Property Valuation

The Red Book – changes & new requirements

The Red Book is issued by RICS as part of our commitment to promote and support high standards in valuation delivery worldwide. The publication details mandatory practices for RICS members undertaking valuation services. It also offers a useful reference resource for valuation users and other stakeholders

RICS Website (Jan 2025)

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Agenda – The Red Book – changes & new requirements

- **RICS Valuation - Global Standards & UK National Supplement** (together known, colloquially, as the Red Book).
  - The Red Book is there to help and support valuers undertaking valuations for clients; it is a quality assurance document
  - A base level of professionalism, consistency & transparency
- **The 2025 changes to the Red Book**
  - RICS Valuation: UK Supplement (1st May 24), Global Standards (31st Jan 25)
  - The importance of ESG (Environmental, Social & Governance)
- **The importance of context in Report Writing**
  - The need for diligence in undertaking valuations so not to stray into the areas of professional expertise outside that of the valuer
- **Conclusions**

STOP PRESS – Public Sector Investment Valuations

- **Sector Valuer Rotation Working Group - final report**
  - This report considers the recommendation of the RICS Independent Review of Real Estate Investment Valuations (2022) for valuer rotation in the public sector
- **Recommendation – NO VALUER ROTATION REQUIRED**
  - “Public sector investment property valuations for financial reporting should NOT BE considered as regulated purpose valuations as defined in the RICS Valuation - Global Standards: UK national supplement 2023”
- **Principal reasons for exclusion**
  - Public sector valuations are not figures on which third-party investors rely. Public sector debt is considered in total and not by individual assets
  - Existing oversight mechanisms of other bodies are robust and ensure that all property investment valuations are reviewed

RICS Red Book – Approaches

- **Income** - The income approach provides an indication of value by converting future cash flows to a single current capital value
- **Cost** - The cost approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction
- **Market** - The market approach provides an indication of value by comparing the subject asset with identical or similar assets for which price information is available

RICS Red Book – Methods

- Comparable Method (Market Approach)
- DRC/Construction Method (Cost Approach)
- Investment Method (Income Approach)
- Residual Method (Income Approach)
- Profits Method (Income Approach)

Although not explicitly stated in the Red Book, the calcuations undertaken are “models” or “techniques”.

IT IS IMPORTANT TO BE CLEAR IN VALUATION REPORTS

Hierarchy – Approaches, Methods & Models

1. APPROACH	INCOME APPROACH
2. METHOD	**Investment Method**
3. MODEL	Implicit Capitalisation – ARY/Current Day Rents
3. MODEL	Explicit DCF – Target Rate/Growth in Rents/Exit
2. METHOD	**Profits Method**
3. MODEL	Implicit Capitalisation – Once Rent established
3. MODEL	Explicit DCF – Projected Cash Flows
2. METHOD	**Residual Method**
3. MODEL	Implicit – Simple – ignores timings
3. MODEL	Cash flow or DCF – Time Value of Money
1. APPROACH	COST APPROACH
2. METHOD	**Depreciated Replacement Cost**
1. APPROACH	MARKET APPROACH
2. METHOD	**Comparable Method**

RICS Valuation Standards (Red Book)

Global Standards and UK National Supplement

- The Red Book is no longer red and it is no longer a book. Instead, it is two PDFs that work side by side
- The importance of economic commentary and due diligence to place the market value figure in context
- Dealing with and commenting upon uncertainties in the market
- Including ESG issues

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Statement – The Red Book – Reference within reports

