate evidence to be able to draw reasonable conclusions on which to base their auditor's opinion and report. Procedures to obtain audit evidence can include *inspection*, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry.
- 5 The role of an independent auditor is to obtain 'reasonable assurance' that the *financial statements* as a whole are free from material misstatement and thus present a 'true and fair' view of the reporting entity's position. Reasonable

assurance is a high but not an absolute level of assurance, due to the inherent limitations of an audit – much of the evidence on which auditors draw their conclusions and base their opinions is persuasive rather than conclusive. In evaluating evidence, auditors are required to apply professional scepticism in reaching a judgement as to whether that evidence is relevant, reliable, sufficient and appropriate.

- 6 Consistent with the ‘reasonable assurance’ objective, auditors also apply the concept of materiality in performing their work. Under most financial reporting frameworks, misstatements (including omissions) are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions taken on the basis of the *financial statements*.
- 7 Auditors remain solely responsible for the audit opinion at all times, and regardless of the degree of use of an expert’s work as audit evidence. For entities that apply the *UK Corporate Governance Code* in the preparation of their Annual Report – principally Premium Listed entities on the London Stock Exchange (LSE) Main Market – the auditors have to disclose the scope of their audit and how that scope addressed the assessed risks of material misstatement and in doing so they could be expected to make reference to their use of the work of experts (where applicable). A company can list on the Main Market of the LSE in either the Premium or Standard segment in accordance with the Financial Conduct Authority (FCA) listing categories. For other entities, auditing standards expressly preclude auditors from referring to the work of an expert in their report and, if they do make such a reference, indicate that this reference does not reduce their responsibility for their opinion.

The valuer as management’s expert

- 8 Under ISA, a management expert may be either an individual or an organisation, and may be either employed (in the case of an individual) or engaged by the reporting entity – in other words, they could be an *internal valuer* or an *external valuer*.
- 9 If information to be used as audit evidence has been prepared using the work of a management’s expert, the auditor will need to consider and evaluate the significance of the expert’s work having regard to:
 - a) the competence, capabilities and objectivity of the expert
 - b) an understanding of the work of the expert and
 - c) the appropriateness of the expert’s work as evidence for the ‘relevant assertion’ (in this particular context, the *valuation* opinion).
- 10 It will be self-evident that, seen from the auditor’s viewpoint, there could potentially be a greater threat to a valuer’s objectivity through being an employee of the entity rather than being independently engaged by it. This is something that both entity and expert will need to bear in mind.
- 11 Other considerations the auditor will need to take into account include:

- a) the relevance and reasonableness of the expert's findings or conclusions, their consistency with other evidence, and whether they have been appropriately reflected in the *financial statements*
 - b) the relevance and reasonableness of any significant *assumptions* or methods and
 - c) the relevance, completeness and accuracy of significant source data used.
- 12 The nature, timing and extent of audit procedures to assess these various criteria will depend on a number of factors. In essence they relate to:
- the nature of the valuer's employment/engagement relationship with the entity
 - the valuer's scope of work and how much control over that work is exercised by the entity
 - the valuer's professional standards and how they are regulated
 - the risk of error affecting value and
 - what alternative evidence is available (to the auditor).

The valuer as auditor's expert

- 13 An auditor's expert can again be either an *internal valuer* or an *external valuer*. Thus, the expert could be a partner or a staff member of the auditor's firm or a network firm, including a temporary staff member. Where the audit firm does not have an in-house capability, or chooses to supplement its resource, then an external appointment might be made.
- 14 In all cases, the auditor will need to check the valuer's competence, capabilities and objectivity for the relevant purpose, which will include checking for any potential or actual conflict of interest.
- 15 For obvious reasons, it is essential that the *terms of engagement* are clear, particularly regarding:
- the roles and responsibilities of both auditor and expert
 - the nature, scope and objectives of the work itself and
 - the communication arrangements between the two.
- 16 In general, similar criteria apply as in paragraph 12 in relation to the auditor's reliance on the work of the expert.
- 17 In most cases, an auditor's expert will not be requested to provide an independent opinion of value, assuming they can satisfy the criteria necessary to do so, but instead will be asked to focus on matters such as the valuation approach, the evidence relied on and the *assumptions* made. Attention is drawn to the requirements of **PS 2 section 6** in this latter regard.

The auditor's requests and the valuer's response

- 18** Quite apart from its obligations under UK law, it is clearly in a reporting entity's interest overall to facilitate the process of audit and deal properly with requests for information or clarification. Where acting as management's expert, a valuer would expect to support the entity in this aim, but there are some points that such an expert will need to bear in mind. For obvious reasons, where acting as auditor's expert, such provisos do not arise as there is a direct (contractual) relationship between valuer and auditor.
- 19** More specifically, legal advice obtained by RICS indicates that there is no legal relationship between the auditor and an *external valuer* acting as management's expert. An *external valuer* can therefore refuse to produce the file, and even refuse to answer an auditor's questions, though the valuer should be satisfied that there are reasonable grounds for refusal before taking this action. This does not apply to an *internal valuer*, who is an officer of the company within the meaning of the *Companies Act 2006*, and so must cooperate.
- 20** However, if an *external valuer* refuses to cooperate this could constitute a limitation on the scope of the auditor's work. It may therefore lead the auditor to qualify any report on the accounts and make some comment that it was not possible to obtain all the information and explanations necessary to achieve the reasonable assurance sought.
- 21** The valuer should therefore be prepared to cooperate reasonably and responsibly with any auditors, an aspect that any *external valuer* accepting instructions to undertake a *valuation* for inclusion in a financial statement might wish to take into account when settling the *terms of engagement*. In order to avoid any breach of a duty of confidentiality, client's written instructions should always be obtained before cooperating with any request from the auditors. Where necessary the directors' permission to override any confidentiality obligations in the valuer's engagement contract with the company should be obtained.
- 22** The auditor will usually obtain a copy of the expert's report, either from the audited entity or directly from the expert, and will then review the report and, as appropriate, discuss it with the expert, among other things addressing the issues and questions previously mentioned.
- 23** Prior to issuing the report, the valuer should also be prepared to bring to the auditor's attention, and discuss as appropriate, matters relating to the *valuation* that may have an impact on the audit and the auditor's responsibilities. This is important because it is an offence under UK company law to make a statement to an auditor that is knowingly or recklessly misleading, false or deceptive. Additionally, there will be occasions when the valuer will welcome the opportunity to verify information and *assumptions* relevant to *valuations*. In some cases, a discussion between the auditor and the valuer before the latter starts to fulfil the audited entity's instructions can be helpful to both parties, and will promote smooth completion of the audit. Needless to say, a valuer acting as management's expert must maintain good liaison with their client to ensure

that there are no misunderstandings regarding compliance with the law and maintenance of confidentiality.

- 24 The valuer may be asked, in falling markets, whether the property value has suffered a diminution of value. The valuer should be prepared to give an opinion on the basis of a definition of ‘diminution’ provided by management.

Summary of the auditor’s evaluation and commentary on the valuer’s response

- 25 The following table provides some cross-references that may be useful when fielding questions from auditors on the previously mentioned issues.

Acting as management's expert	Acting as auditor's expert	Valuer's response
Details of the expert's experience, qualifications, membership of professional body or similar and the relevance of the expert's specialism to the matter being audited.		<i>Member</i> qualification and experience requirements, including RICS Valuer Registration requirements, are covered in PS 2 .
Details of published papers or books written by that expert.		A matter of fact in each individual case – though publication of books or papers is not a requirement in order for a valuer to demonstrate sufficient expertise.
An understanding of the expert's knowledge of relevant accounting requirements.		A matter of fact in each case.
Details of any interests and relationships that may create threats to objectivity and any applicable safeguards against this, including financial interests, business and personal relationships, provision of other services. [Note: Where the expert is an employee of the entity they will not be regarded as being more likely to be objective than other employees of the entity.]	Details of any interests and relationships that may create threats to objectivity and any applicable safeguards against this, including financial interests, business and personal relationships, provision of other services. A written representation about these interests or relationships may be requested.	Independence and objectivity requirements are covered in PS 2 , which also addresses issues and risks concerning conflicts of interest. Note that a valuer who is in the employ of either the enterprise that owns the assets, or the accounting firm responsible for preparing the enterprise's financial records and/or reports is an <i>internal valuer</i> .
What professional or other standards and regulatory or legal requirements apply to the expert's work.		Compliance and regulation in relation to Red Book Global Edition is covered in PS 1 . Valuers should be alert to any other regulatory or legal requirements that apply in individual cases.

Acting as management's expert	Acting as auditor's expert	Valuer's response
	<p>What <i>assumptions</i> and methods are used by the expert and whether they are generally accepted within that field and appropriate for financial reporting purposes.</p>	<p><i>Assumptions</i> are covered in VPS 4. Note that <i>special assumptions</i> should not normally be used where <i>valuations</i> are to be included in <i>financial statements</i> – see VPS 4.</p> <p>Methods are a matter of judgement for the valuer, and their general acceptance and appropriateness are matters that will depend on individual circumstances.</p>
	<p>The nature of internal and external data or information the expert uses.</p>	<p>The nature and source of the information relied on is covered in VPS 3.</p>
<p>Obtain a copy of the expert's engagement contract or other written agreement between the expert and management.</p>		<p>The valuer should provide the auditor with a copy of the <i>terms of engagement</i> agreed with the client and any subsequently agreed variations of those terms.</p>

Table 1: Fielding questions from auditors

UK VPGA 10 Valuation for commercial secured lending purposes

Overview

The UK commercial *real estate* lending industry has evolved significantly in recent years, and valuers are servicing a more diverse client base than before. As the 'mainstream' established lenders are subject to enhanced regulatory and capital requirements, a range of alternative lenders have emerged who may operate on different business models. The due diligence requirements, risk governance structure and risk appetite can therefore vary significantly across the lending industry.

It is impractical to devise a rigid protocol for all commercial secured lending, as lender requirements will vary. The valuer and lender may therefore agree and document a *departure*, as defined in **PS 1**. The overriding objective is that the valuer should understand the lender's requirements and the lender should understand the advice that is given. UK VPGA 10 therefore reflects the general requirements of the lending market, on which liaison with UK Finance is maintained. It also provides supplementary guidance to valuers on mitigating risks and ensuring that the *terms of engagement* and reporting are fair and reasonable for all parties involved.

UK VPGA 10.1 Application of the RICS Valuation – Global Standards 2017

The global guidance for secured lending valuations is contained in VPGA 2, *Valuation of interests for secured lending*. This remains wholly applicable to UK secured lending, and valuers should have full regard to this in conjunction with this UK-specific guidance.

- 1 UK VPGA 10 applies specifically to *valuations* for commercial secured lending against investment, development and owner occupied real property. For this purpose, the definition of commercial property includes 'standard' asset classes, operating assets, and residential assets that are considered to fall within the professional investment sector.
- 2 *Members* are reminded that the DRC method is conceptually unsuitable for use as the sole or primary valuation method for secured lending purposes, but may in appropriate circumstances provide a useful crosscheck to help inform where other methods have been applied.

UK VPGA 10.2 Independence, objectivity and conflicts of interest

Members are reminded that they must comply with the requirements set out in the RICS professional statement *Conflicts of interest*, 1st edition in addition to complying with the standards and guidance in the Global Standards, with particular reference to **PS 2** and VPGA 2.

- 1 Lenders usually have distinct internal risk and compliance policies, which are supplementary to the satisfaction of regulatory requirements. In this context, a valuer's opinion of what circumstances could give rise to a conflict may differ from the perspective held by a lender. Therefore, it is best practice for the valuer to make a full and transparent disclosure of any involvement that is, or may be perceived to be, a conflict of interest, irrespective of the valuer's assessment of the materiality of that situation. This is fully in accord with the last sentence of **PS 2 section 5.3 paragraph 5.3.1**.
- 2 Valuers are reminded that the criteria against which they should judge whether there is an actual, perceived or potential conflict of interest is set out in the RICS professional statement *Conflicts of interest*, 1st edition and having regard to the provisions of **PS 2**, VPGA 2 and this guidance.
- 3 A discussion should, as necessary, take place about the valuer's proposals to manage any conflict or perceived conflict with a view to reaching agreement. The lender will review this in the context of their policies and if the proposed solution does not meet the lender's criteria, they may be unable to instruct the valuer. It is not within the scope of this guidance to comment further, as policies will vary across the lender community, but a valuer acting in full compliance with the RICS standards and guidance referred to previously is not under any obligation to agree to terms or measures that they believe to be unduly onerous when settling *terms of engagement*. See also UK VPGA 10.3.

Valuer communication with a borrower

- 4 The valuer should take instructions from the lender in regard to the method of obtaining information that is not publicly available. If the lender elects to open a communication channel directly between the borrower and the valuer in order to promote an efficient exchange of data, it is good practice for the valuer to request these instructions in writing.

Status of valuer

- 5 The provision of advice that is objective and free from bias assumes particular importance in relation to secured lending, and therefore the valuer providing the opinion of value on which the lending decision will ultimately be made will – at a minimum – be expected to be an '*external valuer*' as defined in the Global Standards *Glossary*. However, as **PS 2 section 3 paragraph 3.4** makes clear, some lending clients may adopt specific criteria that a valuer must meet, using terms such as 'independent valuer' in this connection. As there is no universally recognised definition of this or other similar terms, it is essential that the valuer

ensures the instructing client has defined the term or terms employed in writing, so the criteria for independence being applied are crystal clear. It follows that the valuer must meet those criteria before agreeing to act.

- 6 See UK VPGA 10.4 regarding the other roles that valuers may perform in relation to the secured lending process.

UK VPGA 10.3 Instructions and disclosures

Valuers are reminded of the need to mitigate risk in *valuation* work, pursuant to the RICS guidance note *Risk, liability and insurance in valuation*, 2nd edition. RICS Rules require that the *terms of engagement* are fair and reasonable for all parties involved. Prior to accepting any instruction, valuers may or will need to discuss with clients the principle of liability caps and the reliance that will be placed on the *valuation*. The resultant agreement must be unambiguously documented in both the *terms of engagement* and the valuation report.

