Valuology
Reducing Valuation Risk

RICS Consultation Draft

proposed changes to Global Red Book for 2025

VPGA 1 – Valuations for Financial Reporting

There has been content on valuations needed for financial reporting purposes ever since the Red Book came into being nearly fifty years ago. Indeed, this was the prime reason for RICS starting to issue valuation standards and for the first twenty years the Red Book only applied to financial reporting, company takeovers and new public listings in the UK. So, while VPGA1 is not strictly a new VPGA it has been completely rewritten. It now provides guidance on the various valuation requirements for non-financial assets and liabilities in the current International Financial Reporting Standards, which are used in over 140 countries.

> Our Comment:
> We make no comment other than to disclose that RICS commissioned one of our directors, Chris Thorne, to write this VPGA, assisted by a small working group of experts.

VPGA 2 – Valuations for Secured Lending

Valuations of assets, especially but not limited to real estate, is probably the most common type of valuation undertaken by RICS members.

Section 3, *Independence, objectivity and conflicts of interest,* has been significantly simplified. The previous paraphrasing and discussion of the requirements in PS2, the Rules of Conduct and the PS Conflicts of Interest is now omitted with just cross reference links to the relevant documents. The bullet point list of examples of where a conflict is either likely or may arise in secured lending valuations has been retained.

> Our Comment:
> We welcome this simplification. It avoids the risk of different interpretations of RICS professional standards arising.

A new paragraph, 4.2, has been added to Section 4, *Taking instructions and disclosures*, to refer to the new requirement in VPS1 clarifying that confirmation of some aspects of the instruction will still be required even if there is a master agreement in place between the lender and valuer in order to ensure all points required by VPS1 are covered.

> Our Comment:
> This is a useful addition because some matters, such as confirming what is to be valued, identifying the responsible valuer, that they have no involvement with any party or the property and that they are free from conflict will be specific to each instruction. Furthermore, few master agreements will define comprehensively the scope of the valuer's investigations or the limitations and assumptions that will apply to those investigations.

The new paragraph 4.3, formerly 4.2, dealing with situations where the commissioning party is not the lender, has been extended as follows:

> *If the identity of the intended lender is unknown, this should be clearly stated in both the terms of engagement and the valuation report. Any new information regarding the identification of the lender that arises after the terms of engagement are finalised must be documented and referenced in the valuation report. Once details of the lender become available, retrospective conflicts of interest checks should be conducted.*

Our Comment:
We agree that it is sensible to make it clear if the lender is unknown in the terms of engagement and report, although arguably this is already implied in relation to the terms of engagement in the existing text.
We find the use of "retrospective" in the final sentence odd and liable to misinterpretation. If the instruction from a broker or borrower has been accepted conflict checks should have been undertaken before this. If another party who wishes to rely on the report comes on the scene later, a new conflict check has to be undertaken on that party and any appropriate consents obtained. There is nothing retrospective about this.

Paragraph 4.5 now states:

> *The valuer should request details of the pertinent terms of the lending facilities being contemplated by the client, including the term (duration) of the loan. The client is not obliged to provide details of the loan terms.*

Our Comment:
We believe that the ONLY information that a valuer should request from a lender is the duration of the proposed loan because this could be material to any comments the valuer may be requested to make on future risks. No other comment should be offered by the valuer on the loan terms. The second sentence of this paragraph is otiose because Red Book does not apply to clients.

Section 5, Bases of value and special assumptions, has a number of proposed changes or problems with existing text that have not been fixed.

The following two additional paragraphs have been inserted:

5.4 In recent years there have also been much more direct referencing of ESG and sustainability issues within special assumptions. Examples of special assumptions include:

- *that the asset(s) meet(s) a specific legal/regulatory energy efficiency standard*
- *that the asset(s) align(s) with a net zero pathway or target (usually by a certain year).*

5.5 It is important that ESG and sustainability special assumptions are specific rather than general and where referring to a particular regulatory requirement, certification, rating and/or timeframe that this is included in the wording of the special assumption.

Our Comment:
We do not find these comments to be helpful. It is not clear why the two examples provided are special assumptions and the second example contradicts 5.5 as alignment with a pathway is not specific.

ESG factors, mainly environmental factors, are inherent in the valuation of most non-financial assets. Treating them as separate from all other factors that influence value and need to be considered by a valuer is counterproductive. We would prefer to simply add an example to the list of special assumptions in 5.3, as per our revised list below and delete the proposed 5.4 and 5.5.