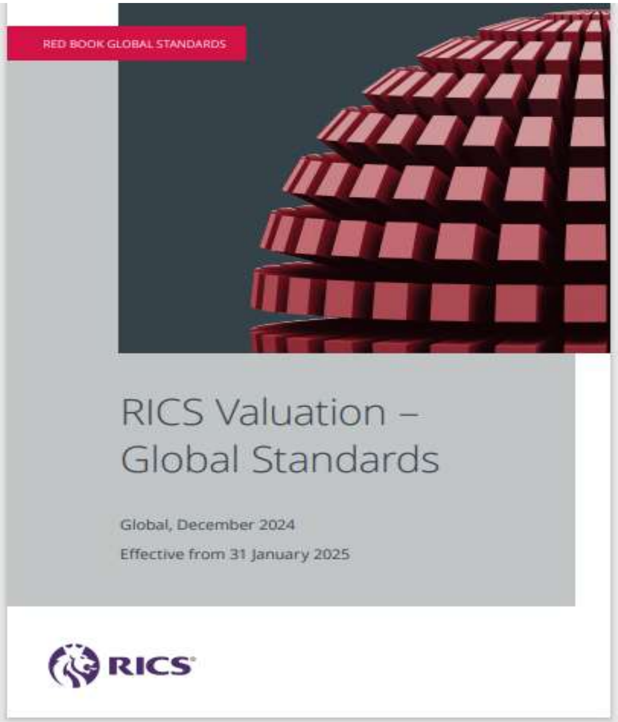
- All members, whether practising individually or within an RICS-regulated or non-regulated firm, who provide a written valuation must comply with the mandatory standards set out in the Red Book
- Must comply with the RICS Valuer Registration Scheme
- RICS Regulation is an integral part of the process
- Professional Standards are MANDATORY and MUST be followed
- Practice Information documents are BEST PRACTICE and are advisory.

Statement – The Red Book – Reference within reports

- VPS 1 Terms of engagement (3.1 n) - Confirmation that the valuation will be undertaken in accordance with RICS Valuation - Global Standards, which incorporate IVS, and (where applicable) the relevant RICS national or jurisdictional supplement. Where appropriate, such confirmation may refer simply to RICS Red Book Global Standards

The RICS Valuation – Global Standards 2024 (which incorporate the International Valuation Standards 2024) and the UK National Supplement 2023

RICS Valuation: Global Standards



- **VPS 1 remains as VPS 1**
  (Terms of Engagement)
- **VPS 2 becomes VPS 4**
  (Inspections, Investigations and records)
- **VPS 3 becomes VPS 6**
  (Valuation Reports)
- **VPS 4 becomes VPS 2**
  (Bases of Value, Assumptions & Special Assumptions)
- **VPS 5 splits into VPS 3 & VPS 5**
  (3. Valuation Approaches & Methods – 5. Valuation Models)

RICS Valuation: Global Standards

- The Red Book Global Standards structure comprises 6 parts:
  1. Introduction
  2. Glossary of terms
  3. Two RICS Professional Standards (PS) – MANDATORY
  4. Six Valuation Technical & Performance Standards (VPS) – MANDATORY
  5. Eleven* Global Practice Guidance – Applications (VPGAs) - ADVISORY
  6. International Valuation Standards (IVS)
- RICS has mandatory valuation governance requirements for RICS members and regulated firms globally e.g.:
  1. RICS Rules of Conduct,
  2. RICS Conflicts of interest professional standard
  3. RICS Red Book Global Standards (notably PS1 and PS2)
  4. RICS Valuer Registration

Changes – The Red Book – Global Standards

- Alignment with developments in other relevant global standards and regulations such as the new International Valuation Standards (IVS), published 31 January 2024 and effective 31 January 2025
- New content relating to modelling and methods
- Adaptation to practice and process changes from evolving areas such as technology and Environmental, Social and Governance (ESG)
- Basis for Conclusions on RICS website and redline comparison with 2022 edition

RICS Valuation: UK national supplement

- The UK supplement supports the Global Red Book for UK valuations but does not replace the Global Standards BOTH BOOKS APPLY TO ALL UK VALUATIONS
- ESG has been incorporated into the UK Supplement
- UK commercial property for secured lending purposes may include the valuation impact of MEES, EPCs, sustainability-related property certification, 'green' leases and flood risk

RICS Valuation Standards (Red Book)

Impact of ESG on Market Value of property

- ☐ If, at the date of valuation, the market does not differentiate “sustainable” and “non-sustainable”, there will be no impact on value
- ☐ While valuers should reflect markets, not lead them, they should be aware of sustainability features and the implications these could have on property values in the short, medium and longer term

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UK Supplement: Sustainability, Resilience & ESG

- "Sustainability – the consideration of matters such as (but not restricted to) environment and climate change, health and wellbeing, and personal and corporate responsibility that can or do impact on the valuation of an asset"
- "In some jurisdictions, the term 'resilience' is being adopted to replace the term 'sustainability' when related to property assets"
- "Sustainability may also be a factor in environmental, social and governance (ESG) considerations"

In simple terms – is the MV valuation being affected by changes in demand in the market?