- 1 Many lenders deploy framework agreements or 'panel agreements', which may be made directly with the *valuation* firms or managed via a third-party panel management firm. Where these are agreed and adopted by the parties concerned, they may have the benefit of standardising terms of instruction/engagement and the associated reporting requirements. However, great care must be exercised to ensure that where such agreements are in place, they are and remain appropriate in relation to individual *valuation* assignments. This is of as much importance to the lender as to the valuer. The great diversity of circumstances relating to property assets that may be considered for secured lending means that *members* should be alert to instances where, for specific and identified reasons, standardised *terms of engagement* may not be appropriate. Such cases should be identified and discussed with the instructing client as appropriate – but *members* should not feel obliged to undertake assignments under unduly onerous or inappropriate terms and must always bear in mind the requirements of **PS 2** and in particular **section 2 paragraph 2.4**. In short, *members* must not undertake work that is outside their remit and competency.
- 2 Panel agreements may require revisions from time to time to reflect changes in regulation or market practice. Valuers are therefore advised to keep such agreements under regular review to ensure relevance and clarity of the expectations on both parties to the agreement.
- 3 VPGA 2 sets out guidance on agreeing *terms of engagement* with those lenders who do not issue panel agreements, and on responding to requests for *valuations* by brokers and prospective borrowers. For *valuations* undertaken in the UK, it is strongly recommended that any loan security report is addressed only to the named lender, and not to a broker or potential borrower.

Limitation of liability

- 4 The actual limits of liability to be agreed between the lender and the valuer in relation to the *valuation* are a matter for commercial negotiation. However, both

parties should have regard to the requirement that any cap in liability should be reasonable and proportionate to the nature of the instruction and their respective exposures to risk. Particular care is required, both to understand the potential extent of liability and to understand its management, if the valuer is asked to provide advice or assurance in relation to matters that would trigger the need for action under **PS 2 section 2 paragraph 2.4**.

Limitation of reliance

- 5 As a default position, the *terms of engagement* should limit reliance only to the addressee, who should be the named lender. They should also state as default that any third-party reliance is specifically excluded. However, if any other beneficiaries are to be included, as appropriate to the nature of the instruction, these should be specifically named.

UK VPGA 10.4 Reporting

Valuers usually need to review a range of technical reports and other due diligence information sources in arriving at their opinion of value. The key topics are listed within VPGA 2, though it is not intended as an exhaustive list. It is important for the valuer to recognise the limits of their expertise and to restrict any comments to observations of fact. Valuers should always recommend that the relevant specialists, e.g. legal, technical and environmental advisors, review where appropriate their interpretation of those reports, and revert if they are not correct.

Regulatory requirements

- 1 A lender may request the valuer to provide an opinion of asset quality in accordance with categories established by regulatory authorities. In these instances, the valuer should confine their response to a direct answer to the questions. Any limitations on the valuer's ability to complete these questions accurately should be noted.

Suitability for loan security

- 2 It is wholly the responsibility of the lender to assess and take the final decision on the suitability of the asset for loan security, as this will involve factors other than the property being taken as collateral. Any comments by the valuer should be limited to those property or market factors that could or may have an impact on cash flow, value or liquidity.
- 3 The valuer is only expected to provide an opinion based on information that is readily available in the market and/or is reasonably foreseeable. Where forward-looking advice is provided to the lender, it must meet the requirements of **VPS 3 section 2 paragraph 2(e) subparagraph 3** and **VPS 4 section 11**.

Extensions of validity and revaluations

- 4 In the event that the completion of a loan is delayed, a lender may revert to a valuer to ask for confirmation that a *valuation* is still valid. The valuer must exercise caution should there be any material change in the facts and circumstances that may influence the *valuation*, but nevertheless may confirm the *valuation* where appropriate.
- 5 An instruction for a revaluation without *re-inspection* should follow the guidance in **VPS 2**. The valuer should additionally ascertain whether the loan is being treated as an extension of the original loan, or a new loan, which may have different consequences regarding valuer liability.

UK VPGA 11 Valuation for residential mortgage purposes

This guidance is designed to achieve a uniform approach to the provision of *valuation* advice in connection with UK residential secured lending. Specifically, it covers the provision of advice to prospective lenders where the security to be offered is either:

- a) an individual residential property that is intended to be occupied, or is occupied by the prospective borrower or
- b) an individual residential property purchased as a buy-to-let investment (see also UK VPGA 13.6).

Overview

- 1 When valuing UK residential properties on behalf of building societies, banks and other lenders for mortgage purposes, the valuer is expected to follow the guidance in this *valuation* application unless otherwise agreed in writing, in advance, with the client. See paragraph 3 regarding the existing RICS Residential Mortgage Specification, which has been widely adopted.
- 2 In Scotland, the procedures for buying residential property differ from those in England, Wales and Northern Ireland. This guidance is nevertheless of general application, save for the practicalities concerning agreement of *terms of engagement* in Scotland – see **UK VPS 2**.
- 3 Most lenders have standard *terms of engagement* and in many cases these refer to and expressly adopt the RICS Residential Mortgage Valuation Specification contained in UK Appendix 10 of the January 2014 (revised April 2015) edition of *RICS Valuation – Professional Standards UK*. This Specification may continue to be adopted where agreed between the parties (and will be regarded as consistent with the guidance in this UK VPGA) subject to cross-references to the 2014 Global Edition now being read as relating to the equivalent sections in the 2017 Global Edition. In Scotland, regard must also be had to **UK VPS 2**.
- 4 It is anticipated that an updated version of the Specification will be developed in liaison with UK Finance and any other key stakeholders and published in due course. Any consequential changes to UK VPGA 11 will be made if necessary.
- 5 In general, *firms* that provide advice on residential mortgages are regulated by the *FCA Mortgages and home finance: conduct of business sourcebook* (FCA MCOB). The regulations apply to 'regulated mortgage contracts'. In order for a loan to fall within the definition of a regulated mortgage contract, at least 40% of the total of the land to be given as security must be used as, or in conjunction with, a dwelling. To be 'residential property', at least 40% of the land must normally be used as or in connection with one or more dwellings, or has been or is to be developed or adapted for such use.

- 6 A lender may ask the valuer for advice on the extent of the use of the property for residential purposes. The advice required should relate to the use of the property, and the valuer should not be influenced by the relative capital values or floor areas in isolation from the accompanying land.

UK VPGA 11.1 Application of the RICS Valuation – Global Standards 2017

The global guidance for secured lending valuations is contained in VPGA 2. This remains wholly applicable to UK secured lending, and valuers should have full regard to this in conjunction with this UK-specific guidance, which addresses in particular the full level of *inspection* and investigations appropriate.

- 1 In its capacity as regulator, the Financial Conduct Authority (FCA) through its handbook of rules and guidance requires in connection with secured lending that, where a physical *valuation* is completed, the 'property shall be valued by an independent valuer at or less than market value'. An independent valuer is defined as a 'person who possesses the necessary qualifications, ability and experience to execute a *valuation* and who is independent from the credit decision processes'.
- 2 In the case of RICS *members* the FCA's criteria are met by compliance with **PS 1** and **PS 2** – additionally, when agreeing *terms of engagement*, the valuer must also comply with the requirements of **VPS 1**.
- 3 Most lenders have standard *terms of engagement*. The valuer must ensure that in confirming the terms, whether as a generic standing instruction or for an individual instruction, all the requirements of **VPS 1** are addressed. Where generic standing *terms of engagement* are in place, these must be assumed to apply in all subsequent cases, subject to any specific amendments that may be required.
- 4 Where a lender's request incorporates special requirements – for instance a limited *inspection*, or *no inspection*, or *special assumptions* – the valuer must expressly confirm and as necessary clarify them in the *terms of engagement*, and consider any potential impact on the fee, before accepting the instruction.
- 5 It should be emphasised that in all cases the requirements of **PS 2** apply. The valuer must have the appropriate knowledge and skills to undertake the *valuation* competently. If not, the instruction should be declined. Where it is discovered on arrival at the property that it is exceptional, or even includes some commercial property element, the valuer should consider referring back to the lender and seeking further instructions.
- 6 In Scotland, due to time restrictions sometimes created by the traditional and accepted procedures for buying residential property, it may be difficult to confirm the *terms of engagement* prior to issuing the *valuation* report – see **UK VPS 2**.

The valuer's role and remit

- 7 The role of the valuer is to advise the lender on:
 - a) the nature of the property and factors revealed during the *inspection* that are likely to materially affect its value
 - b) the *market value* (and/or *market rent* if required), with specified *assumptions* or *special assumptions* and
 - c) where there are serious cases of disrepair or obvious potential hazards revealed during the *inspection* that may have a material impact on its value.
- 8 The remit of the mortgage valuer is to provide an objective *valuation* opinion having regard to the lender's policy and requirements.
- 9 Decisions on mortgage term, size of advance and lending outcome are a matter for the lender and the valuer must not accept instructions to make such recommendations.
- 10 The valuer's remit is also defined by and limited to the *terms of engagement*, which will address compliance with the terms of reference provided by the lending source in writing, either for the individual property or on the basis of generic terms agreed for all *valuations* to be undertaken by the valuer.
- 11 It is recognised that although the *valuation* report is provided to the lender there is established case law that the valuer may have a duty of care to the prospective purchaser, who may or may not be provided with a copy of the report, or with a summary of its relevant recommendations.
- 12 The report will include the valuer's opinion of value at the specified date together with comments on the factors that may materially impact on the value established during the *inspection* and any matter identified that is not in accordance with the standard *assumptions*.

UK VPGA 11.2 Bases of value

The bases of value to be adopted for a loan security *valuation* is *market value* or *market rent* as defined in **VPS 4**.

- 1 Where an existing property has, or has a reasonable prospect of obtaining, planning approval for future development, that value is to be excluded from the assessment of *market value* by way of a *special assumption* (**VPS 4 section 9**) unless instructed otherwise by the lender.
- 2 In some cases, a projected market value (PMV) is requested by the lender. This is for the purpose of providing a residential mortgage lender with a simple numeric indication of the valuer's opinion of short-term market trends, and is to be used only for this purpose. A valuer may comply with such a request, using the following established definition:

- 'The estimated amount for which an asset is expected to exchange at a date after the valuation date, and specified by the valuer, 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.'
- 3 When adopting PMV it is essential that the following is clearly understood:
 - a) the *valuation date* is the date on which the estimate is given
 - b) the *valuation* should be carried out on the basis of *market value* but with a clearly stated and agreed *special assumption* that the asset will exchange at a future date after the *valuation date* specified by the valuer – see **VPS 4 section 11**
 - c) this date should assume that marketing begins on the date that the *valuation* is prepared and reflect the period that the valuer considers will be necessary for adequate marketing and the completion of negotiations and
 - d) the definition assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise occur.
 - 4 A PMV is a projection, not a forecast. It recognises that most reports for this purpose are based on a simple pro forma, and that the degree of market analysis and commentary required in commercial lending situations is inappropriate. It is stressed that the purpose of such a *valuation* is simply to illustrate the valuer's opinion of whether the market is likely to fall, rise or remain static in the period that it is anticipated will be necessary to complete the sale. Values can change rapidly due to unpredictable events, thus a *valuation* based on this *special assumption* is not a substitute for a current market value, nor is it necessarily the case that the two figures will be the same.

UK VPGA 11.3 Valuation investigations

The purpose of an *inspection* for a mortgage valuation is to ensure the provision of a *valuation* upon which the lender can base the terms of a loan, and to identify and report those matters that may have a material effect on the value.

Unless otherwise instructed, the valuer will inspect the property to be valued.

Inspection

- 1 The visual *inspection* to be undertaken in the present context covers as much of the exterior and interior of the property as is readily accessible without undue difficulty or risk to personal safety. Although personal judgement has to be used, this *inspection* should include all of the property that is visible when standing at ground level within the boundaries of the site and adjacent public/communal areas, and when standing at the various floor levels.

- 2 More specifically, and subject to any *assumptions*:
- a) Roof voids and under floor voids are not to be inspected. Furniture and effects are not to be moved, and floor coverings are not to be lifted. Cellars and basements should be inspected where there is safe access.
 - b) The availability of services, including green technologies, should be recorded but not tested by the valuer.
 - c) The *inspection* includes garaging, car parking, other outbuildings (excluding leisure complexes) of permanent construction and any other structures attached to the dwelling. If relevant, their impact on the value of the property is to be noted.
 - d) The valuer is not expected to comment on the size, condition or efficiency of any leisure facility in the grounds of the property of which the dwelling forms part. However, comment may be expected where it falls outside expected norms due to factors such as size, siting or disrepair.
 - e) The land within the ownership should be inspected as far as is practicably possible, and any material matters recorded and reported. This will include any obvious access restrictions and easements.
 - f) Where there are locational factors that may impact value, they should be recorded and reported, with some comment where appropriate. Certain problems, such as flooding, mining settlement, subsidence, woodworm, invasive vegetation, radon gas, mundic and other issues are particularly prevalent in certain districts. If appropriate, the valuer should make some reference to these defects, even if the subject property does not appear to be affected at the time of the *inspection*. Where appropriate, the valuer should advise that an environmental assessment or a mining report should be obtained.
 - g) The energy-efficiency rating provided within the Energy Performance Certificate (EPC) is to be considered, if it is available.
 - h) Where the property is a flat or maisonette, the following additional requirements will apply:
 - i) The external *inspection* will be of the main building within which the flat or maisonette is located.
 - ii) The external *inspection* will include the primary communal access areas to the property and any communal areas on the floor on which the flat or maisonette is located.
 - iii) Where communal services are provided it may be assumed that the right to use these and have them maintained passes with the property.
 - iv) The general standard of management and maintenance may have an impact on the service charge, and the possibility of the owner having to contribute to capital expenditure may have a substantial effect on the value. The valuer does not have to provide any estimates of such costs, but will draw attention to them in the report.

- e) To be able to respond to a future enquiry, legible notes (which may include photographs) of the findings and, particularly, the limits of the *inspection* and the circumstances in which it was carried out must be made and retained. The notes should also include a record of any comparable transactions and/or *valuations* considered when arriving at the *valuation*.

Valuation advice without a full inspection

- 3 The valuer may be asked for *valuation* advice without an internal or physical *inspection*, and with or without the benefit of an earlier report. Such a request may be complied with, but the consequential limitations on the valuer's liability need to be drawn to the attention of the lender.
- 4 When an opinion is provided on this basis, it must be confirmed in writing, and the manner of *valuation* and the restrictions under which it is given clearly stated (see **VPS 2**). The lender must be informed that the value stated must not be disclosed to the borrower or any other party, unless required to do so by the FCA rules in *Mortgages and home finance: conduct of business sourcebook* (MCOB).
- 5 Many lenders use a standard pro-forma report for *valuations* without an internal *inspection*. Where this is the case, and subject to the *terms of engagement* being absolutely clear, the valuer does not separately need to comment on:
 - i) the manner of **valuation**
 - ii) the restrictions under which it is given
 - iii) the non-disclosure to the borrower and/or other third parties or
 - iv) the **assumptions**, restrictions and terms under which the valuer should prepare the report where the pro-forma, lender's **terms of engagement** or lender's guidance manuals (or equivalent) already state them.
- 6 Where a desk top opinion is sought without any form of *inspection* of the property itself, the valuer should exercise additional caution particularly as to the intended use of the *valuation*. The valuer should ensure that the source of information and the rationale used in arriving at the desk top *valuation* are documented and retained, given that there will be no site notes.
- 7 In Scotland the valuer is not required to read the Home Report documents unless carrying out the original Single Survey, in which case the valuer is not required to read the Property Questionnaire.