The existing list of special assumptions in 5.3 often fails to make it clear that a change in the present facts and circumstances has been assumed. We recommend the following replacement:

5.3 Examples of *special assumptions* may often be needed in secured lending valuations if a lender needs to know the effect on value of a change in the facts or circumstances existing on the *valuation date*. Examples include:

- that planning consent had been granted for development at the property when it has not been granted on the *valuation date*
- that a physical change to the property, such as proposed new construction or refurbishment, had occurred on the *valuation date*
- that a new letting on given terms, or the settlement of a rent review at a specific rent, had been completed on the *valuation date*
- that any lease or leases between connected parties has been disregarded
- that an identified special purchaser is interested in buying the asset
- that a constraint which could prevent the property being either brought to or adequately exposed to the market is to be ignored
- that a proposed economic or environmental designation was already in effect on the *valuation date*
- that proposed work to meet a specific energy efficiency standard had already been completed on the *valuation date*.

Paragraph 5.7 has been amended to:

Any valuation for secured lending made using a special assumption should also include a valuation without that special assumption if the difference between the two is material.

The existing equivalent paragraph is:

Any valuation for secured lending purposes arrived at by making a special assumption must be accompanied by a comment on any material difference between the reported value with and without that special assumption.

The proposed change would mean that an “as is” valuation is always required alongside a valuation made on a special assumption unless the difference is immaterial.

Our Comment:
We consider it unreasonable to also require a valuation without a special assumption if the effect of the special assumption is material. A prospective lender may only be looking for the value of the security after the change envisaged by the special assumption has occurred. The RICS cannot dictate what the client wants or can ask for, only what the valuer provides. The wording in the current VPGA is ambiguous. We suggest it be revised to:

> *If the valuer is instructed to provide only a valuation subject to a special assumption, they should include a comment indicating whether this value is likely to be materially different from the value without the special assumption.*

Section 6, Reporting and disclosures, is already a very long section and further additions are proposed.

Paragraph 6.1 in the current VPGA consists of a list of matters that "frequently require consideration and comment in a report". This list has now been extended from sixteen to twenty items. We do not reproduce it here, but it takes up most of pages 108 – 109 of the consultation draft.

Our Comment:
This list appears to have been developed without regard to the rest of the Red Book. Many of the items are requirements that are always required in a valuation report, not "frequently required" as suggested here. The target of reducing repetition has certainly been missed here. Rewriting a standard rather than cross referencing it is also bad practice as it runs the risk of introducing alternative interpretations. A further risk is that it leads readers into thinking this is a self-contained document and they do not need to look at, or comply with, other provisions in the Red Book.

We consider only the following of the list in the new 6.1 relate to content that should not already be included in a report produced in accordance with VPS 6, or covered in asset specific VPGAs

- d) risks that could arise during life of loan
- m) marketability over the life of the loan
- p) the impact of incentives on the value of new developments
- s) if this is an update of a previous valuation, comment on the reason for any change.

We therefore recommend this paragraph is much simplified and confined to simply matters specific to lending valuation reports that are additional to the VPS 6 requirements or that are not covered in the asset specific guidance in VPGAs 3-10 inclusive.

Paragraph 6.2 applies to all valuation and is an unnecessary repetition of VPS 6 2.2 k).

Paragraph 6.3 is required by VPS 6, included in VPGA 8 and there is also standalone guidance that is applicable on ESG in valuation.

Our Comment:
These two paragraphs should be deleted.

A new section 7 is included – Implementation of the Basel III regulatory framework

Our Comment:
This section should not be included. As drafted it contains errors, not least that the Basel Committee does not define anything called prudent value. It issues guidelines on prudential valuation adjustments, but it is for the National Competent Authorities (NCAs), the government approved banking regulators in each country, to determine the detailed implementation in their jurisdictions. It is wrong to think that “prudential” or “prudent” value is a specific type of valuation; all recommendations from the Basel Committee aim at achieving the prudential regulation of banks. The EU has made many amendments to its Capital Requirements Regulations that apply the most recent Basel recommendations across the EU. One of these has been to change the Article relating to the valuation of real estate collateral but this still requires a market value to be determined. However, there is no consistent application globally.

As is stated in paragraph 7.5, the commentary provided should not be read as creating any specific requirements or recommendations on valuers at this time. RICS has promoted and sponsored research in this area, but the Red Book should not be used to promote or explain this. It is a set of standards updated regularly and should contain only rules and guidance that its members must follow currently.