Ref. Ares(2017)960114 - 22/02/2017

Summary of professional valuer regulation and regulation standards

Deliverable 4.1
10 February 2017

D4.1 REVALUE Inventory of relevant norms and outlook for future development

Deliverable	: D4.1
Title	: Summary of professional valuer regulation and regulation standards.
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Reviewer	: RICS, Vanhier, Maastricht University
Type (R/P/DEC)	: Public
Version	: 2
Date	: 9th January 2017
Status	:
Dissemination level	:
Download page	: N/A
Copyright	: N/A

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B&W	Bax & Willems
Savills	Savills UK
MU	Maastricht University
RICS	Royal Institute of Chartered Surveyors UK
Luwoge	Luwoge Consult
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Deliverable description

The Deliverable D4.1 now renamed a Summary of professional valuer regulation and regulation standards documents the current relevant norms and the ideas and assessment of potential future changes in the practice and use of norms and standards.

This document can be viewed as complementing the REVALUE Contract Grant Agreement (GA), Technical Annex (TA) and Consortium Agreement (CA) with respect to valuation norms and standards. It shall communicate all relevant norms and standards to all REVALUE project partners. Therefore, this document can be seen as an important hinge document that on the one hand looks at current practice and on the other hand explores possibilities in the way these standards and norms can change or be revised over time.

This project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No. 649705

Executive summary

An objective of the REVALUE project is to understand the ways in which Energy efficient improvements in residential rented stock can be incentivized, primarily through a 'value' case. Current professional standards and norms under which valuers operate are summarised and outlooks for future development are considered in order to identify methods for doing this.

Valuation standardisation bodies including IVS, RICS and Tegova are outlined along with their remit. Energy efficiency related guidance has been identified within these standards and within EU directives such as the measurement of Energy Performance Certificates (EPC) and policies leading towards 'nearly zero energy' by the end of 2020. Other identified drivers include National Government initiatives such as the requirement from 2018, in England and Wales for properties rented out to meet minimum energy efficiency standards (initially set at label E on an Energy Performance Certificate (EPC).

Limitations on the effect of the standardisation bodies and their influence on the valuation process have been identified for example, they prescribe the valuation process but do not tell valuers how to do their job, although failure to comply could lead to negligence claims. Some standards are mandatory whereas others are advisory. Valuers also value and report under instructions from clients on the basis of the evidence available, although they are required to collect sustainability information, where available, even if there is no obligation to reflect and report. It is important to remember that valuers reflect but don't lead markets.

A summary of the International Financial Reporting Standards (IFRS) guidance on valuation for accounting standards is also included.

Potential drivers for value as a result of investments in Energy Efficiency have been summarised by considering the factors, including energy efficiency that may impact on a valuation. The indirect impact of energy efficiency on value may include discount rates, voids/bad debts, turnover ratio, arrears, maintenance costs/cyclical repairs, management costs, rents and service charges, lifetime expectancy, lower consumption costs, market price, energy labeling, grants and guarantees, life cycle costs, market price (comfort, green perception, adoption of air conditioning). The impact may be tempered by policy measures and regulation (subsidies, tax interventions, soft loans), temperature response, household composition, dwelling size, building age and other factors which the research is seeking to unpack.

After consideration of the remit of standardisation bodies and the current limitations in terms of driving implementation of energy efficiency measures though value impacts whilst also deliberating on what the potential drivers, a number of future developments have been proposed. They include:

- production of a Royal Institute of Chartered Surveyors (RICS) Insight Paper (using qualitative and quantitative research) which will then provide the basis of updating the relevant Guidance Note;
- production of a guide for understanding Energy Efficiency Factors for valuation professionals who are not experts in energy efficiency;
- Review of the validity of Energy Performance Certificates (EPC) in the light of consideration of different building typologies;
- Advice to professionals on practical implementation issues such as provision of multiple Energy Performance Certificates through Automated Valuation Models (AVM).

Content

Valuation standardisation bodies and the valuation industry

Across Europe the principal valuation body is the Royal Institution of Chartered Surveyors (“RICS”) who produce the RICS Valuation - Professional Standards, colloquially known as the Red Book. The standards are mandatory, have a global reach and contain high level principles of valuation. The aim of the Red Book is “*to engender confidence in, and to provide assurance to, clients and recognised users alike, that a valuation provided by an RICS-qualified valuer anywhere in the world will be undertaken to the highest professional standards overall*”.

