Information Bulletin **Valuation Uncertainty and Market Instability**

The valuation of many assets, including property, in the current market is unusually challenging due mainly to a reduction in the number of comparable property transactions in what is a rapidly changing macroeconomic climate.

Chartered Valuation Surveyors continue to deliver high levels of professional service to clients by applying the professional standards as stipulated in **Guidance Note 5** (GN 5) of the RICS Red Book which covers valuation uncertainty.

GN5 states that the degree of certainty (that is, the probability that the valuer's opinion would be the same as the price achieved by an actual sale at the valuation date) that can be attached to a particular valuation will vary significantly from time-to-time, because of the inherent features of the property, the market place or the information available to the valuer.The resultant subjectivity in the valuation opinion is not a reflection on the professional skill or judgement of the valuer.

GN5 lists Market Instability as one of the specific causes of Valuation Uncertainty.

Market Instability can arise when an unforeseen macroeconomic event causes a sudden and dramatic change on markets. *This could manifest itself by either panic buying or selling, or simply disinclination to trade until it is clear how prices in the market will be affected in the longer term. If the valuation date coincides with the immediate aftermath of such an event, the data on which any valuation is based may be confused, incomplete or inconsistent, with an inevitable effect on the certainty that can be attached to it (GN5).*

The above circumstances have existed for some time and have in recent months become more marked in a broad sense to the property markets in many world regions. However, in the narrower sense of the local market (and asset type), the valuer must decide whether there is *market instability* and, if so, to what degree this impacts on the advice given.

It should be emphasised that the characteristics of *market instability* as described in GN5 will not be the same in all circumstances. For example reference is made to an event which causes a sudden and dramatic change on markets. This was evidenced by conditions immediately post 11 September 2001 and which was a driver to the introduction of GN5. In reality, there are a range of issues which can bring about market instability. There can be circumstances, such as those which exist at the present time, which can lead to a more prolonged period of uncertainty and possibly instability.

Notwithstanding the very significant fall in the volume of transactions together with similar falls in the availability of bank financing, markets may still be functioning, albeit at far lower volumes of transactions than hitherto. In such circumstances, it is likely that a valuer will still be able to make a judgement regarding value albeit that this judgement would be expressed as being provided in conditions of uncertainty.

If the valuer decides there is *Valuation Uncertainty* then, in order to comply with the general requirements of Practice Statement 6.1 that valuation report must not be misleading or create a false impression, the valuer must:

1. Draw attention to the cause of the *Valuation Uncertainty*.
2. Comment within the valuation report on the nature and degree of *Valuation Uncertainty.*
3. Give a full written commentary on the particular difficulty - for example, a lack of comparable evidence on which to base a valuation in a rapidly changing market.

In addition, the valuer is encouraged to:

1. Enter into a dialogue with the client with a view to agreeing any *special assumptions,* such as alternative valuation bases which may better express the particular circumstances. It would be (and always has been) entirely appropriate for the valuer to include forward looking advice as part of the advisory service to the client. This would be included within the report commentary and outside the formal valuation statement.
2. Consider whether for certain assets such as development properties (and for example, large lot sizes), the valuation report should include a sensitivity and risk analysis within the explanatory commentary.
3. At all times give a full and clear account within the report as to why these items are being included.
4. Consider in the report the context of the valuation against the market and economic trends over time.

It is highlighted that:

1. For financial reporting and many other valuation purposes, the valuer must give a single valuation figure and not a range of values, although a comment on the degree of subjectivity is encouraged.
2. It would not be acceptable for a valuation report to have a standard caveat to deal with *Valuation Uncertainty* which devalues or questions the authority of the advice given. The task is to produce authoritive and considered professional advice within the report, and *Valuation Uncertainty* should be reported in this context.
3. *Valuation Uncertainty* is not a reason for putting a formal qualification to a report, nor is it a reason to be interpreted in the current market as a qualification to an auditor, in the case of company asset valuations.
4. A general disclaimer to the report is unacceptable.

It is recognised that where *Valuation Uncertainty* exists, the demands and pressures put on valuers are unusually testing. The emphasis of this advice is to encourage a constructive dialogue between valuers and their clients, which results in the issues being properly reflected by measured consideration within the body of a valuation report. Good, well thought out, and reasoned advice which addresses clients' needs is to be encouraged; standard caveats and disclaimers or the lack of well reasoned valuations figures are to be avoided.

Additional Notes

When issuing financial statements, the Directors and auditors of a company must be confident that the asset figures reported are, in the opinion of the valuer, correct as at

the balance sheet date. Therefore all valuation reports carried out for these purposes must contain specific values that are stated as being the Market Value of the properties at the date of valuation. Many Clients will require further information, such as a commentary on the current liquidity in the market, the factors influencing property purchase decisions, and the current direction of travel of the market having regard to recent transaction evidence. However, these comments should not be linked back to infer that the Market Value reported is somehow incorrect or unproven. This would then be considered a caveat to the valuation, which might make it unsuitable for use as a basis for financial statements.

Clients' requirements for additional commentary will vary, and valuers are advised to discuss these matters with Clients, and perhaps the auditors, before the report is issued, and record this as part of the terms of engagement. Property Unit Trusts, for example, may be faced with pricing future fund withdrawals and require a detailed commentary. This may include comments on direction of travel and likely quantitative movements in the near future. Companies who report property asset values but for which these are not considered as central to the financial standing of the company may be less concerned with anticipated future movements and would prefer a shorter commentary that does not raise any additional uncertainty in readers' minds.

The RICS cannot give detailed guidance on the wording of such commentary as this will depend on the market for each property as the date of valuation. However, phrases such as:

> "We are not able accurately to assess the effect of [macro-economic and market events] as at the balance sheet date with the evidence available to us and therefore there is an abnormal degree of uncertainty attached to our valuations"

could amount to an unacceptable caveat of the valuation and should be avoided.

This advice has been issued by a working party of the RICS International Valuation Faculty Board.

26 November 2008.