UK VPGA 11.4 Factors with a material impact on value

The *inspection* and investigations may reveal various factors that could have a material impact on the value. These factors need to be carefully considered by the valuer in the context of the *valuation*. The valuer may wish to alert the lender, in advance of any final report, of any matters which raise significant concern from a *valuation* perspective.

- 1 Factors with a material impact on value can include:
 - the tenure of the interest offered as security and, if known, the terms of any tenancies to which that interest is subject
 - where the property is leasehold, the length of the remaining lease term
 - the location, age, type, accommodation, fixtures and features, and amenities of the property, including *sustainability* considerations
 - the apparent general state of, and liability for, repair, form of construction and apparent major defects, liability to subsidence, and/or other risks
 - the location of a property in an area known to be at risk from flooding or other adverse environmental factor
 - any current or potential *valuation* impact of the Energy Performance Certificate rating
 - any easements, servitudes, burdensome or restrictive covenants, and third-party rights and
 - any obligations relating to planning conditions, for instance Section 106 agreements or restrictions related to affordable housing conditions.
- 2 The *valuation* of a new-build property should be approached in the same way as any other *valuation*. There are, however, specific aspects of the new-build residential market that have led certain mortgage lenders to require an alternative approach to *valuation*. In all instances, the notified sale price must be treated with caution. The RICS guidance note, *Valuation of individual new-build homes*, 2nd edition is relevant when valuing these types of property.

UK VPGA 11.5 Assumptions and special assumptions

During the course of a mortgage valuation, and in the absence of any lender provided information, a valuer is expected to make oral enquiries of an owner/occupier or selling agent (if applicable) regarding any elements of the property that may have an impact on value.

Legal and planning matters

- 1 Overall, it is not necessary for the valuer to make detailed enquiries into legal or planning matters. These should be left to the lender's or borrower's legal advisers. Any obviously visible breach of planning control or evident legal concern, however, should be reported. The lender should also be advised

- of any obvious, recent and significant alterations and extensions, so that the lender's legal adviser is alerted to the possible need to make enquiries.
- 2 The valuer is not obliged to search for statutory notices, although the lender's legal advisers may ask if any such matters that come to light during their own searches have a material effect on value. Consideration may have to be given to known, or suspected, planning restrictions or conditions. The valuer is under no duty to search, but may be called on for advice as to any material effect on value if adverse matters are disclosed.

Contamination and environmental hazards

- 3 No enquiries regarding contamination or other environmental hazards are to be made but, if a problem is suspected, the valuer should recommend further investigation. The valuer will not carry out an asbestos *inspection* and will not be acting as an asbestos inspector in completing a mortgage valuation *inspection* of properties that may fall within the *Control of Asbestos Regulations 2012*.

Other matters

- 4 In the absence of details and considering the limited nature of an *inspection* for a mortgage valuation, the valuer is entitled to make reasonable *assumptions* with regard to the state of the property and other factors that may affect value.
- 5 Unless limited enquiries reveal otherwise the following *assumptions* and *special assumptions* may be made without verification:
 - a) The property will be transferred with vacant possession, unless it is a buy-to-let instruction being valued with the tenant in situ.
 - b) All required valid planning permissions and statutory approvals for the buildings and for their use, including any extensions or alterations, have been obtained and complied with.
 - c) In the case of a building that has not yet been constructed, the valuer will, unless instructed otherwise, provide a *valuation* on a *special assumption* that the development had been satisfactorily completed, as at the date of the *inspection*, in accordance with planning permission and other statutory requirements.
 - d) No deleterious or hazardous materials have been used in the construction. However, if the limited *inspection* indicates that there are such materials, this must be reported and further instructions requested.
 - e) The site is not contaminated and is free from other environmental hazards.
 - f) The property is not subject to any unusual or especially onerous restrictions, encumbrances or outgoings, and good title can be shown.
 - g) The property and its value are unaffected by any matters that would be revealed by a local search (or their equivalent in Scotland and Northern Ireland), or in replies to the usual pre-contract enquiries or by any

statutory notice that may indicate that the property and its condition, use or intended use are, or will be, unlawful.

- h) An *inspection* of those parts that have not been inspected, or a survey *inspection*, would not reveal material defects or cause the valuer to alter the *valuation* materially.
 - i) There is unrestricted access to the property, and the property is connected to, and has the right to use, the reported main services on normal terms.
 - j) Sewers, main services and the roads giving access to the property have been adopted, and any lease provides rights of access and egress over all communal estate roadways, pathways, corridors, stairways and use of communal grounds, parking areas and other facilities.
 - k) In the case of a newly constructed property, it has been built under a recognised builder's warranty or insurance scheme approved by the lender, or has been supervised by a professional consultant capable of fully completing the UK Finance Professional Consultant Certificate acceptable to the lender.
 - l) There are no ongoing insurance claims or neighbour disputes and the property is insurable under normal terms.
- 6 Where the *inspection* reveals matters that affect any *assumption* or the value of the property, the details are to be included in the report together with, if appropriate, recommendations for further action to be taken.
- 7 Where RICS has published guidance on specific areas of *valuation*, the valuer should have regard to this – as at the date of publication these include:
- **Valuation of individual new-build homes**, 2nd edition
 - **Leasehold reform in England and Wales**, 3rd edition and
 - **Valuation of buy-to-let and HMO properties**, 1st edition.

Leasehold properties

- 8 Leasehold data including unexpired lease term, ground rent and any further relevant information should be considered and reflected in the *valuation* based upon data that can be sourced on the day of *inspection* or beforehand from either the vendor or the selling agent as applicable following reasonable investigation. However, the valuer clearly cannot give any absolute assurance that, if verbally provided, such data is reliable – verification will be a matter for the lender's legal representatives as appropriate.
- 9 Where the dwelling is leasehold, and it is not possible to inspect the lease or details have not been provided, the following *assumptions* will be made, unless instructed to the contrary:
- a) The unexpired term of the lease is assumed to be 85 years, and no action is being taken by any eligible party with a view to acquiring the freehold or extending the lease term.

- b) There are no exceptionally onerous covenants upon the leaseholder.
 - c) The lease cannot be determined, except on the grounds of a serious breach of covenant in the existing lease agreement.
 - d) If there are separate freeholders, head and/or other subhead leaseholders, the terms and conditions of all the leases are in the same form and contain the same terms and conditions.
 - e) The lease terms are mutually enforceable against all parties concerned.
 - f) There are no breaches of covenant or disputes between the various interests concerned.
 - g) The leases of all the properties in the building/development are materially the same.
 - h) The ground rent stated, or assumed, is not subject to unreasonable review and is payable throughout the unexpired lease term.
 - i) In the case of blocks of flats or maisonettes of over six dwellings, the freeholder manages the property directly, or there is an appropriate management structure in place.
 - j) There is a dutyholder, as defined in the *Control of Asbestos Regulations* 2012, and there are in place an asbestos register and an effective management plan, which does not require any immediate expenditure, pose a significant risk to health, or breach Health and Safety Executive (HSE) requirements.
 - k) Where the subject property forms part of a mixed residential or commercially used block or development, there will be no significant changes in the existing pattern of use.
 - l) Where the property forms part of a development containing separate blocks of dwellings, the lease terms of the property apply only to the block. There will be no requirement to contribute towards costs relating to other parts of the development, other than in respect of common roads, paths, communal grounds and services.
 - m) Where the property forms part of a larger development whose ownership has since been divided, all necessary rights and reservations have been reserved.
 - n) There are no unusual restrictions on assignment or subletting of the property for residential purposes.
 - o) There are no outstanding claims or litigation concerning the lease of the subject property or any others within the same development.
 - p) Where the property benefits from additional facilities within the development, the lease makes adequate provisions for the occupier to continue to enjoy them without exceptional restriction, for the facilities to be maintained adequately and for there being no charges over and above the service charge for such use and maintenance.
- 10** Where the proposed security is part of a building comprising flats or maisonettes, the following *assumptions* will also be made, unless instructed to the contrary:

- a) The costs of repairs and maintenance to the building and grounds are shared equitably between the flats and maisonettes.
 - b) There are suitable, enforceable covenants between all leaseholds, or through the landlord or the owner.
 - c) There are no onerous liabilities outstanding.
 - d) There are no substantial defects, or other matters requiring expenditure (in excess of the current amount or assumed amount of service charge payable on an annual basis), expected to result in charges to the leaseholder or owner of the subject property during the next five years, that are equivalent to 10% or more of the reported *market value*.
- 11 For the avoidance of doubt, the valuer will not be under a duty to purchase data from third parties or to read the lease documentation. If further information is provided to the valuer after the mortgage valuation has been completed and submitted, the valuer may reconsider the *valuation* and if necessary issue an amended report. But again, for the avoidance of doubt, the valuer will not be under any obligation to read the lease document and would only be expected to base a revised *valuation* on further information provided to the valuer by the lender's legal representatives.
- 12 In respect of insurance, the following *assumptions* will be made, unless instructed to the contrary:
- a) the property can be insured under all-risks cover for the current reinstatement cost and is available on normal terms
 - b) there are no outstanding claims or disputes
 - c) where individuals in a block make separate insurance arrangements, the leases make provision for mutual enforceability of insurance and repairing obligations and
 - d) any landlord responsible for insurance is required to rebuild the property with such alterations as may be necessary to comply with current Building Regulations and planning requirements.

UK VPGA 11.6 Reporting

The lender will often provide a standard valuation report format. Whatever format is used the information provided in the report should comply with **VPS 3**.

- 1 The valuer's duty is to prepare a report on the basis of the *terms of engagement* settled and of the information or questions contained in the instructions received, unless there are obvious errors or inconsistencies.
- 2 If other *assumptions* are made in addition to those described in UK VPGA 11.5, they must be explicitly stated in the report.
- 3 In addition to reporting the value, an important part of the report is to identify those factors that may have materially impacted value, or may be expected do

- so in the future. Where such factors are identified the valuer will, as appropriate, recommend appropriate action.
- 4 If it is suspected that hidden defects exist that could have a material effect on the value of the property, the valuer should recommend more extensive investigation. It may be appropriate, in exceptional circumstances, to defer making a *valuation* until the results of the further investigations are known.
 - 5 If it is not reasonably possible to carry out any substantial part of the *inspection* this should be stated.
 - 6 The report should include reference to:
 - a) the form of construction
 - b) the existence of any obvious, recent and significant alterations and extensions
 - c) any obvious evidence of serious disrepair or potential hazard to the property, and any other matters likely to materially affect the value (although minor items of disrepair, poor design or lack of decoration that do not materially affect the value of the security do not need to be reported)
 - d) items that are not serious at the date of *inspection* but could become so if left unattended and
 - e) other items of disrepair or poor design, or a lack of maintenance, that may adversely affect the structure in the future and lead to a material effect on the value of the security.
 - 7 Where there is a basic structural defect, such that renovation ceases to be possible or economic, a *valuation* should not be provided, subject to the lender's more specific reporting requirements.
 - 8 The valuer should also comment on:
 - a) any apparent deficiencies in the management and/or maintenance arrangements observed during the *inspection* that materially affect the value
 - b) the current amount of the annual service charges payable, if available and
 - c) any situation where the apparent sharing of drives, paths or other areas might materially affect the value of the subject property.
 - 9 If the valuer's *inspection* reveals anything that gives reason to suspect an encumbrance, for instance, easements and other rights pertaining to way, light and drainage, they must be reported even if the report is in the lender's format and no provision is made on the form for such information to be provided.
 - 10 If the *inspection* and *investigations* reveal the possibility that *third parties* have the right of occupation, this must be reported in all cases.

- 11** Where the valuer does not have the necessary expertise to estimate any repair and maintenance costs and their impact on value, specialist advice should be obtained or the instruction declined. One example would be a property of architectural or historic interest, listed as such, or in a conservation area. Another would be a property of unusual construction, where any remediation of defects may require planning permission, or other consent. The repairs may also have to be to a standard that would not be detrimental to the property's architectural or historic integrity, its future structural condition or the conservation of the building fabric.

UK VPGA 11.7 Treatment of incentives

- 1** Sales incentives and the marketing of property, especially new-build homes, have become increasingly more innovative and sophisticated. Incentives can differ between development sites, between properties being sold and between the types of purchaser being attracted by the seller (owner-occupier or buy-to-let investor).
- 2** Where the property is a new-build, the valuer must obtain a copy of the developer's Disclosure Form. More detailed guidance on the treatment of incentives and how to report on their impact is contained in the RICS guidance note, *Valuation of individual new-build homes*, 2nd edition.
- 3** Where the property is a new-build, it is recommended that the valuer considers including a statement to the following effect:

'It should be appreciated that the *valuation* provided is for the property as new. It may not be possible to obtain the *valuation* figure if the property is resold as second-hand, especially if comparable new property is on offer at the same time.'

UK VPGA 11.8 Estimates for insurance purposes

Where the lender requests that an insurance replacement cost be provided it should be in accordance with Building Cost Information Service (BCIS) guidance.

- 1** The rebuilding costs used in accordance with the BCIS guidance refer to the expense of demolishing and clearing away the existing structure, and then rebuilding it to its existing design in modern materials, using modern techniques, to a standard equal to the existing property and in accordance with current Building Regulations and other statutory requirements. The costs normally exclude VAT, except on fees (it should be noted that on a claim where the insured cannot however recover VAT, it may be paid under the relevant policy – this is however a matter for the lender and insurer).
- 2** Where the building is not of modern materials, or is a protected building that is required to be reinstated exactly and is therefore outside the scope of BCIS guidance, the reinstatement cost should not be provided unless the valuer has

- expertise in that type of property. If necessary, a professional cost assessment should be recommended.
- 3 Where the subject property is a flat or maisonette, the valuer should assess the reinstatement cost of that part of the total structure constituting the proposed security. It is the lender's responsibility to enquire whether a management committee or the landlord arranges insurance for the building as a whole and whether that cover is adequate.
 - 4 Any exceptional risks likely to affect the premiums for insurance purposes should be reported. There is, however, no obligation for the valuer to seek out such factors. The duty is limited to factors that come to notice during the ordinary course of *inspection*.