The International Valuation Standards (IVS) are standards prepared by a worldwide consortium of standard setters and the Royal Institute of Chartered Surveyors is part of this group. The standards cover not just real estate valuation but are concerned with accounting principles, including of intangible assets and financial instruments. The International Valuation Standards are not enforceable but the Royal Institute of Chartered Surveyors effectively enforces them on their members in so far as they relate to real and personal property and business assets.

The Royal Institute of Chartered Surveyors has a major input into International Valuation Standards and embed the principles in its Red Book. The Red Book is updated frequently (next edition 2017 underway).

RICS Valuation – Professional Standards

The Red Book uses the definitions that are developed by the International Valuation Standards Board and provides explanation and application. They are supplemented by national chapters which apply only to local jurisdictions; not every country has published mandatory standards. The Red Book contains formal application notes for specific purposes; these being recommended but not mandated.

By definition they do not tell valuers how to do their job: they prescribe the **process** to be adopted and failure to comply could lead to claims of negligence.

The Royal Institute of Chartered Surveyors global material is grouped under three distinct headings, the first two covering matters relevant to valuation assignments generally, the third covering matters relating to particular applications. The intention is to make clear to members what is mandatory and what is advisory – thus collected together under the first two headings is the mandatory material and under the third the advisory material:

- RICS Professional Standards (PS) – mandatory
- RICS Global Valuation Practice Statements (VPS) – mandatory
- RICS Global Valuation Practice Guidance – Applications (VPGA) – advisory

Valuation practice guidance will be issued either in the form of Guidance Applications, covering specific asset types or situations that are closely linked to one or more practice statements, or in the form of Guidance Notes, in all other cases. Guidance Applications and Guidance Notes are of equal status – they contain advisory, recommended but not mandatory material.

There are currently four Valuation Practice Statements covering broad topics such as terms of engagement, inspections, valuation reports and the bases of value and assumptions. By definition the guidance is high level and capable of being applied across geographies – but may be restricted to particular property types or purposes.

More specific guidance is given on valuation for financial statements, secured lending and portfolios and valuation certainty within the practice guidance.

They do not:

a. instruct members on how to value in individual cases
b. prescribe a particular format for reports: provided the mandatory requirements in these standards are met, reports should always be appropriate and proportionate to the task.
c. override standards specific to individual jurisdictions.

Royal Institute of Chartered Surveyors professional guidance publications are concise technical documents that set out accepted good practice for RICS members. Drafted by commissioned experts and panels, and subject to consultation and stakeholder review, the development of guidance is core to the Royal Institute of Chartered Surveyors proposition of instilling confidence in the market through leading professional standards.

Royal Institute of Chartered Surveyors guidance conforms to current legislation and best practice, and reassures clients and members of the public of the level of service they can expect from an RICS qualified chartered surveyor.
If a valuer complies with both standards and Guidance there will normally be a legal presumption that, within reason, the valuation produced, even if found to be inaccurate when tested in the market place, is not negligent.

RICS Information Papers are more discursive in nature than Guidance Notes. They aim to set out the latest technical information and knowledge in order to raise awareness. They are normally also drafted by commissioned experts and panels, and may be subject to consultation and stakeholder review. They are more likely to be country specific than Guidance Notes and they are advisory and educational in slant. They will often deal with areas where practice is developing fast or where the market context is changing. They are not mandatory but it is advisable to use them.

RICS Insight Papers are very similar to Information papers and they are being introduced to replace Information papers. They are more concise and the aim is to provide a more immediate response to market conditions.

Individual countries have their own national chapters (though not all do yet). At this level the guidance to valuers is more detailed – and in the case of e.g. UK Social Housing there is a specific additional basis of valuation pertinent to this project: Existing Use Value – Social Housing and this is the basis adopted for the reporting of social housing values for accounts purposes.

