3. PROPERTY VALUATION

3.1. INTRODUCTION PROPERTY VALUATION

PV-I01 Property valuations, to a large extent, drive vehicle performance and Net Asset Value (NAV). Management and performance fees are also often directly or indirectly linked to property valuations. From an investor's perspective it is therefore important to receive information from a vehicle which is based on a consistent and transparent approach to underlying property valuations. Other stakeholders including analysts, lending banks and market participants may also have an interest in valuations being prepared on this basis.

The aim of these guidelines is to define a common approach to property valuations that can be used for performance measurement, vehicle valuation and reporting.

The valuation guidelines should be seen as a minimum requirement from an investor's perspective. Because investor requirements for property valuations do not generally differ between the various types of vehicle, no differentiation has been made in the best practice for open end or closed end vehicles. This means, for example, that the frequency of external property valuations for reporting purposes does not necessarily depend on the nature or type of the vehicle.

These best practice requirements are not aimed at giving recommendations or guidance regarding property valuations for unit pricing purposes.

The principles and guidelines for property valuation are listed below. Where appropriate, further explanation is provided to assist your understanding.

3.2. PRINCIPLES

PV-P01 **Property valuations should be reliably, consistently and independently arrived at in compliance with regulations, undertaken by a professionally qualified valuer and transparently reported to investors.**

3.3. GUIDELINES

3.3.1. FUND DOCUMENTATION FOR VALUATION FRAMEWORK

PV01 **The fund documentation should include details of valuation rules and procedures, pricing methodology including the methods used in valuing hard-to-value assets, and the frequency of valuation for all material assets and liabilities of the vehicle.**

3.3.2. THE VALUER AND RELATED MATTERS

PV02 **The external valuer must be independent. When other services are provided by an external valuer which could possibly harm the independence of the external valuer, these must be disclosed.**

When the external valuer firm involved in valuing a property is or has recently been involved in the leasing, sale or purchase of the property, or the firm earns significant fees for other services besides the external appraisal, this should be properly disclosed, including a description of these services.

PV03 **The external valuer must have the appropriate professional qualifications and competence to perform the property valuation.**

The external valuer should have a local and/or international professional appraisal accreditation, and should be authorised or regulated to undertake valuations in the country concerned for the intended purposes. They should also have the requisite level of competence and possess relevant market knowledge and experience in order to perform the property valuation.

The external valuer firm must demonstrate that the level of competence and expertise is maintained throughout the organisation and its key employees.

It is also important that the valuer is regulated by the local and/or international professional appraisal accreditation, for example through Royal Institution of Chartered Surveyors (RICS) valuer registration.

Any deviations from the above principles should be fully disclosed and explained.

PV04 **A review of the continuing appointment or re-appointment of the external valuer firm should be undertaken on a regular basis, and at least once every three years.**

The assessment of the external valuer firm is an ongoing process. A formal assessment must take place at least once every three years, with the objective that the external valuer firm is the best-suited valuer to perform the valuation. The assessment may result in a rotation of external valuer firm. The assessment also includes an evaluation of whether the external valuer firm is properly insured against claims. In the event of rotation, there should not be any affiliation between the external valuer firms. Reference is also made to the code of conduct included in the INREV Corporate Governance framework.

PV05 **The valuation fees of an external valuer should not be directly linked to the outcome of the valuation.**

In addition, the valuer should not hold any shares in the valued interest and its remuneration for a given valuation mandate should not represent a significant amount of its total annual turnover.

3.3.3. THE VALUATION PROCESS

PV06 **External property valuations must be performed at least once per year for all properties.**

External property valuations are generally required for:

- (statutory) financial reporting;
- management reporting to shareholders and other stakeholders;
- performance measurement and (incentive) fee determination;
- regulatory authorities;
- securing finance / debt and on-going loan covenant compliance;
- corporate acquisitions and assessment of enterprise value.

Valuing property at least once per year does not mean all properties have to be valued at one time or necessarily at year-end, although this is best practice. More frequent external valuations or internal valuations may be undertaken to comply with the specific reporting requirements of the vehicle.

Although the professional valuation standards of the external valuers would already require physical inspection, this requirement has been included here in order to impose a partial responsibility in this respect on the manager as well.

In addition, for large portfolios, and based on its professional judgment, the external valuer may consider using a rotation principle on a three year rolling basis for the physical inspection of properties that have a homogeneous risk profile such as portfolios of residential units or storage space. If a rotation principle is applied by the external valuer, the manager should ensure that this approach is reasonable.

Newly acquired properties and properties undergoing significant (re)development activities should be included in the physical inspection sample of the year.

PV07 **The manager must ensure that comprehensive, appropriate and transparent information is provided to the external valuer to enable it to undertake a proper valuation and to enable it to make its own assessment of expected costs, including estimates of long-term maintenance and/or ground pollution costs.**

The manager must inform the external valuer in sufficient detail and not withhold any information that may be relevant to the property valuation. Examples of the kind of information provided by the manager to be used in determining property valuations and which may be verified by the external valuer with source documentation include lease/rent roll information, lease incentives granted, refurbishment costs, measurement data, property operating expenses, real estate taxes and any other information in connection with changes of market circumstances, tax and regulatory changes.

The manager should ensure that the legal ownership right (i.e., leasehold, freehold) and any restrictions or encumbrances are properly reflected in the value assessment.