UK VPGA 11.9 Possession following default

Valuations of residential property for the purpose of possible possession proceedings, or the proposed sale of a repossessed property, should be on the basis of projected market value (PMV), subject to the following *special assumptions* that:

- the asset will exchange at a future date after the **valuation date** specified by the valuer
 - during the marketing period the property has been unoccupied and all furnishings and fittings have been removed and
 - the vendor (the mortgagee) has to sell the property within a reasonable period to recover the secured debt.
- 1 The requirement to assume that during the marketing period the property has been empty, i.e. unoccupied and with all furnishings and fittings removed means that the valuer has to take into account the adverse effect this may have on its marketability.
 - 2 The conceptual framework for *market value* in **VPS 4** applies, but the second *special assumption* does slightly modify 'and without compulsion'. While a mortgagee is not compelled to sell, there is a requirement to capitalise a non-performing asset. Therefore, there is less flexibility than a typical owner-occupier would have. In certain market conditions this could affect the price that could be achieved.
 - 3 The mortgagee as vendor has a duty to secure the best price available in the prevailing market conditions and has to act reasonably.
 - 4 In Scotland, in recognition of the Single Survey, the *basis of value* for a lender's repossessed property, which is being exposed to the market, will be the same as any other property being brought to the market, that is, *market value*. Should the lender require any other method of *valuation*, this must be made clear in the *terms of engagement* and the report.

UK VPGA 12 Valuation of residential property for miscellaneous purposes

UK VPGA 12.1 Home finance products

Valuations for home finance products shall be in accordance with the requirements of the Financial Conduct Authority (FCA) *Mortgages and home finance: conduct of business* sourcebook (FCA MCOB).

- 1 *Firms* that carry out activities related to home finance transactions are regulated by the FCA MCOB. A home finance transaction may be one of four products:
 - regulated mortgage contracts (including lifetime mortgages)
 - home reversion plans
 - sale and rent back and
 - home purchase plans.

Lifetime mortgages and home reversion plans are together referred to as 'equity release products'. Equity release products and associated valuations are highly sensitive due to the age of the occupants.

- 2 The regulations apply to 'regulated mortgage contracts'. The full regulations may be obtained at www.fca.org.uk/handbook
- 3 The *valuation* of residential property for home finance products requires consideration over and above the standard mortgage valuation specification.
- 4 Although the purpose for which these *valuations* are required is regulated, they are not 'regulated purpose valuations' in the terms of **UK VPS 3**, and so the particular requirements specified in **UK VPS 3** do not apply.

UK VPGA 12.2 Lifetime mortgages

- 1 In this form, repayment is deferred until the sale of the property (lifetime).
- 2 Apart from indicating that the provider may include a property *valuation* in its illustration, there are no specific *valuation* requirements for lifetime mortgages. Such *valuations* should therefore be provided in accordance with VPGA 2 and UK VPGA 11.
- 3 The main differences between a lifetime mortgage and a conventional mortgage are:
 - a) the redemption date is not fixed but comprises the date of death of the mortgagor and

- b) no repayments of capital are made, and the interest is 'rolled up' and compounded over the length of the mortgage term.
- 4 Therefore the amount of mortgage debt to be redeemed at the end of the term (the date of death of the mortgagor) is much greater than with a conventional mortgage, because of the lack of any capital repayment during the term and the accumulation of 'rolled up' interest. Due to the undetermined length of the mortgage term and the higher than normal amount to be redeemed at the term date, *valuation* advice should include comments on *sustainability* (especially in respect of features of design, condition and location) that may influence value over a longer term.
 - 5 It is also important to appreciate that the lifetime mortgage lender places more emphasis on maintenance items and the timing of essential repairs as a condition of the mortgage. The forms and guidance published by the lender should therefore be considered in order to establish if they differ from the normal mortgage specification.

UK VPGA 12.3 Home reversion

In this form the occupant sells all or part of the home to a reversion company or an individual. The occupant no longer owns all or part of the home, but continues to live there rent-free for the remainder of their life.

- 1 The regulations provide that *valuations* for home reversion products must be carried out by a competent valuer who is independent of the reversion provider. The reversion provider *firm* must also provide the customer with copies of the *valuation* report.
- 2 In the absence of any specific *valuation* requirements, *valuations* for home reversion products should be provided in accordance with VPGA 2. However, they should be treated in the same way as under section 8.1 in most respects, except as mentioned in the following paragraphs 3 and 4.
- 3 Equity release products for home reversion, although for residential property, may need to be treated differently where there is some development potential reflected in the *market value* (in contrast to section 8.2, where such value is usually excluded). The title to the property, and thus the benefit of any development potential, passes to the company on completion of the equity release transaction. The exploitation of any development potential would effectively be deferred until the company realises the value of its reversion on the death of the applicant. The development potential could be released during the term of the investment (the life of the applicant), but only with the applicant's consent.
- 4 Where the *market value* reflects development potential, whether arising from actual planning consents or the prospect of future development, the lender should be advised accordingly. So that the lender can assess the significance for underwriting purposes, the valuer may be requested to provide further

information and a *valuation* on the *special assumption* that no development would be permitted.

UK VPGA 12.4 Sale and rent back

- 1 Sale and rent back (SRB) is a facility whereby individuals sell their homes to an authorised firm at a discount, in return for the right to remain as a tenant for a set period. The tenancy has to be for a minimum term of five years on a fixed-term assured shorthold tenancy (AST), or equivalent in Scotland and Northern Ireland.
- 2 The regulations prescribe a procedure for commissioning a *valuation* that has the following elements:
 - a) The *valuation* must be commissioned jointly by the SRB firm and the customer. A standard joint instruction letter is provided by the FCA, but its use is optional.
 - b) The *valuation* must be carried out by a valuer who is independent of the SRB firm.
 - c) The SRB provider must ensure that the *valuation* is carried out by a valuer who owes a duty of care to the customer in valuing the property. The FCA has suggested that the following wording is to be included in the appointment letter:
 ‘By accepting this instruction you acknowledge that you owe a duty at common law to exercise reasonable care to both [*name of firm*] and [*name of owner*], the property owner, and in addition you agree with each of [*name of firm*] and [*name of owner*], the property owner, that you will carry out this instruction with reasonable skill and care.’
- 3 The *basis of value* is *market value* at the reporting date.

Valuations for prospective lenders to sale and rent back (SRB) companies

- 4 Where the valuer is requested by an SRB provider or *third party* to provide a *valuation* for a prospective lender to an SRB company, it should be made clear that:
 - a) while the original SRB *valuation* was on the basis of *market value* assuming vacant possession, the *valuation* provided to a prospective lender will be on the basis of *market value* on the *special assumption* that the property is subject to a five-year tenancy and
 - b) these two *valuations* may be different from one another.
- 5 Where the valuer is requested directly by a lender to provide a mortgage *valuation* in respect of an application to finance an SRB purchase, the valuer must make clear to the lender that:
 - a) the *valuation* will be on the basis of *market value* on the *special assumption* that the property is subject to a five-year tenancy and

- b) this may differ from the original SRB *valuation* on the basis of *market value* assuming vacant possession.

UK VPGA 12.5 Home purchase plans

- 1 A home purchase plan serves the same purpose as a regular mortgage, but it is structured in such a way that makes it acceptable under Islamic Law.
- 2 The regulations do not provide any specific *valuation* requirements, and in the absence of specific instructions, valuations should be provided in accordance with VPGA 2 and VPGA 11.

UK VPGA 12.6 Home ownership schemes

The value of a share in a shared ownership property shall be in the same proportion of the *market value* of the whole interest with vacant possession as that share bears to the whole.

- 1 There is a wide range of schemes that enable an individual to purchase a dwelling using a combination of part ownership and part rental. Such schemes usually allow the part owner to purchase further shares in the dwelling, called 'staircasing', usually in 20% or 25% tranches.
- 2 The valuer may be asked to provide either the *market value* of the dwelling, where the share value is calculated according to the individual arrangements, or the value of the share to be acquired.
- 3 Where *market value* of the whole is provided, the sharing terms are ignored but any other terms that are in place, such as restrictions on purchasers or price and lease terms, are reflected. It is essential that the valuer is aware of the shared ownership document.
- 4 Where a value of a share is provided, there may be evidence that a share has sold at a higher or lower price than the same arithmetical share of the value of the whole property. If the different price can be identified and quantified, the report should include a reference to it.

UK VPGA 12.7 Shared equity schemes

Valuations for individual properties under a shared equity scheme shall be the *market value* of the whole interest.

- 1 Shared equity arrangements may arise as a result of developers offering either their own shared equity scheme, or a scheme as a result of government initiatives. Several different types of scheme exist, and valuers should ensure they are aware of the nature of the scheme proposed in respect of the property to be valued.

- 2 The valuer will usually be asked to provide the *market value* of the whole interest. Where this is provided, any restrictions on purchasers or resale price, or other restrictive terms, will need to be reflected. It is essential that the valuer is fully aware of the shared equity arrangements as well as any other restrictions.
- 3 Where there are circumstances that may unduly affect the resale value of the property because of the nature of the scheme, the valuer should provide further information to the lender and reflect this in the *market value* figure.
- 4 Generally, the buyer purchases an interest in the whole property, but only pays a percentage of the price. The remaining percentage is financed by a company in the form of an equity loan, and the company will take a second charge on the property. Some schemes require the equity loan to be repaid in full or in part at a specified date.
- 5 Conventional shared equity may enable the buyer to make partial repayments of the equity loan, thus increasing the purchaser's percentage share of the whole. Fixed shared equity does not enable the buyer to make partial repayments. Perpetual shared equity, more commonly associated with social housing schemes, does not allow for the repayment of the equity loan on sale, but perpetuates the arrangement on the same terms for a new purchaser. This may also be associated with restrictions regarding the nature of purchasers, for example, key workers.
- 6 On sale, the proceeds are shared in the same ratio as the initial percentages. This may result in either a gain or a loss for both parties, depending on whether the sale proceeds are more or less than the original purchase price.
- 7 Where it is not clear that the lender is aware that the property is being purchased under a shared equity scheme, the valuer should inform the lender.

UK VPGA 12.8 Trustee mortgage valuations

Valuations undertaken for trustee mortgages must be by an 'independent valuer' in accordance with section 8 of the *Trustee Act* 1925.

- 1 Under the Act a trustee must obtain a report of the value made 'by a person whom he reasonably believes to be an able practical surveyor or valuer instructed and employed independently of any owner of the property', and the loan must be 'made under the advice of the surveyor or valuer expressed in the report'.
- 2 As a result of case law it should be noted that:
 - the surveyor or valuer must be instructed and employed independently of both the mortgagor and his or her solicitor in the transaction
 - the amount or payment of the fee must not in any way depend on the proposed loan being effected and
 - where a security is introduced by the surveyor or the valuer, the latter should not be employed to make the *valuation*.

UK VPGA 13 Residential secured lending guidance for other related purposes including RICS HomeBuyer Service

While *valuations* of residential property for mortgage purposes generally should follow the guidance in UK VPGA 11, UK VPGA 13 covers various specific matters:

- *re-inspections*
- retype reports and transcriptions
- further advances
- buy to let
- **valuations** without internal *inspection* – see UK VPGA 11.3 and
- retrospective **valuations**.

Valuation advice may also be sought on a variety of other matters, such as mortgage rescue and accounts in arrears.

Unless the instructions specify otherwise, in all cases the *basis of value* will be *market value*.

UK VPGA 13.1 Re-inspections

A '*re-inspection*' is a further visit to a property for which the valuer has previously provided a report where the lender has either imposed conditions or made a retention.

- 1 The cases that may arise include:
 - consideration of the release of money by way of stage payments applicable to the stage of construction reached
 - whether the (new, or newly-converted or improved) property has been completed to the state assumed in the initial mortgage *valuation* report (where a mortgage offer has been made on this basis, but no advance has actually been made) and
 - in circumstances where part of the advance has been retained until specified works have been undertaken, whether those works have apparently been completed as assumed in the initial *valuation* report, or as otherwise specified by the lender, to a standard satisfactory to justify lending on them and without significant adverse effects on the value of the property.
- 2 The valuer may be asked to advise whether the previous *valuation* report (which must always be available to the valuer) is still sufficiently accurate for the lender to assess the adequacy of the security, when deciding whether or not to release a retention or stage payment. In this case the valuer's duty is to inspect only

those parts of the property with which the lender is concerned. It is not the task of the valuer to inspect the whole property.

- 3 The lender must be advised if, during the *re-inspection*, the valuer:
 - becomes aware of any material changes or factors additional to those in the previous report, which would materially affect the *valuation* of the proposed completed security
 - becomes aware of any other factor that might materially affect the *valuation*
 - is of the opinion that the *valuation* of the proposed completed security would be materially different from that previously reported
 - considers that the property may have been affected adversely by the works carried out
 - observes new defects and/or repair requirements and/or unsatisfactory workmanship and/or
 - becomes aware that the problem originally causing the need to carry out the remedial works is now affecting another part of the structure, or that part of the structure which is the subject of the required *inspection* is suffering from a further defect.

However, there is no requirement to provide a revised *valuation* unless requested to do so.

- 4 A new figure for reinstatement insurance purposes is not to be provided, unless requested by the lender.

UK VPGA 13.2 Retype and lenders transcriptions reports

A 'retype report' is the generic name applied to a request for a 'copy report' or 'transcription', which is commonly requested by brokers and lenders.

- 1 When receiving instructions from a *third party* (e.g. broker) to complete a retype, the valuer should be clear as to the acceptability of such reports by the lender whose report form is being completed. The lender's requirements will usually be made clear in the lender's panel contract and guidance. These requirements will always prevail over any contrary instructions from *third parties*, particularly in respect of retype acceptability, timescales, applicable *valuation dates* and valuation definitions.
- 2 Some requests for a retype report can lead to a potential conflict of interest, which should be considered in relation to the specific guidance in table 1 (see UK VPGA 13.4) and generally in **PS 2**.
- 3 Retype reports can be categorised as either:
 - a copy report – a duplicate copy of a previous report stating exactly the same facts with the same *inspection* date, *valuation* date and valuation figure as in the original report or

- a transcription report – the transcription of data, which was presented in a previous report, to another report format stating the same facts with an *inspection* date, *valuation date* and valuation figure.
- 4 There may be minor amendments to meet lender requirements for additional data that can be presented in the transcription report if it was collected during the original inspection. Where additional data is requested that would require another visit to the site, the valuer should negotiate the appropriate fee for the additional work.
 - 5 Where the valuer is aware that the value of the property has reduced to a level materially below the *valuation* at the original *inspection* date, the valuer should initially decline instructions. In the absence of a contract or agreement to provide a copy report stating both the original and current valuation figures, the valuer should offer to provide a revaluation at an appropriate fee.
 - 6 Where the lender's requirements are for a *valuation* based on a different valuation definition from the original, the instructions should be declined. The valuer should then offer to provide a revaluation at an appropriate fee.