Since January 2015 the UK portion of the Red Book has been published separately from the global RICS Valuation – Professional Standards. They supplement, expand or amend the global valuation standards so that they meet UK statutory or regulatory requirements. Examples in the UK include:

- UKVS 3: Residential
- UK Appendix 10 and 11: Mortgage valuations
- UK Appendix 13: Valuation of registered social housing providers' stock for secured lending purposes
- UK Appendix 14: Affordable Rents and Market Rents

International Valuation Standards

The current version of the International Valuation Standards was published in 2013 and a new version of the International Valuation Standards is to be launched in early 2017, following which the Red Book will be further revised. The aim of the new release is to expand the depth of International Valuations Standards and ensure they are fit for purpose and meet the needs of the marketplace. This comprises an International Valuation Standards framework, General Standards, Asset Standards, Valuation applications and technical information.

The International Valuation Standards Framework

This serves as a preamble to all the other International Valuation Standards. The International Valuation Standards Framework sets out generally accepted valuation principles and concepts that are to be followed when applying the other standards. The International Valuation Standards Framework does not include any procedural requirements.

The International Valuation Standards-**General Standards** set out requirements for the conduct of all valuation assignments, except as modified by an Asset Standard or a Valuation Application. They are designed to be applicable to valuations of all types of assets and for any valuation purpose to which the standards are applied.

The Asset Standards include requirements and a commentary. The requirements set forth any additions to or modifications of the requirements in the General Standards together with illustrations of how the principles in the General Standards are generally applied to that class of asset. The commentary provides background information on the characteristics of each asset type that influence value and identifies the common valuation approaches and methods used.

European Valuation Standards

The European Group of Valuers' Associations, ("TEGoVA"), issue the European Valuation Standards (EVS). TEGoVA is a European nonprofit association composed of 64 valuers' associations from 35 countries representing more than 70,000 valuers in Europe. Its main objective is the creation and distribution of standards for valuation practice, education and qualification as well as for corporate governance and ethics for valuers across Europe. The most recent version of the European Valuation Standards (EVS) was released in 2016.

Methodologies

Like the International Valuation Standards and Royal Institute of Chartered Surveyors standards the European Valuation Standards do not deal with approaches as they are a matter of professional judgment of the valuer, however more guidance as to methodology is provided within the European Valuation Standards. EVS 2012 intended to be consistent with International Valuation Standards. They added valuation requirements and definitions of EU and European Economic Area (EEA) legislation.

Country specific guidance

Valuation reports prepared in accordance with European Valuation Standards respect national legislation, regulation and custom. Valuations are also informed by current market dynamics in each area or sub-area. Country Chapters compiled by TEGoVA Member Associations are provided to outline country-specific legislation and practice. The information provided is not intended to provide definitive advice but assists an understanding of the characteristics employed in any evaluation undertaken in reaching an opinion of value.

Guidance on property valuation and Energy Efficiency within the standards and guidance

There is a clear supra-national drive embedded in regulation aimed at improving the efficiency with which energy is used so that the greatest benefit is achieved for the least use of resources and to meet the inevitable increase in energy demands. Greenhouse gas emissions can be tackled by carbon pricing through mechanisms like the European Union´s Emissions Trading System, making the use of fossil fuels to generate energy more expensive. In addition, energy conservation has a key part to play and this is particularly significant for buildings. Buildings are held to account for 36% of CO2 emissions in the European Union and so energy concerns are now a major factor driving legislation affecting property. Both the EU and individual countries hope to influence property occupiers to change their behaviour, reduce consumption, improve efficiency and make greater use of renewable energy sources.

The best-known EU measure in this regard is the Energy Performance of Buildings Directive of 2002, now replaced by the Directive of 2010. It applies to the buildings themselves, rather than the operations within them, a point not lost on many building managers. One of its prime objectives is to improve market awareness of Energy Efficiency and running costs. Energy Performance Certificates (EPC´s), give a dwelling an Energy Efficiency rating on a relatively standard system. These are required upon the sale or lease to a new purchaser or tenant of a wide range of buildings, essentially all residential, commercial and public sector properties and most other buildings unless they are classified as “low energy demand” buildings, are heritage assets or are “short life buildings” due for demolition.

