

Valuation Information Alert

Guidance to Lenders and Valuers when conducting Loan Security Valuation Reviews.

28th May 2009.

This Information Alert is aimed primarily at commercial property and gives guidance to both valuers and lenders on the advice that can be provided when conducting loan security reviews in circumstances when values are changing rapidly.

There is substantial existing guidance for conducting *Valuations for secured lending* within the RICS Valuation Standards (the *Red Book*), in particular, Practice Statement 4.2 and Appendix 4.4.

This alert provides additional guidance when advice is provided upon the outlook for the value of the property in the period immediately after the date of valuation.

Observing values in rapidly moving markets

Valuers do not make forecasts.

However, they are well placed to comment upon the future prospects for movement in value as they:

- Interface with surveyors and agents active within the market;
- Have an immediate and in depth knowledge of not only a property under valuation but also of a significant range of similar properties;
- Have access to evidence of comparable transactions, property data, and research forecasts, along with financial data for the tenants of property under valuation;
- Have the ability to relate the particular characteristics of a property to broader macro property trends.
- Have the wide range of skills and experience to be expected of a qualified Chartered Surveyor.

Valuation reports for secured lending are likely to address the following issues:

1. What is the anticipated period in which to achieve a sale

- The valuer should comment upon any issues which are likely to influence the marketing period and saleability of the property
- Whether the status of the tenant as perceived by the market may impact upon both saleability and marketing period
- How the supply of similar property in the vicinity or in the relevant sector may influence saleability.
- Will the asset achieve best price by a sale now; what would be the consequence of delaying a sale.
- What is the likely time period before a buyer is found and a sale is completed.

- 2. The market for the asset and the best method of achieving a sale.**
 - Will a disposal be readily achieved by private treaty, tender or auction.
 - What are the prospects for achieving a sale and what sort of parties may be in the market for the asset, and how will they be motivated to buy.
 - The ability or otherwise to secure loan finance. Comments on whether there is a lending appetite for the particular asset type and whether the lot size may restrict the potential to secure a loan. Lenders and Valuers may want to state in the letter of engagement whether the Market Value will be based on a specific level of debt availability. This may take the form of a special assumption that the assumed debt is on favourable or unfavourable terms and whether it would be available to all purchasers in the market. Similarly, if the Market Value is to be based on a specific favourable level of debt being available, then the valuer should be asked to give an opinion of Market Value if debt is provided at a more normal level.

- 3. The strength of the market as a whole.**
 - How do the wider conditions in the property market impact on the foreseeable price.
 - What are the perceived threats to price and prospects for movement in price? Distinction should be made between prospects for market movement which are property specific and those driven by market conditions.
 - What type of purchasers may be in the market for the property? For example, the effect of currency movements and demand from foreign investors.

- 4. Action that can be taken to improve the assets saleability.**
 - If there are possibilities to improve the price of an asset by active management a brief strategy could be presented. This may range from the self evident benefit of letting empty or unused accommodation to the cost/benefit of recommending expenditure to improve an asset in order to secure or enhance income or saleability.
 - Advice may relate to the enforcement of tenant repair covenants or to the possibility of restructuring any superior interests or indeed occupational leases.

- 5. Threats to Market Value price and saleability.**
 - This could take the form of the potential impact of a number of competing assets being readied for sale or likely changes in the law or other forms of regulation. For example sustainability issues, energy performance or empty rates policy.

- 6. The consequence of local market factors.**
 - The valuer's local knowledge may unearth factors that are relevant to the foreseeable price. These may take the form of knowledge of business closures in, or relocations to, the vicinity along with local socio economic factors and demographics.

7. **The impact of current macroeconomic and property forecasts and sentiment.**
 - The perception the valuer has of how purchasers and vendors currently perceive market conditions and the consensus for future prospects (in general terms).
 - The valuer's own perception of how sentiment will specifically impact on the assets prospects.
8. **The degree or severity of market movement expected in the foreseeable future.**
 - The key factors here are severity and degree of volatility of expected market change. This to be seen in the context of the general market prospects for the location and asset type.

You should refer to PS4.2 and Appendix 4.4 for further guidance.

The valuer may be asked to provide a view upon value in the near future.

There are times when markets can experience rapidly changing pricing of assets, with the consequence that a valuation can become out of date very rapidly. It is during periods such as this that a client, particularly a lender conducting a loan security review, may seek additional advice from the valuer.

This is likely to be not only focus upon the Market Value today, but also what it might be in the near future.

There is evidence to suggest that clients are asking valuers to report using a number of poorly defined valuation bases. Lenders are strongly advised not to request valuations on any basis which is not recognised in the Red Book, without giving clear definition.

Best practice is best served by valuers advising lending clients on the potential value of a property in certain strictly defined circumstances.

Market Value is the starting point for the provision of good valuation advice

It is the valuer's role to observe the market and to look at trends and evidence. It is recognised that, in rapidly changing markets, the definition of Market Value would not deliver the same result if the marketing period started on the date of the valuation.

In addition to providing an opinion of Market Value, a valuer can provide a view upon the potential market sale price **with a marketing period commencing on the date of the valuation**. The marketing period should be specified by the valuer.

Any expression as to the potential price in the future must be provided in such a way so as to caution the client that it may include opinions which may be rapidly overtaken by events and should not be relied upon in isolation.

Any such view must always be provided in addition to an opinion of Market Value (Red Book definition).

The advice given should be part of a commentary within the text of the report which may highlight where appropriate:

- Comments on the pace of change observed in the market;
- Consensus forecasts compared to actual returns such as IPD returns or in other indices;
- RICS Commercial Property Confidence Survey;
- Derivatives market (with caution);
- Commercial knowledge, professional skill and discussion with market based colleagues and contacts.

The valuer should take a balanced view of all of the information sources outlined above in order to provide advice on the anticipated trend for values for the asset class, location and property itself.

Valuation Information Alerts are issued periodically by the RICS Valuation Group Board. They are designed to address important areas of valuation practice and respond to issues where clarification or expansion of best practice is required. They do not form part of the RICS Valuation Standards. After publication of a Valuation Information Alert, any changes to guidance which are necessary will be published in the subsequent annual Red Book edition.