IVSC/RICS – MARKET VALUE

MARKET VALUE (MV)

Market Value is the estimated amount for which an asset or liability should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

The Market is in transition

- So that is the default setting – reflect the market, don't correct the market – although there isn't one market. Prime, secondary and tertiary markets are all different
- In the prime and new build markets for offices, retail and industrial/logistics, there is increasing evidence that values are beginning to respond to MEES by the discounting non-compliant buildings
- Investment bids in those markets are now lower to reflect the "MEES related liability" of ownership

Drivers affecting change

- Banks - Lending policies are geared towards lending on MEES compliant buildings with lower rates applying according to EPC rating
- Market evidence of ‘brown discount’ stronger than ‘green premium’: this is likely to become accentuated
- In secondary and tertiary markets, there may be a move towards owner occupation to avoid MEES legislation – a two-tier market?

Valuation Implications

- When reporting, ‘wherever appropriate, the relevance and significance of sustainability and ESG matters should form an integral part of the valuation approach and reasoning supporting the reported figure’
- Valuers should assess the level of risk posed by MEES and the extent to which the market rent/yield will be affected based on market evidence and/or sentiment
- Until comparables adjust the yield, valuers need to “value” any observed change in market sentiment

Due Diligence Implications

- In terms of valuation practice, MEES has become embedded in the due diligence process
- Even if there is no clear evidence of market value change, their due diligence, under the Red Book, extends to accounting for any risks posed by MEES
- Valuers are reminded that they must only operate within their skills and competence
- MEES and EPCs: they are a source of risk and should be checked for validity and accuracy

ESG Valuation Briefing

- Valuation Checklist – November 2024
- The practical impact of ESG on the valuation of commercial properties in the UK
- There are no NEW valuation models for ESG
- The checklist is a personal view of Nick French and is not endorsed by the RICS.
- Its intent is to provide a framework for a valuer to undertake the valuation of commercial property with relation to the current ESG liabilities

Property Valuation Reports

The responsibility on the valuer

The valuation report and supporting documentation must convey a clear understanding of the opinions being expressed by the valuer and provide transparency to the intended user on the valuation approach(es), methods, inputs, models, professional judgement and resultant value(s)

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RICS Red Book: Report Writing

(now VPS 6 previously VPS3)

- If appropriate, the valuer should draw attention to, and comment on, any issues affecting the degree of certainty, or uncertainty, of the valuation
- VPS 6 – 2.1 Reports must address (a-q):
  - (e) Basis(es) of value adopted
  - (l) Valuation approach and reasoning, including any valuation method(s) and complex or proprietary model(s) used
  - (o) Commentary on any material valuation uncertainty (MVU) in relation to the valuation where it is essential to ensure clarity on the part of the valuation user

RICS Red Book: Base(es) of Value

- The basis of value, together with its definition must be stated in full in the report
- Unless agreed otherwise in the terms of engagement, the valuer is not required to provide a valuation on an alternative basis of value. However, where the basis of value is not a market-based figure and the valuation is materially different from market value, an explanatory statement to that effect may be appropriate

RICS Red Book: Valuation Approaches

- To understand the valuation figure in context, the report must make reference to the approach(es) adopted, the method(s) and model(s) applied, key inputs used and the principal reasons for the conclusions reached
- A valuation method is defined in IVS as 'within a valuation approach ..'
- IVS defines a valuation model as 'a quantitative implementation of a method'

RICS Red Book: Valuation Uncertainty

- VPGA 10 Material valuation uncertainty (MVU)
- All valuations are professional opinions on a stated basis of value – a valuation is not a fact. Like all opinions, the degree of subjectivity involved will inevitably vary as will the degree of ‘certainty’
- This requirement is mandatory only where the uncertainty is material. ‘Material’ means where the degree of uncertainty in a valuation falls outside normally expected parameters

Conclusions

- The Red Book is a quality assurance document
- RICS Regulation is different to how the market might view Professional Standards and Practice Information
- The role of the valuer is to "mark to market" so if the market doesn't yet "price sustainability", the valuer would be wrong to increase the value
- The Report must be clear and transparent – Discussion of Approaches, Methods and Models provide a framework
- Valuation Uncertainty is a natural outcome of giving an opinion

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