Directive 2010/31/EU on the Energy Performance of Buildings develops the approach of its predecessor 2002/91. Its preamble notes that: “*The sector is expanding, which is bound to increase its energy consumption*” and so states that *“reduction in energy consumption and the use of energy from renewable sources in the buildings sector constitute important measures needed to reduce the Union’s energy dependency and greenhouse gas emissions. It is necessary to lay down more concrete actions with a view to achieving the great unrealised potential for energy savings in buildings and reducing the large differences between Member States’ results in this sector.*”

Under the Directive, new buildings must be “nearly zero energy” by 31 December 2020 (after 31 December 2018 for buildings occupied and owned by public authorities) – a goal reinforcing other trends in policy to increase the Energy Efficiency requirements of national building standards. It does not enforce standards for existing buildings except where a renovation qualifies as a ‘major renovation’, in which case it requires compliance with energy performance standards. It imposes a regime of inspections for heating and air conditioning systems.

As from the 1st April 2018 in the UK there will be a requirement for any properties rented out in the private rented sector to have a minimum energy performance rating of label E as calculated in its Energy Performance Certificate. The regulations will come into force for new lets and renewals of tenancies with effect from 1st April 2018 and for all existing residential tenancies on 1st April 2020. It will be unlawful to rent a property which breaches the requirement for a minimum label E rating, unless there is an applicable exemption. We are yet to see clear evidence of the market reaction to this change in policy but it could have an impact on demand for the more energy efficient properties, with increased demand and supply remaining at current levels. It may have the impact of driving up rents, and therefore capital values of investment portfolios. It may also lead to earlier demolition of ‘hard to treat’ properties where the economic costs of upgrade will not easily be recouped by additional rental value. However, given that it does not affect sales between owner-occupiers, which represents the dominant number of capital value transactions, the impact may be muted.

Energy is an increasingly significant cost when occupying a property and one that has generally increased in recent years. The requirements of heating, lighting and air conditioning combine with the demands of services, from cooking to lifts, and the energy needs of the processes for which the building is used.

Energy costs are of greater concern to the elderly, the housebound, those with very young children and the poor, although potential purchasers and tenants are usually interested, at least as a matter of practicality, in the availability and cost of suitable energy for their needs. Some may wish to demonstrate particular levels of efficiency or that the energy comes from renewable sources. For demographic reasons, tenants of housing association or other ‘assisted’ housing may be more sensitive to energy cost matters.

The professional valuer is required to report their opinion as to the value of the property under the instructions received from the client on the basis of the evidence available. That will include the evidence of values from the market place. That is essential to the concept of “market value”. This may be a limiting factor in to how much energy efficient measures are reflected in values going forward.

EVS 2016 or Blue Book (8th edition) added the following regarding their view towards Energy Efficiency:

“Feedback from a wide variety of stakeholders has confirmed that European Valuation Standards should remain clearly focused on real estate, provide additional guidance and technical information to meet the diverse needs of the 63 TEGoVA Member Associations and continue to concentrate on high level principles.

In meeting these objectives this publication follows the direction of previous editions, being informed by existing and emerging European regulation, acknowledging that EU law is the origin of an increasing amount of the local property law underpinning valuation. However, Union regulation can presume outcomes that are not always evident in the market. Energy efficiency is an example in point. Europea Valuation Standards helps raise the valuer's consciousness of energy efficiency issues and EU instruments such as the energy performance certificate and its recommendations for improvements, but at the same time upholds the scientific and professional obligation on the valuer to value energy efficiency on the basis that values set must reflect verifiable market reality.”

Royal Institute of Chartered Surveyors guidance

Global Red Book Valuation Practice Statements 4 2.5(g)

Within the current version of the global Red Book at Valuation Practice Statements (VPS) 4 Bases of Value, Assumptions and Special Assumptions, the approach to reflecting energy efficiency is discussed within 2.5(g) entitled Sustainability.

Valuation Practice Statement 4 states that valuers are advised to collect appropriate and sufficient sustainability data, as and when it becomes available, for future comparability, even if it does not currently impact on value. Only where market evidence would support this, should sustainability characteristics be built into a report on value.

Valuers are often asked to provide additional comment and strategic advice. In these cases, valuers will need to consult with the client as to the use and applicability of sustainability metrics and benchmarks that are applicable in each case.