UK VPGA 13.3 Retype reports in Scotland

When producing a Home Report, the valuer has the option to provide a Generic Mortgage Valuation Report (GMVR) in addition to the Single Survey. Buyers will be in the same position as before in having this prior to making an offer.

- 1 A lender may request a *valuation* for mortgage purposes on its own report forms. This can be provided prior to purchase in the prospective purchaser's name when the seller has conditionally accepted an offer to purchase, provided that:
 - the valuer has provided a Generic Mortgage Valuation Report (GMVR) with the Single Survey and is an approved panel member for the lender
 - the *valuation* in the GMVR is replicated exactly in the retyped lender *valuation* and
 - no additional information other than that which is in the Single Survey and GMVR is provided.
- 2 If at the time of such a request the date of the *inspection* on the Single Survey is considered out of date (currently over 3 months from the date of *inspection*) the lender may request a Replacement Single Survey. If the vendor refuses to authorise this the transcription should be declined and the lender will need to source a *valuation* from another panel member. If a Replacement Single Survey is carried out, the transcription to the lender should reflect the terms and *valuation* contained within the Replacement Single Survey, which may vary from the original Single Survey and *valuation*.
- 3 If the Home Report does not include a GMVR, no transcription can be provided and the lender will need to source a *valuation* from another panel member.

UK VPGA 13.4 Retype reports – possible conflicts of interest

Table 1 provides an indication of the circumstances under which a request for a retype report may give rise to a conflict of interest. Further guidance on conflicts of interest is given in **PS 2**.

Instruction source	Acceptable	Not acceptable <i>[not applicable in Scotland]</i>	Acceptable subject to conditions
Lender	<p><i>Different lender, same applicant:</i> acceptable, as this is an accepted industry practice.</p> <p><i>Same lender, different applicant:</i> acceptable, as most likely to be a full revaluation.</p>	<p><i>Different lender, different applicant:</i> not acceptable, as previous applicant and lender case may still be live.</p>	<p><i>Same lender, related applicant:</i> acceptable if applicant 'related' to previous applicant and change is administrative.</p>
Intermediary	<p><i>Same or different lender, same applicant:</i> acceptable, as this is an accepted industry practice.</p>	<p><i>Different lender, different applicant, or same lender, different applicant:</i> not acceptable, as there's no proof that original applicant has ceased interest, so potential conflict.</p>	<p><i>Different intermediary, different lender, same applicant:</i> can proceed only after the consideration of the risk of multiple applications.</p>
Applicant	<p><i>Same applicant, different lender:</i> acceptable, as applicant has instructed the transfer of information, therefore it is implicit that the valuer has the personal details. It should be stated within the report that the applicant has instructed the valuer.</p>		

Table 1: Conflicts of interest

UK VPGA 13.5 Further advances

Where a property is already in mortgage to a lending institution, the lender may sometimes wish to consider whether a further advance, usually of a specified sum, can be made on the security of the property or the repayment of a loan rescheduled. The *valuation* may be of the property as it stands and/or with works proposed to it. The lender is expected to provide the valuer with the original report, or a copy, wherever possible.

- 1 The valuer's remit is to provide a report on all of the following:
 - the current *market value* of the property in its existing state
 - the current *market value* in its future state, where defined works are contemplated on the *special assumption* that they have been satisfactorily completed
 - where previously provided, a revised estimate obtained for insurance purposes
 - any factors likely to affect its value materially and
 - changes in the accommodation or its amenities since the previous *inspection* report.

UK VPGA 13.6 Buy-to-let

Buy-to-let *valuations* will encompass a number of different categories. The main three are:

Category 1: a single individual residential unit let to a single household on a single assured shorthold tenancy (AST) – Private Residential Tenancy in Scotland – Home Report Scotland where it neither forms, nor is intended to form, part of a portfolio.

Category 2: a single residential unit let on a single AST, but to individuals on a sharing basis up to a maximum of four individuals.

Category 3: licensable houses in multiple occupations (HMOs) and multiple units held on a single title. They will include categories of properties not capable of being valued on an *assumption* of owner occupation and/or by adopting a traditional comparable methodology. These will be valued only after confirmation of direct *terms of engagement* with the instructing lender and referring to the lender's specific guidance.

More detailed guidance is set out in RICS guidance note *The valuation of buy-to-let and HMO properties*, 1st edition.

- 1 The following comments apply to all categories and should be read in conjunction with the RICS guidance note *The valuation of buy-to-let and HMO properties*, 1st edition:
 - a) The valuer must be sufficiently experienced in the residential investment market and have a sound knowledge of the rentals in the locality and be familiar with published Local Authority guidance and criteria.

- b) The valuer should be aware of the impact of rental incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above *market rent* and cashbacks in lieu of rental income for a number of years may have an effect on price. The valuer should consider these impacts and report accordingly.
 - c) The lender may use either or both the *market rent* and the *market value* to determine the size and type of loan to be extended to the borrower. The *market rent* figure may therefore be critical in the underwriting of the loan and should not be viewed just as a guide or confirmation of the current or future rent passing.
 - d) The valuer should fully research, document and retain comparable rental evidence and either decline to provide a market rent figure or clearly state limitations as to accuracy if there is insufficient or limited evidence.
 - e) If the property is likely to incur higher than average maintenance costs due to its age/type, existing condition or intensity of occupation, this should be identified within the report, as the proportion of rent required for reinvestment will exceed normal levels and reduce net income accordingly. Excessive service charges and/or ground rents should also be considered in this regard, as they will similarly affect net income.
 - f) Where the lender advises the valuer that the borrower intends to let a vacant property for residential purposes, the lender should also instruct on whether the valuer is to value the property:
 - i) with vacant possession
 - ii) subject to an AST at *market rent* or
 - iii) subject to such other terms as the lender advises.
- 2 Where market rent is to be provided it will need to comply with **VPS 4 paragraphs 3, 5 and 9** on the *special assumption* that it is an unfurnished, six-month AST. This should be a sustainable rent and not one distorted by temporary factors of high demand, such as seasonal workers, holiday lets, asylum seekers or other special cases. A simple adoption of the current rent passing (if known) will not however be appropriate where market conditions have changed since commencement of the existing tenancy.
- 3 Comparable evidence for *market rent* should be as robust as that obtained for *market value*.

Category 1: Single assured shorthold tenancy

- 4 Individual residential properties that fall into category 1 may be purchased with a view to the owner letting them as investments. Many lenders have specific loans designed for this buy-to-let market. As the security offered is essentially a property that would be in the residential owner-occupier market, it is appropriate that the *valuation* is in accordance with that market.
- 5 The valuer should be aware of the impact of incentives in respect of properties suitable for buy-to-let investment. Guaranteed rents that are above *market rent*

and cashbacks in lieu of rental income for a number of years may affect the price. The valuer should consider these impacts and report accordingly. In some cases, the lender may specifically request the valuer to give an opinion of the *market rent* on an AST under item f(i) in paragraph 1.

- 6 In the case of item f(i) in paragraph 1, the valuer must include in the report a sentence stating that the lender has advised that the property is to be let and that this may adversely affect the *valuation* reported (if the valuer believes this to be the case). In the case of item f(ii) or (iii) in paragraph 1, the valuer must state in the report that a *special assumption* has been made that the property has been let on an AST on market terms, or such other stated terms as advised by the lender.
- 7 Many lenders use a standard pro-forma report for buy-to-let valuations. Where this is the case, the valuer does not need to comment on:
 - a) the letting *assumptions* made and/or
 - b) the possible adverse effect on the capital value of letting.

This applies where the pro-forma, lender's *terms of engagement* or lender's guidance manuals (or equivalent) already state the *assumptions* and/or *special assumptions* that the lender wishes the valuer to make in the preparation of the report.

- 8 In the event that the property is already let and is to be conveyed subject to the letting, the lender may request that a *special assumption* be made that the property is vacant. The current rent passing should not necessarily be confirmed as the current *market rent*. The current *market rent* should be the figure that the valuer considers is the true value irrespective of whether the current rent passing is higher or lower.
- 9 Where the lender requires the *valuation* of more than one category 1 property for the same borrower, the *valuation* is to be on an 'individual property basis' and not as a parcel or portfolio of properties, unless otherwise instructed. In such case this specification does not apply, and the valuer should refer to VPGA 2 and VPGA 8 unless covered in the following paragraphs.

Category 2: Shared houses

- 10 Where a property has been let to a group of tenants, typically a shared student house or as individual rooms, the *market value* may be assessed on a comparable basis. However, these properties may be located in areas comprising a high concentration of similar rented accommodation and limited owner occupation. In this situation, the comparables used to determine the *valuation* may come principally from transactions of other similar *investment property* (rather than owner-occupied property) in the locality.
- 11 The rental value assessment should only be provided at a 'higher' shared occupancy rate, where there is a proven sustainable demand in the area for this type of letting arrangement and the property is suitable for this form of letting.

Category 3: Houses in multiple occupation/multi-unit properties

- 12 For this specialist area of *valuation*, the valuer must have knowledge of, and experience in, the *valuation* of the more complex residential *investment property* in the particular locality.
- 13 Houses in multiple occupations (HMOs) comprise individual units that cannot be sold separately and have at least some shared facilities. If the property appears to be compliant with legislation/safety requirements having regard to the provisions of the *Housing Act 2004*, and any subsequent legislation and any individual requirements in areas with devolved powers, it is reasonable to adopt an *income approach* method of *valuation*, assuming there is a continuing rental demand for this type of accommodation in the area. The *valuation* obtained should be logic-checked against the tone of values for similar *investment property* in the vicinity.
- 14 The valuer should identify whether the property is subject to mandatory HMO licensing and if a copy of the licence has been seen.
- 15 The additional considerations for the category 3 scenarios include:
 - a) management regulations for HMO
 - b) potential mandatory, discretionary or selective licensing schemes
 - c) Local Authority policy on HMOs and areas designated under Article 4
 - d) condition/fitness requirements, that is, Housing Health and Safety Rating System (HHSRS) and
 - e) the possibility that planning consent will be required for the HMO usage, including *sui generis*, in addition to the usual local authority consents for the current property form and layout.
- 16 The *valuation* of larger HMOs/multi-unit blocks requires appropriate knowledge and understanding of the planning regime as it applies in the locality concerned including awareness of any Article 4 Directions. There is also a distinction to be made between use class C4, *sui generis* and self-contained units.
- 17 Where the property is a multi-unit building with self-contained units each capable of being separately sold but not held on individual titles, and where the mortgage is not to be secured against the freehold of the whole building, the *valuation* approach used will need to be informed by lender guidance. Factors to consider typically include:
 - demand for, and the ability to sell, the individual units.
 - legal cost of splitting the title and
 - profit or incentive that an investor or developer might expect to realise or require, although this is not an exhaustive list.

UK VPGA 13.7 Valuations without internal inspection

The valuer may be asked for a *valuation* without the benefit of an internal *inspection*, and with or without the benefit of an earlier report. This may be called a 'desk top', 'drive-by' or 'pavement' *valuation*, or an 'external appraisal', and may include reference to automated valuation models (AVMs).

See also UK VPGA 11.3.

- 1 When an opinion is provided on this basis, it must be confirmed in writing, and the manner of *valuation* and the restrictions under which it is given clearly stated (see **VPS 1 section 3 paragraph 3.1(i)**). The lender must be informed that the value stated in such a fashion must not be disclosed to the borrower or any other party, unless required to do so by the FCA rules in *Mortgages and home finance: conduct of business sourcebook* (MCOB).
- 2 Many lenders use a standard pro-forma report for valuations without an internal *inspection*. Where this is the case, the valuer does not need to comment on:
 - the manner of *valuation*
 - the restrictions under which it is given
 - the non-disclosure to the borrower and/or other *third parties* or
 - where the pro-forma, lender's *terms of engagement* or lender's guidance manuals (or equivalent) already state the *assumptions*, restrictions and terms under which the valuer should prepare the report.
- 3 Where a desk top opinion is sought without any form of *inspection* of the property itself, the valuer should exercise additional caution particularly as to the intended use of the *valuation*. It is likely to be used for a preliminary assessment prior to a more detailed investigation at a later date. The valuer should ensure that the source of information and the rationale used in arriving at the desk top *valuation* are documented and retained, given that there will be no site notes.

UK VPGA 13.8 Retrospective valuations

A *valuation* may be provided at any historical date. However, a lender may be seeking a retrospective *valuation* as part of an internal process of reviewing a specific loan. It is therefore important that the valuer establishes the reason for the request before accepting the instruction.

- 1 Where an instruction is accepted, the *terms of engagement* must incorporate the following statements:
 - The *valuation* will be in accordance with the Residential Mortgage Specification as at the *valuation date*. Previous specifications are available from the RICS Library.
 - Where *inspection* is not possible, or is expressly forbidden, a statement to that effect will be made.

- Because the *valuation* is based on restricted information, it is provided solely for the internal use of the lender. It is not to be used in any proceedings without the valuer's consent, as the opinion may change if the valuer is later required to give evidence in formal proceedings.
- Where the lender decides to institute formal proceedings the valuer must be instructed to act as an expert witness and will follow the RICS practice statement and guidance note, *Surveyors acting as expert witnesses*, 4th edition.

UK VPGA 13.9 RICS HomeBuyer Services and Home Report in Scotland

- 1 There are two RICS HomeBuyer services:
 - a) RICS HomeBuyer Report (Survey).
 - b) RICS HomeBuyer Report (Survey and Valuation).
- 2 Home Report Scotland is a separate service to the RICS HomeBuyer Report services above and includes a Single Survey and *valuation*. Red Book Global Edition applies to b) and c) as these include valuation sections.
- 3 *Members* accepting instructions to provide RICS Home Report Services (HBS) and the Home Report Scotland should comply with RICS HBS guidance.
- 4 RICS HomeBuyer Service (HBS) is a product developed and owned by RICS, designed specifically as an economical service that may be provided only by RICS *members*.
- 5 HomeBuyer Reports that include a *valuation* comprise:
 - an *inspection* of the property
 - a concise report based on the *inspection* and
 - a *valuation*.

They report on the general condition of the main elements of the relevant property and particular features that affect its present value and may affect its resale. The report focuses on matters that the surveyor judges to be serious and/or urgent.

- 6 *Members* who provide the HBS (Survey and Valuation) should comply with the guidance as published by RICS. In particular, the standard documentation and report form must be used without alteration as set out in the current edition of the professional statement.
- 7 The HBS documentation and reports may be used only under copyright licence obtained from RICS. Further details can be found on the **Home Surveys section** of the RICS website.

