Property Chronicle – Summer 2025

Property Valuation: All uncertainty creates risk but not all uncertainty is material

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Summer 2025

Introduction

It is very clear since the commencement of his second term in office that President Donlad Trump (of the USA, if anyone has missed it) that he divides opinions, mostly at the two extremes, but in all cases, he does so with great bravado and noise.

But this article is not about his politics or, indeed my or your view on the same, it is about his impact on the world economy. What it is clear, regardless of where you stand, that he has created a new world of great uncertainty and, in many cases, confusion.

From a property valuation viewpoint, the question is "does this Trump related uncertainty create risks that should be reported in property valuations across the globe?"

Uncertainty and Risk

There are two things that need to be clarified before we answer that question. One is to understand what we mean when we talk about uncertainty. It was one of the USA's founding fathers, Benjamin Franklin, that is attributed with the quote "everything is uncertain except death and taxes" and whilst somewhat whimsical that is absolutely true.

Uncertainty is an innate and unequivocable part of life and, in the context that we are discussing, all markets. Nobody knows exactly what the outcome of any decision will be. We have a good percentage knowledge of what is most likely relative to the date in the market when the decision is made but it only takes a shock to the system (such as covid) for all our understandings to be turned on their heads and for nothing to have any degree of certainty.

So, uncertainty is a driver of markets. The more certain something is, the more stable the market (or is that vice-versa?) The more uncertainty, the less people will feel comfortable that the outcome that they are wanting (included in the price) will be the outcome that they will achieve. Risk is the flipside of all this and is simply a measure (quantitatively or qualitatively) of the likelihood that the result will be different to the expected outcome. The more uncertainty in the market, the more risk there will be in the final outcome.

But what is odd is that nearly everyone, including seasoned investors and purchasers of property, always associate risk with a negative outcome. Yet, the reality is that risk is a measure of the outcome not being achieved as expected so, if that risk is expressed as a bell/normal distribution, there is as much chance of the outcome being better that expected as there is for it to be worse.

So that is point number one, the second point seems to always cause more consternation when receiving a valuation from a qualified property valuer. And that is the difference between valuation uncertainty and investment uncertainty.

Valuation Uncertainty and Investment Uncertainty

Risk, as we have seen is a measure of a number NOT being as expected. You can upside risk (something is better than expected) and downside risk (something turns out to be worse). In statistics, this can be measured and view as a range of outcomes above and below the expected outcome. If the market is particularly poor, there may be more outcomes that are likely to be worse than better and this is shown as a skewed distribution. And, of course, the opposite can be true as well.

In investment, this generally is shown as an expected (most likely, central tendency) return relative to a spread of possible outcomes above and below this expectation. Thus, an investor might pay a price that reflects that if all goes as expected, then the return will be, say, a 12% internal rate of return (IRR). But, it is possible that the final return (measured with the benefit of hindsight after, say, a ten-year holding period) might be less at, say, 10%. That would have been within the range of possible outcomes as explained by the risk profile at the commencement of the investment. This is investment risk.

This is NOT valuation risk. When we talk about valuation risk, we are actually looking at the likelihood of the valuation figure exactly matching the sale price of the property were it to be sold in the open market on the date of the valuation. Valuation is an estimate of price. Another way of looking at this is to ask the valuer about how sure they are that their valuation figure will match that hypothetical sale price. In a strong market, they might say 90% certain, in a poor market (with few comparables and less market evidence) this might be lower at, say, 70%. Valuation uncertainty and investment uncertainty are two very different things.

Property Valuation Uncertainty

The Royal Institution of Chartered Surveyors (RICS) recognises the issue of valuation uncertainty and, indeed, states in its Global Valuation Standards:

"All valuations are estimates and therefore always subject to a degree of uncertainty. However, this ordinary uncertainty should not be confused with Material Valuation Uncertainty (MVU) where the degree of uncertainty in a valuation falls outside any parameters that might normally be expected and accepted"

And it is the acknowledgement of normal uncertainty that, by definition, recognises abnormal uncertainty or, as the RICS refer to it MVU and it requires the valuer to comment at times when they think that MVU is present.

Playing Top Trumps

So, to return to the question about whether Trump's economic challenges, especially in the realm of tariffs (his favourite word by his own admission) are creating a world of abnormal uncertainty, I personally think, for property, that it is not. Yes, as I mention, the world is more challenging now and property investors will be more unsure of both the investment market and the underlying occupational market but I would argue that this is a transition to a new-normal. The tariffs were a cumbersome and awkward mechanism for countries to renegotiate trade deals, short and long, with the USA. In the UK, the doom and gloom of the April has turned into a celebration of a new deal in May. So, the normal may have changed, but it isn't an abnormal.

Also, one correlation that often happens in the UK when markets are less certain is that international investors see London and the big regional cities as "safe havens" where they can invest and tread water until perceived risks elsewhere change. So, Trump creates both uncertainty and certainty at the same time.

And from a valuation viewpoint, this may be challenging but it isn't material.