Valuation Practice Statement 4 also requires a valuer to assess the extent to which the subject property currently meets sustainability criteria and arrive at an informed view on the likelihood of these impacting on value, i.e. how a well-informed purchaser would take account of them in making a decision as to offer price

They are also required to provide a clear description of the sustainability-related property characteristics and attributes that have been collected, which may, where appropriate, include items not directly reflected in the final advice as to value provide a statement of their opinion on the relationship between sustainability factors and the resultant valuation, including a comment on the current benefits/risks that are associated with these sustainability characteristics, or the lack of risks and provide a statement of the valuer's opinion on the potential impact of these benefits and/or risks to relative property values over time.

Therefore, there is no obligation to reflect and report on sustainability impacts on current value. The Red Book is of the opinion that *over time the data will become more readily available to valuers but they must not build it into MV unless there is good evidence.* At the moment, this could be a stumbling block to improving practice and ways to overcome this are under consideration.

Sustainability and Residential Property Valuation Information Paper 2011
Part of the RICS valuation standards includes an Information Paper written in 2011 entitled Sustainability and Residential Property Valuation. The document concludes that the role of valuers is to assess Market Value in the light of evidence normally obtained through analysis of comparable transactions. It reiterates that valuers reflect not lead, markets.

When assessing the impact of sustainability on Market Value or in calculating worth to individual, valuers should be aware of the variation in impact that is likely to arise depending on the type of building, which market sector it falls within, and the profile of potential purchasers or tenants. While some purchasers or tenants are likely to move towards requiring sustainability features based on cost savings, for others less tangible considerations may be of greater concern.

Overall the paper recognised that residential markets can be expected to become increasingly sensitised to sustainability considerations; and as part of establishing Market Value and market rent, residential valuers should seek to keep abreast of trends and ensure that they collect appropriate and sufficient sustainability data when inspecting property, as this will enable them to analyse and apply them to any property valuation.

It is recognised by RICS that the residential markets have moved in the last five years and that this paper is now outdated. Further it is of UK application only and there is a need to develop guidance with a wider scope to cover other jurisdictions. However, by doing this it is recognised that the guidance will become more 'high level' in nature given the variance in climate, built stock and tenurial and legislative arrangements and regulatory standards imposed.

RICS Red Book UKGN 4 Inspections and material considerations
Section 6 within the UK Guidance Note 4 relates to Energy Performance Certificates and in the UK from 1 October 2008 an Energy Performance Certificates must be made available by the 'relevant person' whenever a non-domestic building is constructed, sold or rented out, subject to certain exemptions. Energy Performance Certificates are valid for ten years. The valuer should be aware that the 'relevant person' (such as a prospective landlord or a tenant making an assignment of, or subletting, a non-domestic building) is responsible for making an Energy Performance Certificate available free of charge to the prospective buyer, tenant or assignee.

RICS Red Book UK Appendix 10
The UK specific Red Book refers to RICS residential mortgage valuation specification. Section 3 relates to inspections and 3.7 states that "the energy-efficiency rating provided within the Energy Performance Certificate (EPC) is to be considered, if it is available."

The RICS guidance note, Contamination, the environment and sustainability: their implications for chartered surveyors (2010)
This guidance note, whilst dealing with a wide range of environmental issues, does specifically address Energy Performance Certificates and states that "*These documents are likely to be increasingly important as landlords and tenants begin to benchmark their properties in terms of energy performance, whereby any deterioration may have an impact on value.*"

The RICS guidance note, Sustainability and commercial property valuation (2013)
This guidance, whilst specifically relating to commercial property and hence outside the scope of this project, again underscores the requirement for valuers to consider energy efficiency but to also place this within a market evidence base. However, it recognizes that the investment market is likely to be sensitized as investor recognize the likely increasing impact of energy efficiency on values and reflect this in their purchasing decisions.

It might be worth adding that RICS also offers a subscription only service to members which contains updates on sustainability and valuation matters but this is UK focused and not available to all valuers. However, RENOVALUE (another EC supported project in which the Royal Institute of Surveyors participated) does provide some free training primarily geared to commercial real estate.