The Home Report in Scotland

- 8 *Members* accepting instructions to provide the Home Report in Scotland should comply with the legislation set out in the *Housing (Scotland) Act 2006* and the *Housing (Scotland) Act (Prescribed Documents) Regulations 2008*.
- 9 The Home Report is legislation introduced by the Scottish Parliament. RICS Scotland has developed products in response to this legislation, introducing a requirement for the provision of a report when a house or flat is brought to market. The Home Report was effective from 1 December 2008.
- 10 The Home Report comprises three elements, which are prescribed documents but can also contain a GMVR, which is a required document within a Home Report if a separate retype to a lender is to be prepared by the surveyor (see paragraph 13.3):
- Single Survey and *valuation*
 - energy report and Energy Performance Certificate (EPC) and
 - property questionnaire.

Collectively these elements cover the general condition of the property and particular features that affect its present value and may affect its resale. The Home Report focuses on matters that the surveyor judges to be urgent or significant, and it also includes a *valuation* of the property.

- 11 *Members* who provide services as part of the Home Report service must comply with the standard documentation and report form, which must be used without alteration.

Mandatory documentation

- 12 **Mandatory documentation** of the Home Report includes:
- terms and conditions, with a generic mortgage valuation report (GMVR)
 - terms and conditions without a GMVR and
 - Single Survey report, including the scope of *inspection*.

These documents ensure that *members* carry out the same Single Survey in accordance with the regulations and prescribed report format.

Optional documentation

- 13 Optional documentation providing guidance for the Home Report includes:
- letter of engagement with a GMVR
 - letter of engagement without a GMVR and
 - property *inspection* technical guidance for completing Single Surveys.

The letters of engagement are not prescribed as it is expected that *members* will develop their own in accordance with their *firms'* style. They are therefore available as examples only.

- 14 Paper versions of all the documents are available from RICS Scotland, and digital versions can be found at www.rics.org/uk/knowledge/more-services/guides-advice/home-surveys/home-reports-in-scotland/home-report-member-information

UK VPGA 14 Valuation of registered social housing for loan security purposes

Scope

This application provides guidance on the additional matters that should be taken into account by valuers undertaking *valuations* for registered social housing providers' stock for secured lending purposes. Its provisions also apply to *valuations* of their interests in property in shared ownership.

References to the 'client' are to the lender who will normally issue any *valuation* instructions.

UK VPGA 14.1 Identifying the property

The valuer first needs to agree with the client whether the stock is to be valued as a single portfolio, or in lots, which could be individual dwellings.

- 1 If the stock is not to be valued as a single portfolio, the client needs to be made aware that the aggregate of the *valuations* provided may differ from the price that could be achieved if some or all of the properties were sold as a portfolio, or if a large number were placed on the market concurrently for sale individually (see **VPS 1**, **VPS 3** and VPGA 9).
- 2 Particular care is necessary to establish the nature of the housing provider's interest(s) to be valued. Restrictions and encumbrances (for example, Section 106 agreements, right to buy and nomination rights) are common. Planning consents may include restrictions on occupation or tenure. Obviously, the *valuation* must reflect the terms of any shared ownership leases.

UK VPGA 14.2 Extent of inspection

Where the stock to be valued comprises a large number of similar properties, or a number of estates or blocks (each of which comprises similar properties), the valuer must agree with the client whether every property will be inspected or, as is more usual, whether sample *inspections* should be completed.

- 1 In such cases, the valuer will assume that the properties selected for *inspection* are representative of those properties that have not been inspected.
- 2 The extent of each sample *inspection* (for example, internal and external, external only or front elevation only) must also be agreed.
- 3 Where the *inspection* is to be of a sample only, the extent of the sampling and the method of its selection must be agreed with the client. If the valuer subsequently considers that the extent of the *inspection* is not adequate for the purpose of the service, the client must be advised accordingly and further instructions sought and agreed before reporting.

UK VPGA 14.3 Basis of value

- 1 The *basis of value* to be adopted will be subject to agreement between the lender and the valuer.
- 2 Existing use value for social housing (EUV-SH) is defined in UK VPGA 4 and UK VPGA 7. Its use is appropriate in secured lending *valuations*, as it assumes that the properties will continue to be let as social housing and that any vacant dwellings will be re-let to tenants in the registered social housing provider's target group.
- 3 In some instances a request may be received for *market value* subject to *special assumptions*. These are likely to restrictions on disposal and future management of the property.

UK VPGA 14.4 Calculations of worth

- 1 The client may also require the valuer to provide a calculation of *worth* on the *assumption* that the lender was in control of the security, following default by the borrower. In this case the client's potential rights (for example, whether it will be entitled to sell vacant dwellings, or where tenants' rights to buy exist), along with its willingness and ability to raise rents and sell dwellings that become vacant, will be relevant.
- 2 The client may also be interested in receiving, and hence will specify, a return that is to be adopted through the discount rate used in the calculation of *worth*. *Special assumptions* such as this must be stated in the report.
- 3 Where a calculation of *worth* is provided, an opinion of value on *market value* or EUV-SH should be provided concurrently.

UK VPGA 14.5 Development property

Where the security of a proposed development (or a development in the course of construction) is being considered for lending purposes, it will normally be appropriate to provide both a *valuation* of the property in its current condition, and a further *valuation* on the *special assumption* that the development will be completed in accordance with the plans and specification provided.

In establishing the current value, the valuer will need to determine what information is available on the anticipated development costs, and the extent to which these may be relied on by the valuer. Reference may be made to RICS VIP 12 *Valuation of development land*, 1st edition (currently under review).

UK VPGA 14.6 Reporting

The report should contain, in addition to those matters listed in **VPS 3**, where appropriate:

- a statement of the average rents being charged for each dwelling and tenancy type, and a comparison of these with the valuer's assessment of the level of rents that could be obtained if the properties were let unfurnished on the open market
- a statement as to the existence of nomination rights
- a comment or explanation if there is an exceptionally high number of vacant dwellings
- an appreciation of the strength of demand for the dwellings, both let at the level of rents charged, or to be charged, by the registered social housing provider and if offered for sale with vacant possession, along with any known factors likely to significantly affect these strengths
- a statement where the *valuation(s)* reported has been affected by the existence of an unimplemented planning permission for change of use or other development, or by the prospect of such consent(s) being available, with advice as to the amount(s) of the increase reported in consequence
- an opinion as to whether, over the period contemplated for the loan, material changes in the necessary level of expenditure, in real terms, are likely to be required
- the valuer's opinion of the property as a lending security, including implications relating to the ability to realise the security in the event of default, bearing in mind the length (which will be stated) of the term of the loan contemplated by the client, and assuming that the borrower will maintain the property in a reasonable state of repair and a statement as to the *valuation* method(s) adopted, and an indication of the extent to which the valuer has been able to have regard to comparable market transactions. The yield, the principal inputs (where a discounted cash flow method is used), *assumptions* and the discount rate adopted must be stated.

UK VPGA 14.7 Liaison with lenders

UK Finance and RICS regard it as important that the lender and the valuer develop a close working relationship in respect of *valuation* and appraisal, especially in more complex cases, to ensure that the service provided by the valuer reflects the lender's needs and that the lender fully understands the advice that is being given.

UK VPGA 15 Valuations for Capital Gains Tax, Inheritance Tax, Stamp Duty Land Tax and the Annual Tax on Enveloped Dwellings

Scope

UK VPGA 15 provides guidance to valuers who furnish valuation advice to clients reporting in accordance with UK capital taxation requirements.

Overview

- 1 Capital Gains Tax (CGT), Inheritance Tax (IHT), Stamp Duty Land Tax (SDLT), Land and Buildings Transaction Tax (LBTT) in Scotland and Land Transactions Tax (LTT) in Wales) and the Annual Tax on Enveloped Dwellings (ATED) are included in self-assessment procedures where the taxpayer is responsible for calculating the appropriate amount of tax based on the *valuation* provided to the tax authority.
- 2 CGT, IHT, SDLT and ATED are complex taxes and *members* should take care to understand the background to the event triggering a potential or actual tax liability before proceeding.
- 3 Further information is available on the HM Revenue and Customs (HMRC) pages on [GOV.UK](https://www.gov.uk), which gives access to HMRC's internal guidance manuals, and on the [Valuation Office Agency \(VOA\)](https://www.valuationofficeagency.gov.uk), which gives access to the instructions to its valuers in preparing *valuations* for tax purposes.

Capital Tax Gains (CGT)

- 4 In the case of individual taxpayers, business partnerships, self-employed sole traders and trusts, any CGT calculation will be included in the tax return for the tax year in which the transaction requiring the tax computation took place.
- 5 Large companies, on the other hand, pay their corporation tax on any capital gains in advance by instalments based on a prediction of their results for that tax year. A large company is one whose profits for the accounting period in question are at an annual rate of more than the 'upper limit' in force at the end of that period.

Inheritance Tax (IHT)

- 6 In IHT cases the personal representatives are required to submit an IHT account that identifies all 'appropriate' property and its value.

Stamp Duty Land Tax (SDLT)

- 7 Stamp Duty Land Tax (SDLT) is paid on the purchase of a property or land over a certain price in England and Northern Ireland. It is also paid when taking a new lease and in some other circumstances. SDLT no longer applies in Scotland and Wales – Land and Buildings Transaction Tax (LBTT) is payable in Scotland and Land Transactions Tax (LTT) in Wales.

Annual Tax on Enveloped Dwellings (ATED)

- 8 Annual Tax on Enveloped Dwellings (ATED) is an annual tax payable mainly by companies that own UK residential property valued at more than £500,000.
- 9 An ATED return to HMRC is required if the property:
- is a dwelling
 - is in the UK or
 - is valued at more than a specified threshold.

UK VPGA 15.1 Application of statute

The *valuations* used by taxpayers in their tax computations are subject to examination by valuers in the Valuation Office Agency (VOA) on behalf of the HMRC. It is therefore essential that any *valuation* used in those tax calculations has been prepared on the statutory basis having due regard to case law and in accordance with best practice.

- 1 It is of great importance, when preparing a *valuation* for taxation purposes, to apply the statutory rules appropriately and to have a proper understanding of the basis of *market value* for taxation purposes.
- 2 If, following discussion with the VOA, a different *valuation* or apportionment is agreed or determined and results in a materially different tax bill, a taxpayer could be faced with a claim for interest and, in some cases, additional penalties. Where the taxpayer has paid too much tax, the HMRC may pay interest.
- 3 Valuations for tax purposes are based on the concept of a hypothetical sale for which a statutory definition is required. In some cases, it may also be necessary to undertake apportionments of value. The statutory definition and interpretation of market value for tax purposes is not exactly the same as the definition of *market value* in **VPS 4**. In particular, the existence of a *special purchaser*, where relevant, is a factor that is to be reflected properly.
- 4 UK VPGA 15 is based on interpretations arising from cases that have been determined by the Upper Tribunal (Lands Chamber) or higher courts on appeals made by taxpayers against tax assessments based on the value of property. It is recognised that there may be circumstances where the client wishes to challenge an aspect of the tax calculation, including the interpretation of the statutory basis or the method of *valuation*. If the valuer is instructed to give

valuations on specified assumptions that differ from those in this guidance, the procedures in **VPS 3 section 2 paragraph 2.2(i)** will need to be followed.

UK VPGA 15.2 Basis of value

Definitions of the *basis of value* for:

- Capital Gains Tax (CGT) can be found in section 272, *Taxation of Chargeable Gains Act 1992*
- Inheritance Tax (IHT) in section 160, *Inheritance Tax Act 1984*
- Stamp Duty Land Tax (SDLT) in section 118, *Finance Act 2003* and
- the Annual Tax on Enveloped Dwellings (ATED) in section 98(8) of the *Finance Act 2013*.

These definitions are written in similar terms and broadly define market value as:

‘the price which the property might reasonably be expected to fetch if sold in the open market at that time, but that price must not be assumed to be reduced on the grounds that the whole property is to be placed on the market at one and the same time.’

The definitions are similar to those used in earlier tax acts and their practical application has been examined in considerable detail by the courts over the years. Thus, case law has established that, in arriving at market value, the following *assumptions* must be made:

- the sale is a hypothetical sale
- the vendor is a hypothetical, prudent and willing party to the transaction
- the purchaser is a hypothetical, prudent and willing party to the transaction (unless considered a *special purchaser*)
- for the purposes of the hypothetical sale, the vendor would divide the property, i.e. asset to be valued into whatever natural lots would achieve the best overall price
- all preliminary arrangements necessary for the sale to take place have been carried out prior to the *valuation date*
- the property is offered for sale on the open market by whichever method of sale will achieve the best price
- there is adequate publicity or advertisement before the sale takes place so that it is brought to the attention of all likely purchasers and
- the *valuation* should reflect the bid of any *special purchaser* in the market (provided that purchaser is willing and able to purchase).

- 1 UK VPGA 15 deals solely with the statutory basis of *market value* for Capital Gains Tax (CGT) (including corporation tax on capital gains), Inheritance Tax (IHT), Stamp Duty Land Tax (SDLT), Land and Buildings Transaction Tax in Scotland, Land Transactions Tax (LTT) in Wales and Annual Tax on Enveloped

Dwellings (ATED), and does not cover *valuations* that may be required for income tax or corporation tax (such as capital allowances).

- 2 *Valuations* for CGT, IHT, SDLT and ATED purposes are based on a statutory definition of ‘*market value*’, which is similar to the definition used in *RICS Valuation – Global Standards 2017*. However, the statutory definition has been the subject of interpretation by the Upper Tribunal (Lands Chamber). Valuers should be aware of the differences between the definitions, to ensure their *valuations* are made on the correct basis.
- 3 Clients will often request a *valuation* for ‘probate purposes’, when they actually need a *valuation* for IHT purposes. When confirming instructions and in the report, the valuer must make it clear that although the *valuation* is required as part of the procedure for obtaining a ‘grant of probate’, the *basis of value* will be in accordance with the statutory definition. Valuers should therefore avoid using the term ‘probate value’.
- 4 The definition of *market value* for tax purposes may be broken up into elements that have been defined in case law, as can be seen in the following paragraphs.

‘The price...’

- 5 In *Duke of Buccleuch v IRC* (1967) the price that the property might reasonably be expected to fetch was defined as the gross sale price for the property without deducting any selling costs.
- 6 In *Ellesmere v IRC* (1918) the price was held to mean the best possible price that would be obtainable in the open market, if the property was sold in such a manner (and subject to such conditions) as might reasonably be calculated to obtain for the vendor the best price for the property.
- 7 However, it should not be assumed that the best price is automatically the highest possible price that could be achieved. What is required, in *valuation* terms, is an estimate of the price that could be realised under the reasonably competitive conditions of an open market on a particular date.

‘... the property...’

