INREV response to Independent Review of Real Estate Investment Valuations

31 March 2021

About INREV: the voice of the European non-listed real estate investment industry

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe.

INREV currently has more than 450 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in the UK and the rest of Europe. Our fund manager members manage more than 500 non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

Introduction

INREV welcomes the Independent Review of Real Estate Investment Valuations and would like to offer the following comments in response to the questions raised in the call for evidence.

Summary of INREV's main points that we hope will be considered for the RICS Valuation Review:

- Transparency: Encourage wider transparency (leasing and capital market transactions) and additional disclosure of market assumptions, e.g., what qualifies as market evidence, the reasoning used, in arriving at an opinion of value.
- Consistency: Encourage valuers to apply guidance consistently. At the moment it appears that valuers take different approaches across different countries; for example, RICS could consider helping to define and educate the valuation community on what is acceptable as market evidence. Local knowledge complemented with broader pan-European / global perspective is critical for better quality valuation judgements.
- Communication: Ensure timely communication around new valuation guidance and measures taken during shock events / exceptional market circumstances.
- Data and back-testing: Encourage more back-testing between current and past valuations as well as common datasets to make information easily accessible and limit timing lag in value changes.
- Sustainability: Include climate risk analysis in the valuation process and consider issuing guidance over the impact of ESG on the opinion of value. There is need for valuers to measure / quantify value impact of sustainability features.

Valuation Methodology

1. Should RICS be more prescriptive in the requirements it places on members to employ certain valuation methodologies in particular circumstances?

We believe the current valuation methodology to be generally robust for assets that are let on conventional lease terms. The Red Book and IVS Standards provide a robust framework which cover most valuation requirements. However, as landlords and tenants have moved closer together with turnover rent and profit-sharing arrangements, practices should be updated to ensure conformity of approach.

For portfolio valuations, our members see a need for additional disclosure and details on the subject properties themselves (e.g., on conducted investigations and inspections) as well as for the rationale behind the valuation methodology and its market assumptions, compararables or data sources. We would therefore welcome further RICS guidance to valuers so they explicitly state all relevant market assumptions used in the valuation, along with market evidence and the rationale behind these inputs.

RICS valuer guidance and training are important so that the quality of valuations is further improved and reflective of current market changes. This concerns the level of detail in portfolio valuation reports mentioned in the points above as well as the rationale behind the different income-approach techniques.

Consideration should also be given to local market valuation methodologies, which can be a risk since public data in these markets generally complies with the local methods. It is important that local market conditions can be reflected appropriately.

As derivation of yields and costs is not always clear there is also a need for a harmonised approach on derivation and disclosures of valuation assumptions across Europe, independently on the actual valuation methodology that is being used.

Obviously, a shock induced by exceptional circumstances, e.g., COVID-19, reduces the number of comparable transactions in the market, but in normal conditions there should be reliability in the valuation approach. Valuers should take more and more into account the market sentiment so that valuations are 'marked-to-market' in a timely manner as opposed to derived through a 'rear view mirror'.

2. Would any increase in prescription on methodology lead to a reduced obligation on the professional valuer to reflect a particular market characteristic?

3. Do the current applications of valuation methodologies meet market requirements – i.e., do valuations provide sufficient information to clients and others who rely on them about the factors that have influenced the valuation opinion?

4. Do the requirements of the Red Book / IVS create an adequate global/national framework for provision of high-quality valuation advice?

5. Is there a need for additional guidance, training and data to RICS valuers to support the provision of high-quality valuation advice?

RICS valuer guidance and training are important so that the quality of valuations is further improved and reflective of current market changes. This concerns the level of detail in portfolio valuation reports mentioned in the points above as well as the rationale behind the different income-approach techniques.

Consideration should also be given to local market valuation methodologies, which can be a risk since public data in these markets generally complies with the local methods. It is important that local market conditions can be reflected appropriately.