International Financial Reporting Standards (IFRS)
The International Financial Reporting Standards ("IFRS") contains guidance on valuation according to accounting standards. IFRS is the collection of financial reporting standards set by the International Accounting Standards Board ("IASB"). IFRS standards have been implemented or permitted in almost 100 countries worldwide. Listed companies, and sometimes unlisted companies, are required to use the standards in their financial statements in those countries which have adopted them. The EU regulation 1606/2002 on the application of these standards made this a requirement for listed companies in the European Union.

Within IFRS the most relevant standards with respect to the valuation of residential real estate are the conceptual framework, International Accounting Standards ("IAS") 40 and IFRS 13.

Conceptual Framework
The IFRS Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users. The IFRS Framework serves as a guide to the Board in developing future IFRSs and as a guide to resolving accounting issues that are not addressed directly in an International Accounting Standard or International Financial Reporting Standard or Interpretation.

International Accounting Standards 40 (IAS40)
IAS 40 *Investment Property* applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Investment properties are initially measured at cost and, with some exceptions, may be subsequently measured using a cost model or fair value model, with changes in the fair value under the fair value model being recognised in profit or loss.

Investment property should be recognised as an asset when it is probable that the future economic benefits that are associated with the property will flow to the entity, and the cost of the property can be reliably measured.

Investment property is initially measured at cost, including transaction costs. Such cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy.

IAS 40 permits entities to choose for measurement subsequent to initial recognition between:

• a fair value model, and
• a cost model.

One method must be adopted for all of an entity's investment property.

Fair value model
Investment property is measured at fair value from International Accounting Standards 40, which is the amount for which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Gains or losses arising from changes in the fair value of investment property must be included in net profit or loss for the period in which it arises.

Fair value should reflect the actual market state and circumstances at of the end of the reporting period. The best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts. In the absence of such information, the entity may consider current prices for properties of a different nature or subject to different conditions, recent prices on less active markets with adjustments to reflect changes in economic conditions, and discounted cash flow projections based on reliable estimates of future cash flows.

There is a rebuttable presumption that the entity will be able to determine the fair value of an investment property reliably on a continuing basis. However:

- If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it measures that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed.
- If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in International Accounting Standards 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply IAS 16 until disposal of the investment property.

Where a property has previously been measured at fair value, it should continue to be measured at fair value until disposal, even if comparable market transactions become less frequent or market prices become less readily available.

International Financial Reporting Standard 13 (IFRS13)
IFRS 13 *Fair Value Measurement* applies to International Financial Reporting Standards (IFRS) that require or permit fair value measurements or disclosures and provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurement. The Standard defines fair value on the basis of an 'exit price' notion and uses a 'fair value hierarchy', which results in a market-based, rather than entity-specific, measurement.

IFRS 13 defines fair value as: the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

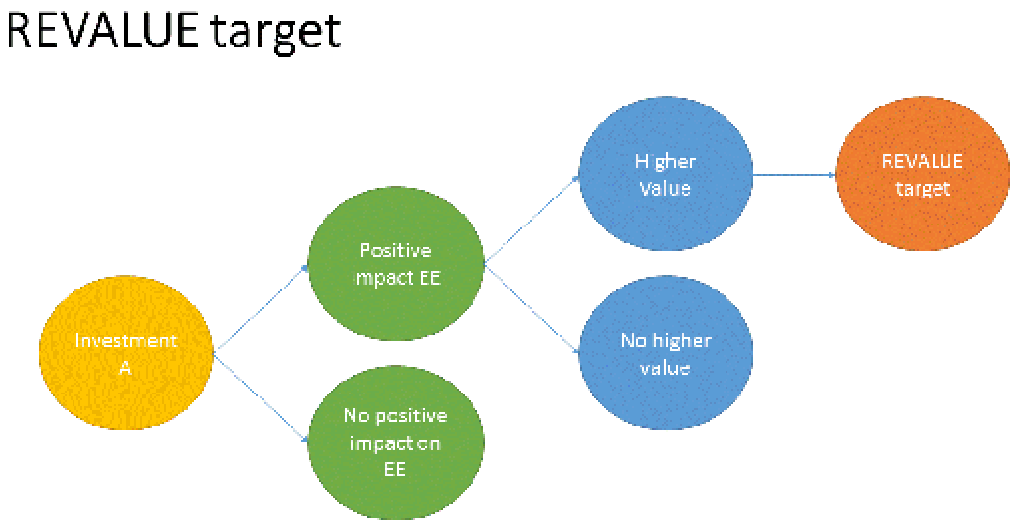
*International Financial Reporting Standard 16 (**IFRS 16**)*
The International Accounting Standardisation Board (IASB) has published a new standard, IFRS 16 'Leases'. This will bring most leases on-balance sheet for lessees under a single model, recognising assets and liabilities and eliminating the distinction between operating and finance leases.