- 8 In *Duke of Buccleuch v IRC* it was held that the reference to ‘the property’ was not a reference to the whole estate being valued, but meant any part of the estate that was proper to treat as a unit for *valuation* purposes. Similarly, in *Ellesmere v IRC*, it was held that the market price was a price based on the separate values of the various parts. It was also indicated that the price must be estimated on the basis that the properties were sold in whatever lot(s) would realise the best price.
- 9 In *IRC v Gray (Executor of Lady Fox decd.)* (1994) it was held that the property must be valued as it actually existed, even if, in reality, a vendor would most likely have made some changes or improvements before putting it on the market. Although this case referred to variations in the way in which the

property was held by the parties (rather than physical works), it identified the general principle of valuing the property as it stands at the *valuation date*.

- 10** As a consequence, in preparing any taxation *valuation*, it is important to have proper regard to the most viable lotting of the property (or properties) to be valued, in order to maximise the overall price. This is effectively a notional marketing exercise, commonly referred to as ‘prudent lotting’.

‘... if sold...’

- 11** The statutory definitions of *market value* are concerned with a hypothetical sale, not an actual one. As originally held in *IRC v Crossman* (1937), and confirmed unanimously in *Duke of Buccleuch v IRC* and in *Lynall v IRC* (1972), in arriving at the value, it is irrelevant to consider what would have been the circumstances attending an actual sale.
- 12** The price that the property would have actually realised in the open market, or the potential impossibility of putting the property on the market at the *valuation date*, is also irrelevant. In other words, one does not have to assume that the property actually had to be sold, as a hypothetical market must be assumed, as at the *valuation date*.
- 13** In *IRC v Gray (Executor of Lady Fox decd.)*, it was said that the property must be assumed to have been capable of sale in the open market, even if it was in fact inherently unassignable or held subject to restrictions on sale. The relevant question is what a purchaser would have paid to enjoy whatever rights were attached to the property at the relevant date, assuming a hypothetical sale.

‘... in the open market...’

- 14** In *Lynall v IRC* it was held that the property must be valued on the basis of a hypothetical sale between a hypothetical willing vendor (not the actual owner of the property in question) and a hypothetical willing purchaser. The hypothesis used was that potentially no one was excluded from buying (the hypothetical purchaser thus potentially including even the actual owner).
- 15** The statutory definitions refer to ‘the open market’ and not ‘an open market’. This has been interpreted to mean a real market made up of real people. In *Lynall v IRC* the open market was regarded as a blend of reality and hypothesis. It was held that the conditions under which the hypothetical sale is deemed to take place should be built on a foundation of reality as far as is possible. However, it was deemed even more important not to defeat the intentions of statute by an undue concern for reality in what is essentially a hypothetical situation.
- 16** Case law has further refined the components of the open market definition and, in particular, those parties assumed to be active in it. In *Lynall v IRC* it was held that the statute implied that there had been adequate publicity or advertisement before the sale, and that steps had been taken (before the sale) to enable a variety of persons, institutions or financial groups to consider what offers they would be prepared to make.

17 However, in *IRC v Gray (Executor of Lady Fox decd.)* it was said that it could not be emphasised too strongly that although the sale is hypothetical, there is nothing hypothetical about the open market in which it is supposed to have taken place. The hypothetical sale envisaged (in order to ascertain the *market value* for taxation purposes) presupposes a willing vendor and a willing purchaser.

'... at that time...'

18 This is defined by statute for the purposes of the *valuation* exercise in question. The *assumption* regarding the definition of the date is that all the preliminary arrangements have been made prior to the *valuation date* so that a hypothetical sale can take place at the statutory point in time. The objective is to ascertain the value of the asset at the prescribed time (and not at any other time), and this can only be achieved by assuming that all preliminary arrangements have been made beforehand.

Further interpretation

19 As part of the consideration of the definition of *market value* for tax purposes, the courts have also given guidance on other terms that, although not appearing in the statutory definition, are used in the interpretation.

20 A willing vendor or willing seller is one who is prepared to sell, provided that a fair price is obtained. It does not mean a vendor who is prepared to sell at any price and on any terms. In short, the hypothetical vendor is assumed to be a reasonable and prudent person.

21 A willing purchaser presupposes that the open market includes everyone who has the will and the money to buy. It has been said that the buyer, like the vendor or seller in paragraph 20, must be a person of reasonable prudence.

22 In *Palliser v HMRC (2018)* it was made clear that 'hope value' as it is often described (i.e. the 'expectation' of additional value being created in the future by the prospect of development – see **VPS 4 section 4 paragraph 4.4**) is to be properly reflected in a *valuation* for taxation purposes.

23 A *special purchaser* is one who has a particular interest in acquiring a property. The case of *IRC v Clay (1914)* effectively established that where there is a known purchaser in the market who is willing to buy at a considerably higher price than anyone else, the value of the asset for tax purposes is represented by the higher price the *special purchaser* is willing to pay, or by a close approximation to this. This is a very important difference from the general definition of *market value* in **VPS 4**, and valuers need to ensure both they and their clients are alert to it wherever it arises.

24 In *Walton v IRC (1995)* it was held that it was a question of fact – to be decided by evidence – whether or not there were any *special purchasers* in the market and what price they would be prepared to pay.

UK VPGA 15.3 Methods of valuation

For the taxes covered by this guidance, no particular method or methods of *valuation* are prescribed, either by statute or by case law.

- 1 In practical terms, property assets are valued or appraised by whichever 'method' is most appropriate. Special classes and categories of asset will be valued in different ways because of how 'the market' values them.
- 2 A presumption of the *Lynall* case is that the vendor, when advertising the property, makes such information available to purchasers of that type of asset as they would expect to receive, or to be able to access, in a normal market transaction.

Special cases

- 3 It is not unusual for *valuations* for taxation purposes to be required in relation to interests in land that are rarely (as in the case of undivided shares) or never (as in the case of unassignable agricultural tenancies) sold in the real world. The approach to be used in such instances has been considered on a number of occasions by the courts and tribunals, and those involved in such matters should study the relevant HMRC and VOA manuals and guidance as well as ensure they are familiar with current case law.
- 4 There are also occasions where, under the capital gains regime, a historic *valuation* is required, i.e. as at 31 March 1982. **RICS' Find a Surveyor website** lists a number of potential sources for accessing market evidence around that date, though it is emphasised that such evidence must always be viewed and interpreted with caution in terms of its relevance to the particular valuation assignment.
- 5 *Valuations* relating to apportionments for part-disposal calculations or in connection with capital allowances are beyond the scope of this *valuation standard* – those involved in such matters are again referred to the relevant HMRC and VOA manuals and guidance.

Cases references

The references for the cases referred to in the text above are:

- *Duke of Buccleuch v IRC* [1967] 1 AC 506.
- *Ellesmere v IRC* [1918] 2 KB 735.
- *IRC v Clay* [1914] 3 KB 466.
- *IRC v Crossman* [1937] AC 26.
- *IRC v Gray (Executor of Lady Fox decd.)* [1994] STC 360.
- *Lynall v IRC* [1972] AC 680, HL (this case was heard in a range of courts between 1969 and 1972); see also *Attorney-General for Ireland v Jameson* [1905] 2 IR 218.

- *Palliser v HMRC* (2018) UKUT 71 (LC).
- *Walton v IRC* [1995] EWCA Civ 61.

Annual Tax on Enveloped Dwellings [ATED]

- 6 Unlike CGT, IHT and SDLT – which are event-based – ATED is an annual tax payable mainly by companies that own UK residential property with a value above a specified threshold. While most residential properties (dwellings) are owned directly by individuals, in some cases they may be owned by a company or other collective investment vehicle. In these circumstances the dwelling is said to be ‘enveloped’ because the ownership sits within a corporate ‘wrapper’ or ‘envelope’. An annual charge is levied on the taxable value of a single-dwelling interest, which is its *market value* at the end of the most recent ‘*valuation date*’. ‘*Market value*’ for this purpose follows the same principles as set out in paragraph 23 of UK VPGA 15.2. The ‘*valuation date*’ is a fixed date, as specified in the legislation, unless there have been substantial acquisitions or part disposals involving the dwelling concerned during the course of any year.

UK VPGA 16 Valuations for compulsory purchase and statutory compensation

Scope

Valuers are reminded that they should always refer to the mandatory RICS professional statement *Surveyors advising in respect of compulsory purchase and statutory compensation*, 1st edition when undertaking *valuation* assignments for clients exercising, or impacted by the use of, compulsory purchase powers.

- 1 The circumstances in which valuers may be engaged in cases where compulsory purchase powers may be used to acquire interests in *real estate* vary widely. They include:
 - advising an acquiring authority contemplating or exercising the use of compulsory purchase powers, or a commercial partner of such an authority, including advising on land acquisition strategy, pre-powers negotiations, and estimates of potential compensation liability
 - advising land owners and occupiers under threat of compulsory purchase on how to protect their position, including potential objection to any order, preparations in advance of acquisition to protect compensation entitlement, and pre-powers negotiations
 - negotiation of compensation arising from compulsory purchase acting on behalf of the acquiring authority, an authority's commercial partner, or the owner or occupier of the land acquired
 - providing *valuation* advice for Alternative Dispute Resolution (ADR) cases
 - appearing as an expert witness at an inquiry and
 - appearing as an expert witness before the Lands Chamber of the Upper Tribunal.
- 2 The first four categories are covered by the RICS professional statement *Surveyors advising in respect of compulsory purchase and statutory compensation*, 1st edition. For the latter two categories, refer to the RICS practice statement and guidance note *Surveyors acting as expert witnesses*, 4th edition.

Application of the Red Book

- 3 The existence of the two mandatory RICS statements referred to in paragraph 2 raises the obvious question of how far the Red Book applies in detail to this type of *valuation* assignment. For the avoidance of doubt, compulsory purchase work is subject to the general requirements of **PS 1** and **PS 2**, aspects of which assume considerable importance in this context. It is in the nature of this type of assignment that the service may be given over a prolonged period and that it may, and often does, involve the provision of advice on the probable outcome of current or impending negotiations. While the requirements of **VPS 1-5** inclusive

are not mandatory in such circumstances, it cannot be emphasised too strongly how important it is to have fully and carefully documented *terms of engagement* in all cases, and that when reporting to clients with recommendations on any full and final settlement of compensation, all material matters are adequately covered. **VPS 1** (and **VPS 3**) can still provide a useful checklist, as can **VPS 2** together with VPGA 8 in the context of *inspection* and of establishing the facts. **VPS 4** and **VPS 5** must necessarily be read in the context of, and are to be regarded as duly modified by, the statute and accompanying case law applying to the individual assignment.

Other matters

- 4 The exercise of compulsory purchase powers can have a very significant impact on the homes and livelihoods of those affected. It is especially important that surveyors advising acquiring authorities, commercial partners, land owners and occupiers do so competently and responsibly. The aim of all parties and in particular the surveyors acting for them should be to reach agreement on a fair package of compensation, mitigation or where appropriate removal of the land from the order or threat of a future order, as straightforwardly as possible, and for the conduct of both sides to be reasonable and to take account of the constraints, challenges and impacts faced by the other.
- 5 At the commencement of an instruction it is often necessary, and frequently desirable, to provide the client with preliminary advice as to what, in the valuer's opinion, based on the information then available, is likely to be the assessment of compensation in accordance with the relevant statutory compensation code. Such preliminary advice will normally fall within the 'negotiations' exception in **PS 1 section 5 paragraph 5.4** final bullet. In other words, it is looking forward to the probable outcome of negotiations yet to commence or yet to be concluded, and is not a recommendation of a full and final settlement figure, which may differ from the initial estimate once all the facts are known and all aspects of the claim for compensation have been fully weighed and considered. If the client is not prepared to proceed on the basis of what the valuer considers to be a reasonable initial estimate of compensation for *market value*, and outline of any potential claim for disturbance, the client will need to be advised or reminded that the surveyor cannot put forward *valuations* that in the surveyor's professional opinion cannot be reasonably supported and, where necessary, evidenced.
- 6 Valuers are reminded that, particularly but not exclusively where entry onto the land concerned has not yet taken place, they will need to maintain efforts to establish and record the material facts and collect appropriate evidence during the period of the instruction. Where further information becomes available they should, as necessary, update their advice to the client at appropriate intervals.
- 7 Compulsory purchase is a complex area and may involve elements of business *valuation* as well as property *valuation* and procedural matters. It is important that instructed valuers are able to provide the appropriate standard of advice in respect of all aspects, or that they clearly agree with the client the limits of the duties, perhaps working in co-operation with other advisers to provide

- a comprehensive package of advice. It is the responsibility of the valuer to keep up to date with changes in case law, guidance and legislation, including secondary legislation. Although many of the key principles of compulsory purchase compensation are well established, some more detailed aspects of their implementation are still evolving as they fall to be applied in ever more complex situations.
- 8 Finally, valuers need at all times to be alert to the changes in responsibility that will occur should their duties later involve acting as an expert witness, and how that may affect the carrying out of work prior to that change.

UK VPGA 17 Local authority disposal of land for less than best consideration in England and Wales

Overview

- 1 This guidance applies only to interests in *real estate* held by local authorities in England and Wales.
- 2 Local authorities have wide land disposal powers under sections 123 and 127 of the *Local Government Act 1972* and section 233 of the *Town and Country Planning Act 1990*. However, they have traditionally been required to seek specific consent from the relevant Secretary of State where the consideration is less than the best that can reasonably be obtained.

England

- 3 In England, the *Local Government Act 1972: General Disposal Consent (England) 2003* removes the requirement for authorities to seek specific consent from the Secretary of State for any disposal of land where the difference between the unrestricted value of the interest to be disposed of, and the consideration accepted (the 'undervalue'), is £2 million or less.
- 4 The detailed *valuation* requirements are set out in the technical appendix to the Consent, which specifically incorporates this guidance and the definition of *market value* in **VPS 4**.

Wales

- 5 In Wales, the *Local Government Act 1972: General Disposal Consent (Wales) 2003* removes the requirement for authorities to seek specific consent from the National Assembly for Wales for any disposal of land where the difference between the unrestricted value of the interest to be disposed of, and the consideration accepted (the 'undervalue'), is £2 million or less.
- 6 The circular accompanying the 2003 Consent provides that the valuer shall have regard to the guidance on local authority disposals of land at an undervalue in these standards.
- 7 The local authority decides whether any proposed disposal requires specific consent, as the Secretary of State and the National Assembly for Wales have no statutory powers to advise in any particular case.

England and Wales

- 8 The valuer may be asked to provide a *valuation* so that the local authority may consider whether or not an application for consent is necessary, or to support a submission for a specific consent. For either request, *valuation* must be

provided in England following the advice in the technical appendix and in Wales following the advice in paragraph 4 of the circular.

UK VPGA 17.1 Bases of valuation

- 1 The consent requires the valuer to provide the following figures:
 - unrestricted value
 - restricted value and
 - the value of voluntary conditions.