6. Can professional valuers make better use of technology to deliver high quality valuations?

Technology is essential to gather, aggregate and analyse data but software solutions and automated valuation models should not lead to less disclosures or explanations for the rationale behind the chosen valuation technique.

7. Any other comments relating to valuation methodology.

The RICS Red Book recommends valuers to get familiar and include additional requirements when performing valuations for IFRS 13 purposes. However, some of our members note that not all valuation reports include these additional disclosure requirements, e.g., FV hierarchy, principal and most advantageous market, highest and best use, sensitivities. This may also apply to valuations for other purposes (lending, tax, etc.).

Property Risk Analysis

8. Is there a potential conflict of interest for the valuer in providing a valuation figure for regulatory purposes and advice on future market changes?

9. Are valuations appropriately instructed?

10. Are valuations provided in a manner which gives clients sufficient, forward-looking quantitative analysis on risks and their impact on investment worth, in addition to the objective opinion of current value?

Although sufficient for the moment to produce an opinion of value at a certain point in time, property risk analysis is less forward-looking. We acknowledge that more in-depth risk analysis requires a more comprehensive valuation instruction with the help of other specialists.

Investors would like to get a better understanding of the threats or potential impacts on their investment value. One key aspect is reflecting ESG factors in the valuation.

These consist of: i) impact of climate change, including scenario analysis (e.g., with respect to decarbonisation pathways consistent with the goals of the Paris Climate Agreement), ii) asset characteristics and certifications, iii) recent regulations at both EU (e.g., SFDR, EU Taxonomy) and country level, iv) sustainability ambitions and needs of investors and occupiers.

It is expected that real estate market participants will seek further guidance from their valuation professionals on ESG regulatory aspects at property and/or portfolio level, including third-party assurance statement requests for aspects such as:

- If and "how the indicators for adverse impacts in Table 1 of the Sustainable Finance Disclosure Regulation (SFDR) / EU Taxonomy Annex I, and any relevant indicators in Tables 2 and 3 of Annex I, are taken into account" at property level and in the valuation services;
- "Statements if an investment can be deemed an environmentally sustainable economic activity" from valuation professionals, including third party assurance;
- Inefficient real estate asset calculations (as referred to in the EU regulations);
- Statements or calculations in terms of climate risks (e.g., climate value at risk calculations) in order to address stranded asset questions; and
- Specific indicators applicable to investments in real estate, as referred to in the SFDR regulation and its proposed RTS (GHG emissions, Energy consumption, Waste, Resource consumption, Biodiversity).

11. Can more be done to ensure clients understand how to instruct additional supporting, bespoke risk analysis?

12. Do valuers have the tools to deliver this sort of analysis?

13. Any other comments relating to valuation methodology.

Independence and Objectivity

14. Are current RICS requirements in respect of valuer independence sufficient? This will focus on valuations for financial reporting (including investment portfolio performance measurement).

We believe the current RICS requirements and guidelines with respect to maintaining valuer independence are sufficient. Nevertheless, we welcome further RICS guidance regarding disclosures on rotation of valuers, nature of any prior involvement and proportion of fee.

For example, in the INREV Property Valuation module, we state as best practice that 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. More details about the INREV Guidelines can be found: https://www.inrev.org/guidelines/module/property-valuation#inrev-guidelines.

15. Are there any other material threats to objectivity in valuation that RICS should consider?

16. Should valuation firms be required to provide details of their valuation governance structure within there terms of engagement?

17. Any other comments relating to independence and objectivity.

Measuring Confidence

18. How can RICS measure market confidence in RICS valuer performance on an on-going basis?

To measure confidence RICS may consider asking for regular feedback from market participants, perhaps through surveys or other interactive forums.

19. Should insights such as the Valuation and Sale Price Report be undertaken more frequently?

RICS may consider actively encouraging more valuers to retroactively look back at their valuations versus eventual sale prices and recalibrate model assumptions to improve accuracy.

20. Any other questions relating to measuring confidence.