IFRS 16 supersedes IAS 17 'Leases' and related interpretations and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted if IFRS 15 'Revenue from Contracts with Customers' has also been applied.

A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use.
Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly and the liability accrues interest. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined.
As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease.
For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.
IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019.

Evidence of investments in energy efficiency generating value in residential real estate

An objective of the REVALUE project is to understand the ways in which Energy efficient improvements in residential rented stock can be incentivised. Initially the financial case based on return on investment is considered but the objective is to examine the wider business model accepting that this may spread across social as well as economic returns.



The Hypothesis: Value enhancement and wider business benefits provide a compelling case for investing in Energy Efficiency within the residential rental sector

Within the broad definition of value, there are various types of value given to real property:

Market Value (MV), is defined in the RICS Red Book, is the estimated amount for which an asset or liability 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 each acted knowledgeably, prudently and without compulsion

Investment Value, or worth, is defined in the Red Book as the value of an asset to the owner or a prospective owner for individual investment or operational objectives (may also be known as worth!).

A valuer can produce a valuation of the same asset on both bases. Market Value (MV) is the most probable price a property would bring in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimuli. Investment value refers to the value to a specific investor, based on that investor's requirements, tax rate, and financing put simply, an **investment's value** is based on its expected usefulness to the owner/buyer. Whilst Market Value and Investment Worth may result in the same figure: often they do not. If the value of a property has an Investment Worth to its owner that is less than Market Value, it may trigger a decision to sell. Similarly, when considering purchase, an investor will assess value to them (worth) against Market Value; they will only buy if worth is equal to or above Market Value. Often the figures are arrived at using different methodologies: Market Value relies heavily on comparable evidence in the market place; worth is normally assessed using detailed cash flow projections.

As the data collection in the REVALUE project is predominantly of social housing, within the project we have regard to the Royal Institute of Chartered Surveyors guidance in the UK - UK Appendix 13: Valuation of registered social housing providers' stock for secured lending purposes. Guidance is provided on the additional matters that should be taken into account by valuers undertaking valuations for registered social housing providers' stock for secured lending purposes.

Market value will be subject to existing tenancies and reflects any intention that the valuer considers a prospective purchaser would have to raise the rents.

Existing use value for social housing (EUV–SH) is defined in UKVS 1.13, valuations for registered social housing providers. 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 providers' target group.

The valuer may also be required 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.

Within REVALUE we have considered what elements in a valuation could have an impact on value. Although implicit in Market Value and partially explicit in Investment Value, the elements below may vary for properties with energy efficient measures in place, and could therefore have an impact on the valuation:

- Discount rates and depreciation rates:
- Voids/bad debts;
- Turnover ratio;

- Arrears;
- Maintenance costs/cyclical repairs;
- Management costs;
- Rents and service charges;
- Lifetime expectancy;
- Lower consumption costs;
- Energy price;
- Energy labeling;
- Grants and guarantees;
- Legal documentation including reports on title, leases, planning permissions etc.;
- Life cycle costs;
- Indoor air quality;
- Policy measures and regulation (subsidies, tax interventions, soft loans);
- Consumers consciousness and information;
- Temperature response;
- Household composition;
- Dwelling size;
- Building age.

Future Development

We have considered where new guidance reflecting efficiency measures in valuations could be included and where it is currently included.

The aim of the Revalue project is to gather enough evidence and data to produce an Insight Paper which will form the basis of an updated guidance note to reflect energy efficiency measures in residential valuations.