Unrestricted value

- 2 The unrestricted value is the best price that is reasonably obtainable for the property. It is the *market value* of the land, as defined in **VPS 4**, except that it should take into account any additional amount that is, or might reasonably be expected to be, available from a purchaser with a special interest.
- 3 The valuer should take account of any uses that might be permitted by the local planning authority if these would be reflected by the market, and not only a use (or uses) intended by the parties to the proposed disposal. It should also ignore the reduction in value caused by any voluntary condition imposed by the local authority (see restricted value).
- 4 The valuer should assume that the freehold disposal is made, or the lease is granted, on terms that are intended to maximise the consideration. For example, where unrestricted value is based on the hypothetical grant of a lease, at a rack rent or ground rent, with or without a premium, the valuer should assume that the lease would contain those covenants normally included in such a lease by a prudent landlord. The valuer should also assume that the lease would not include unusual or onerous covenants that would reduce the consideration, unless these had to be included as a matter of law.

Restricted value

- 5 The restricted value is the *market value* of the property having regard to the terms of the proposed transaction. It is defined in the same way as unrestricted value, except that it should take into account the effect on value of any voluntary condition.
- 6 Where the local authority has invited tenders and is comparing bids, the restricted value is normally the amount offered by the local authority's preferred transferee. Otherwise it is normally the proposed purchase price.

The value of any voluntary conditions

- 7 Sales may be subject to voluntary conditions. These are any term or condition of the proposed transaction that the local authority chooses to impose. Voluntary conditions do not include any term or condition that the local authority

is obliged to impose, for example, as a matter of statute or a condition that runs with the land. They also do not include any term or condition relating to a matter that is a discretionary, rather than a statutory, duty of the local authority.

- 8 Their value is the total of the capital values of voluntary conditions imposed by the local authority as terms of the disposal, or under agreements linked to the disposal, that produce a direct or indirect benefit to the local authority that can be assessed in monetary terms. It is not the reduction in value (if any) caused by the imposition of voluntary conditions, and any adverse effect these may have on value must not be included in this figure.
- 9 The proposed disposal, or an agreement linked with it, may give rise to non-property benefits to the local authority. For example, these might include operational savings, or income generated as a result of the transaction where the local authority has an associated statutory duty. The monetary value of these benefits to the local authority should be included in the value of voluntary conditions in the valuer's report.
- 10 The valuer will often be able to assess the value of a voluntary condition of disposal to the local authority. However, there may be cases where a question arises about the status, in law, of such value (whether or not it is capable of forming part of the consideration). In such cases, the local authority may need to seek legal advice as to whether the value of the voluntary condition is such that it may form part, or all, of the consideration the local authority proposes to accept. Conversely, there may also be cases where a term or condition of disposal is, in law, capable of forming part, or all, of the proposed consideration, but it has no quantifiable value to the local authority, or its value is nil.
- 11 Where the valuer is not qualified to assess the value of any benefits (for example, of share options) the report should make clear the extent to which the valuer accepts liability for the figures. Where the valuer does not accept full responsibility, the report should make clear who was responsible for assessment of the remainder, and copies of any *valuations* or advice received from accountants or other professional advisers should be annexed.

UK VPGA 17.2 Leasehold disposals

- 1 The valuer is required to assess the unrestricted value in capital terms. The unrestricted value should be assessed by valuing the authority's interest after the lease had been granted, plus any premium payable for its grant. In other words, it will be the value of the right to receive the rent and any other payments under the lease, plus the value of the reversion when the lease expires.

UK VPGA 17.3 Options

- 1 Where a disposal involves the grant of an option, the valuer is required to consider both the payment for the option and consideration that might be

received, were it to be exercised as either, neither or both may involve a discount.

- 2 Paragraphs 19 to 21 of the technical appendix to the General Disposal Consent provide more detailed guidance on the treatment of options.

UK VPGA 17.4 Discount

This is the amount by which the value of the actual consideration is less than that of the best consideration reasonably obtainable.

It is given by the formula:

$$\text{unrestricted value} - (\text{restricted value} + \text{value of conditions})$$

Otherwise, where the value of the consideration for the disposal differs from the restricted value, it is given by this formula:

$$\text{unrestricted value} - (\text{value of consideration} + \text{value of conditions})$$

- 1 The Secretary of State or NAW must be made aware of cases where the proposed consideration is more or less than the value of the interest to be disposed of, subject to the proposed voluntary conditions, so that this can be taken into account when reaching a decision on whether to allow the proposed transaction to proceed.
- 2 Accordingly, where the value of the consideration differs from the restricted value, both figures must be given.

UK VPGA 17.5 Purpose of the valuation

- 1 In addition to stating the overall purpose of the *valuation*, the valuer will need to provide a summary of the proposed transaction, noting the key terms and any restrictions to be imposed by the local authority.
- 2 Where the local authority proposes to grant a lease, a copy of the draft lease should be attached to the report.
- 3 Where this is impracticable, a copy of any heads of terms agreed or a summary of the key terms of the proposed lease should be provided.

UK VPGA 17.6 Assumptions as to planning

- 1 Where there is no detailed scheme, the valuer should make reasonable *assumptions* about the form of the development.
- 2 This should include a note of the existing use(s), current planning consents and use(s) likely to be permitted with regard to the development plan.

- 3 Where the unrestricted value has been based on an assumed planning use other than that for which the property has been sold, a detailed explanation of the planning *assumptions* made is required.

UK VPGA 17.7 Tenure

- 1 A note will need to be included identifying the local authority's tenure and giving details of the purpose(s) for which the land is held (which is normally for the purposes of the power under which it was acquired, or taken on lease, unless it has since been formally appropriated).
- 2 The note will need to include a summary of the details of any leases, or encumbrances such as easements, to which the land is subject.

UK VPGA 17.8 Valuations

- 1 The unrestricted and restricted values, together with the value of conditions, should be given. Where any of these is nil, this should be expressly stated.
- 2 Where the value of a scheme is less than the development cost (that is, there is 'negative development value'), the advice in paragraph 23 of the technical appendix to the Consent should be followed.
- 3 Where the value of land may be affected by the availability of grants, the advice in paragraph 24 of the technical appendix to the Consent should be followed.
- 4 The *valuation date* should not be more than six months before the submission of the application to the Secretary of State.

UK VPGA 17.9 Description

- 1 The report will need to include a written description of the site and buildings, the location and surroundings. A plan (to which the Secretary of State will refer if giving consent) that is sufficiently accurate to identify the land is also to be provided.

UK VPGA 17.10 Existence of a special purchaser

- 1 The effect on value of the existence of a purchaser with a special interest should be described (see **VPS 4 section 4** and the Global Edition *Glossary*).

UK VPGA 17.11 The report

The general requirements of **PS 1**, **PS 2** and **VPS 3** apply.

UK VPGA 18 Affordable rent and market rent under the Housing Acts in a regulatory context

Overview

This UK VPGA provides background information on the regulatory system in England only related to affordable rent, and guidance to the valuer on the application of the basis of *market rent* for this type of property.

Affordable rent is designed to:

- maximise the delivery of new social housing by making the best possible use of constrained public subsidy and the existing social housing stock and
- provide an offer that is more diverse for the range of people accessing social housing and an alternative to traditional social rent.

Affordable rent falls within the definition of social housing in section 68 of the *Housing and Regeneration Act 2008* (and, in particular, the definition of low cost rental accommodation in section 69 of the Act). Affordable rent properties will therefore be subject to regulation where they are provided by a registered provider.

Current regulatory standards that registered providers of social housing must meet are available on www.homesandcommunities.co.uk

UK VPGA 18.1 Status of the valuer

- 1 The regulations neither specify that the valuer should be professionally qualified, nor require the *valuation* to be made by a valuer independent from the landlord. However, where the valuer is a *member* of RICS, attention is drawn to **PS 1** where a written *valuation* is provided.
- 2 Where the valuer is an employee of, or is in any way associated with, the registered provider, then details of such relationship are to be clearly stated in the report to comply with **VPS 3**.

UK VPGA 18.2 Basis of value and assumed tenancy terms

The regulations refer to 'gross market value'. This term is taken to be the same as *market rent* as defined in **VPS 4** having regard to the following assumed tenancy terms:

- The tenancy is assumed to be a 12-month assured shorthold tenancy on market terms, unfurnished but with appliances, carpets and curtains, with an expected right for the tenant to 'hold over' or renew the tenancy.
- The rent is inclusive of any service charges (the *assumption* being that these are paid by the landlord). If this is not the case, the rationale should be explained.
- As long as they do not conflict with the aforementioned *assumptions* the general tenancy terms should reflect those usually applied in the private sector.
- The condition of the property is only taken into account in so far as it impacts upon the rental value.
- The extent of the property being valued should be clearly stated.

UK VPGA 18.3 The property

- 1 Where the *valuation* is for a proposed new development, reference to the plans should be clearly made within the report. The *assumptions* on the quality of specification, and compliance with planning approvals and development control requirements, should also be explicit.
- 2 Where an existing property is being valued, a summary of the condition of the property should be included within the report to the extent that it impacts the rental value.
- 3 All *assumptions* and any *special assumptions* about the property should be stated.

UK VPGA 18.4 Method of valuation

- 1 The method of *valuation* and justification for its use should be stated within the report.
- 2 Where the landlord owns a large number of properties, it is acceptable to provide *valuations* on a sample, or beacon, basis. In such cases the valuer must clearly identify the types of property within each sample or beacon.

UK VPGA 18.5 Analysis of comparable market evidence

Details of comparable evidence should be included in the report, together with the evidence drawn from these cases.

- 1 Some market information is publicly available, but published and website database information must be used with caution and with the full knowledge of how and from where it is derived. While databases may be useful in providing a general background to values, they may not be sufficiently comprehensive by themselves to provide enough data for an accurate *valuation*.

- 2 Details of all comparable evidence, including any adjustments made to reflect the differences between the terms of letting and the *valuation* requirements, should be kept on file and sources of comparables noted in the *valuation* report.
- 3 The difficulty in identifying comparables in certain circumstances is stated in the 2011–2015 Affordable Homes – Framework at paragraph 3.5:

‘Housing for vulnerable and older people often includes a range of services to support the particular needs of the client group. When setting an Affordable Rent, the gross *market rent* comparables should be based on similar types and models of service provision. Where there are insufficient comparables for similar types of provision in the local area, valuers should be requested to identify comparables from other areas, and extrapolate their best view of the gross *market rent* that would be applicable in the location in which the property is situated.’

Valuers should also refer to the Affordable Homes Programme 2015-18 for England and Wales, published by the Homes and Communities Agency in January 2014.

- 4 Where rental evidence of comparable types of property is not available from within the immediate locality, a wider market area should be used. The valuer will need to use professional knowledge and judgement to apply the evidence to the subject property. Comment should be made on similarities and variations in the comparable market and how they affect the *valuation*. Sometimes evidence may be completely lacking, in which case the valuer may be forced to consider an alternative approach or method.
- 5 Comparables may be more difficult to identify in rural areas, or for specialist supported housing being provided for a particular client group. They may also require a wider market area of comparables, or an alternative supporting method of *valuation* adopted to determine the market rental value with details provided within the *valuation* report.
- 6 Output from an automated valuation model (AVM) may also be considered. However, care should be taken to understand how that output relates to the *valuation* requirements – see RICS information paper *Automated Valuation Models (AVMs)*, 1st edition.
- 7 Further guidance on comparable evidence can be found in RICS information paper *Comparable evidence in property valuation*, 2012 (currently under review).

Part 4 Summary of changes from Red Book UK 2014 [revised January 2015]

RB UK 2014	RB UK national supplement 2018	Comment
Introduction	Introduction, UK PS 1 , UK VPS 1 and UK VPS 2	
UKVS 1	UK VPGA 1	
Scope	Introduction and UK VPGA 1.1	
UKVS 1.1	UK VPGA 1.2	
UKVS 1.2	UK VPGA 1.7	
UKVS 1.3	UK VPGA 6	
UKVS 1.4	UK VPGA 1.8	
UKVS 1.5	UK VPGA 1.6	
UKVS 1.6	UK VPGA 1.10	
UKVS 1.7	UK VPGA 1.9	
UKVS 1.8	UK VPGA 1.9	
UKVS 1.9	UK VPGA 1.4	
UKVS 1.10	UK VPGA 1.4	
UKVS 1.11	UK VPGA 4	
UKVS 1.12	UK VPGA 7	
UKVS 1.13	UK VPGA 1.4	
UKVS 1.14	UK VPGA 5	
UKVS 1.15	UK VPGA 1.5	
UKVS 2	UK VPS 3 and UK VPGA 2	
UKVS 2.1	UK VPGA 2.1	
UKVS 2.2	UK VPGA 2.2	
UKVS 2.3	UK VPGA 2.3	
UKVS 2.4	UK VPGA 2.4	
UKVS 2.5	UK VPGA 3	

RB UK 2014	RB UK national supplement 2018	Comment
UKVS 2.6	UK VPGA 3	
UKVS 3	UK VPGA 11, UK VPGA 12 and UK VPGA 13	
UKVS 4	UK VPS 3	
UK appendix 1	UK VPGA 1.2	
UK appendix 2	UK VPGA 1.4	
UK appendix 3	UK VPGA 9	
UK appendix 4	UK VPGA 1.10 and 1.11	
UK appendix 5	UK VPGA 4	
UK appendix 6	UK VPGA 1.12	
UK appendix 7	UK VPGA 2.1	
UK appendix 8	UK VPGA 2.2	
UK appendix 9	UK VPGA 2.3	
UK appendix 10	UK VPGA 11	
UK appendix 11	UK VPGA 12	
UK appendix 12	UK VPS 2	
UK appendix 13	UK VPGA 14	
UK appendix 14	UK VPGA 18	
UKGN 1		The existing guidance has been temporarily retired while a review is undertaken to reflect IFRS 16 changes, which become effective for annual (reporting) periods beginning on or after 1 January 2019. The present intention is to republish it separately as a global GN.
UKGN 2		This has been updated and has been republished as RICS UK guidance note, <i>Depreciated replacement cost method of valuation for financial reporting</i> , 1st edition.
UKGN 3	UK VPGA 15	

RB UK 2014	RB UK national supplement 2018	Comment
UKGN 4		This overlaps with VPS 2 and VPGA 8 in the RB Global Edition and cross-refers to other RICS guidance that deals with particular aspects in more detail. Accordingly, it is being archived.
UKGN 5	UK VPGA 17	
UKGN 6		This is temporarily retired for review with the intention of updating and republishing as a separate GN.
UKGN 7	UK VPGA 8	
	UK VPGA 10	New section on commercial secured lending.
	UK VPGA 16	New section on valuations for compulsory purchase and statutory compensation.