The manager should provide the external valuer with all the latest developments regarding any known environmental issues.

3.3.4. THE VALUATION

PV08 **The value of the property should be its market value or fair value.**

The IVS Committee and The European Group of Valuers' Associations (TEGOVA) define market value as "the estimated amount for which a property 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 IASB definition of fair value under IFRS 13 is "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".

In order to comply with professional international valuation standards, the market value estimate should, in principle, be free of any uncertainty clauses and special assumptions. Any special assumption or uncertainty clause should be adequately disclosed.

In order to comply with IFRS 13 the manager should ensure that the external valuer provides sufficient market evidence (if available in the market) and comparables to support all key assumptions used in the estimation of the market value.

PV09 **Valuers should comply with a recognised international professional valuation standard.**

Appointed valuers should comply with recognised international professional valuation standards such as International Valuation Standards (IVS), RICS or TEGOVA.

PV10 **Transfer taxes and purchasers' costs are deducted when determining the value of properties.**

When determining the market value of a property, the valuer should make the same allowance for transaction costs that a normal purchaser of the property would make in the market, regardless of the exit strategy.

PV11 **External valuation report must include information regarding the valuation method used for investment property, property held for sale, property under construction and ground leases, as well as applicable valuation inputs and market assumptions.**

The valuation methods can include, among others:

- market approach - based on market comparables;
- income approach - based on income capitalisation;
- other valuation models based on earnings multiples or discounted cash flow methodology;
- replacement cost less depreciation (cost approach) should only be used in specific and rare circumstances when other valuation methods cannot be applied.

The valuation of property under construction can be based upon:

- fair value at completion less costs to complete (residual approach);
- cost approach should only be used in specific and rare circumstances when other valuation methods cannot be applied.

During the initial phases of the construction of a property, the level of uncertainty surrounding the fair value of the property is high. In this context, the fair value as determined using the residual approach may be equal to the consideration paid for the property plus subsequent construction costs.

The information regarding applicable market assumptions could, for example, include sensitivity analysis of rent movements and yield changes.

Note that for the purpose of the INREV NAV, valuations of property under construction must be stated at fair value. Refer to INREV NAV adjustments in module 4 - **INREV NAV guidelines**.

In the event of significant changes in market value resulting from a rotation of the external valuer, the manager must perform an assessment of the main underlying assumptions and provide full disclosure of the rationale for such changes.

Finally, the valuation methodology applied must lead to the market value regardless of the agreed valuation methodology as per management valuation regulations.

PV12 **The valuation performed by the external valuer should be subject to the manager's formalised internal valuation review and approval process.**

The manager should ensure that the overall valuation is reviewed and approved internally for accuracy prior to its inclusion in the vehicle's NAV and disclosure to stakeholders. The review and approval process should be impartial, objective, consistent and independent.

The review and approval should include the following controls, among others:

- the manager should ensure that the valuation timing and frequency is consistent with the valuation policies foreseen in the management regulations;
- the manager should ensure that the valuer's valuation assumptions as well as valuation method used are appropriate with regard to the nature of the property to be valued.

The manager's review can be adapted to the nature of the reporting, allowing for high level review for monthly or quarterly reporting as opposed to a full review for annual reporting.

PV13 **The valuation must result in a single number.**

Valuation ranges should not be used. However, if valuation ranges are provided by an external property valuer, it has to be clear which amount is being used in the reporting, for instance, the lowest, average or maximum value of this range.

PV14 **In exceptional circumstances, deviations by managers from property valuations as determined by external property valuers must be clearly explained and disclosed.**

If there is a disagreement between the manager and the property valuer on the market value parameters, these parameters must be clearly explained and disclosed. We expect these deviations and disagreements to occur only very rarely and if so, more in relation to opportunistic investments, where, for example, the manager and the external valuer have different views as to the likelihood of a particular event occurring (because, for example, the manager is in discussion with governmental bodies, potential buyers or tenants). Another example of deviation could be related to disagreement about value changes if there is a considerable time period between the actual date of external valuation and a later reporting date.

In such exceptional circumstances, the market value, as determined by the manager, must be reported in the balance sheet including full disclosure to justify the deviation from the market value arrived at by the external valuer.

Whatever the circumstances, appropriate internal procedures (including escalation measures) should be followed by the manager in the event of valuation adjustments.

3.3.5. FURTHER GUIDANCE ON VALUATION IN CASE OF LIQUIDITY OR WINDING-UP

PV15 **In certain circumstances, the manager should consider and adjust on a case by case basis if there is an impact on the market value due to a liquidation situation or a winding-up (such that valuation should reflect a non-going concern basis).**

While a market value estimate should, in principle, be free of any uncertainty clause and special assumption, the manager should in certain circumstances consider the potential effect of a liquidation value since a vehicle may not have the time for appropriate marketing of property in, among others, the following circumstances:

- distressed situations;
- liquidity issues;

- portfolio transactions;
- constraints on marketing (for instance due to debt maturities or maturity of the vehicle).

The manager shall consider on a case by case basis if there is an impact and whether or not it can be measured. Such impact should be taken into account when preparing the INREV NAV.

3.4. TOOLS AND EXAMPLES

PV-T01 Related Tools & Examples

- **INREV Guidelines Property Valuations Tutorial**