There is currently limited guidance on the topic:

- Current Red Book: Deals with Sustainability inspection (mandatory) and reporting (recommended)
- Current Guidance Notes: None – the only one is commercial not residential (issued 2013)
- Current Information Papers:
    - Valuation of individual new build houses (2012 and currently being updated);
    - Automated Valuation Models (2013);
    - Comparable Evidence in Property Valuation (2012 to be updated in 2017);
    - Sustainability and Residential Property Valuation (2011);
    - Valuing Residential Property Purpose Built for Renting (currently being updated).

A key output for ReValue will be the opportunity to update/upgrade the 2011 Insight Paper and possibly build in consideration more explicitly in other Insight Papers.

Data both quantitative and qualitative is fundamental to all valuations and therefore improvements to the accessibility consistency and quality of data are important

Ways to improve quantitative data could include:

- Improving best practice data collection for energy efficiency which will inform asset managers and prompt valuers to collate energy efficiency data;
- Creation of a simple guide to understanding energy efficiency factors, energy for non-energy professionals). This would be useful and improve both collection methods and detail of data recording. This could be in the form of a flyer/short brochure for brokers, tenants and owners; and
- Improving Automated Valuation Models (AVM's) to assist with data collection. The REVALUE team would like to start conversations with AVM operators and owners to understand what outputs could be created.

The team would also seek to undertake further qualitative research:

- Continuing to examine examples of successful retrofit stories from both social and private rented sector; and
- Carrying out a qualitative survey of housing providers and lenders to investigate further how benefits of energy efficiency retrofitting of residential rented stock in selected European Countries can be quantified and used to incentivise and/or facilitate upgrade projects which will contribute to carbon emission reductions and occupants' health and wellbeing. The plan would be for results of this to be analysed and included within a new Insight paper.

These factors would hopefully improve the quantity and quality of data recorded to assist in further analysis of the impact of energy efficiency in the residential sector.

In addition, it could also be useful to incorporate a critique on the validity of Energy Performance Certificates which could be implemented to feed back to policy makers on their benefits and limitations whilst also helping property professionals, and the wider public understand them.

It is the aspiration of the team to go through Insight Paper 2011/22 and provide sound data to back it up - and enable country versions.

Practical Implementation Issues

Fee levels are such that valuers may have to undertake many valuations per day; this seriously compromises the time available for inspections and research.

Most lending reports are in a standardised formal to aid quick lender decisions, therefore the factors listed in the reporting framework are those on which the valuer will concentrate. However, valuations prepared for other purposes, such as company accounting purposes may allow of greater time and investigation.

As a limited number of comparables are used (due to time constraints and availability) these seldom record all factors contributing to value- just the baseline characteristics, therefore any improvements in value due to energy efficiency specifically may be difficult to explicitly identify. Comparable evidence is often 'advice as to value' and provided by Estate Agents who are not Chartered Surveyors and they may not be aware of the issues and implications of energy efficiency measures.

Automated Valuation Models (AVM) are increasingly being used for low risk residential valuations. At the moment, it is not believed that any commonly used Automated Valuation Models do allow for energy efficiency within its modelling. It is the initial view that the place of energy could be built into the model – and this is a potential for development.

Conclusion

The Royal Institute of Chartered Surveyors Valuation - Professional Standards control the valuation approach – not how to do valuations. The Royal Institute of Chartered Surveyors sets the process and can instruct how inspections and the due diligence process are undertaken.

However, there is a large gap between construction/engineering type of knowledge & skills and that of valuers who are, in effect, applied economists. Valuers need to understand markets and the mind sets that drive them, however the Royal Institute of Chartered Surveyors can raise awareness and ensure questions are asked when valuations are carried out.

The process of changing what valuers do, starts with identifying market and societal needs, getting the right people together and writing the guidance. An Insight paper will begin the process, which is developed with more research to Guidance Notes before being mandated in Red Book.

There is a definite scope to firm up the guidance and approach, starting with re-writing and upgrading the: Sustainability and Residential Property Valuation Information Paper. The approach to reflect sustainability in valuations is dynamic and up to date global guidance is needed.

Any guidance would be subject to the following assumptions that a valuation professional will be:

- Well versed in inspection (but not structural survey);
- Familiar with valuation methods – including Discounted Cash Flow methodology (most residential mortgage valuers are not well versed in Discounted Cash Flow)
- Works within limited sub-markets only.