

# European Valuation Standards 2020 and the Interpretation of Market Value

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# The European Group of Valuers' Associations (TEGoVA)

- Europe's property valuation standards setter since 1977
- 73 member associations (including ASAVAL)
- 38 countries (including Canada, USA, UAE)
- 70 000 qualified valuers

## Outputs

- European Valuation Standards
- European Business Valuation Standards (1<sup>st</sup> Edition March 2020)
- Minimum Educational Requirements & Code of Ethics
- Pan European **REV Designation**
- TEGoVA Residential Valuer (TRV)
- Methodology (European Practice & Methodology Board)

# The Primacy of EU Law

## Treaty of Lisbon – Declaration 17

*“ The Conference recalls that, in accordance with well settled case law of the Court of Justice of the European Union, the treaties and the laws adopted by the Union on the basis of the Treaties have primacy over the law of Member States, under the conditions laid down by the said case law”*

- **Regulation** - a binding legislative act, applied directly across the EU
- **Decision** - binding on those to whom it is addressed (e.g. an EU country or an individual company) and is directly applicable
- **Directive** - a legislative act that sets out a goal that all EU countries must achieve. However, it is up to the individual countries to decide how

# The EU's Response to Financial Crisis!

- **Mortgage Credit** regulation has shifted from national level to the EU.
- In the Eurozone, the same has happened for **Banking Supervision**.
- **CRR/CRD IV package** transposes new standards on bank capital (Basel III agreement) into the EU law

The above have brought valuation to the heart of EU policy

# Mortgage Credit Directive – Valuation Provisions

## Article 19: Property Valuation

1. Member states shall ensure that reliable standards for the valuation of residential immovable property for mortgage lending purposes are developed within their territory.....

## Recital 26.

...In order to be considered reliable, valuation standards should take into account internationally recognised valuation standards, in particular those developed by the International Valuation Standards Committee, the European Group of Valuers' Associations or the Royal Institution of Chartered Surveyors....”

# Capital Requirements Regulation

## Capital Requirements Directive (CRR/CRD IV)

The 'CRR/CRD IV' package transposes new standards on bank capital (Basel III agreement) into the EU law from 1 January 2014

- Tackles the problem of banks holding insufficient capital by setting stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity and sets rules for the treatment of mortgage collateral capital
  - Definition of values
  - General valuation principles
  - Preferential risk weights of mortgage collateral
- Thus CRR/CRD IV package is not only of significance to the world of banking but also impinges on real estate valuation

# Capital Requirements Regulation (and EVS 2016)

## Definition of Market Value

### Article 4

(76) 'market value' means, for the purposes of immovable property, the estimated amount for which the 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 being under compulsion;

"Valor de mercado": para efeitos dos bens imóveis, o montante estimado pelo qual o imóvel seria transacionado à data da avaliação entre um comprador e um vendedor interessados, **no quadro de uma transação em condições normais de mercado**, após a devida comercialização, em que cada uma das partes atua com conhecimento de causa, de forma prudente e sem coação;

# Definition of Market Value EVS 2020 (For translation purposes)

Due to diverging non-English language versions of the CRR definition, TEGoVA has a universally usable common guidance-definition:

*"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller **acting independently of each other** after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."*

# Highest and Best Use, the Original IVS Position

## IVS 2013

*“The Market Value of an asset will reflect its **Highest and Best Use**. The Highest and Best Use is the use of an asset that maximises its potential and that is possible, **legally permissible** and financially feasible” and*

*“to reflect the requirement to be legally permissible, any legal restrictions on the use of an asset, eg zoning designations, need to be taken into account”*

NB The above definition did not include hope value.

# Highest and Best Use/Hope Value, RICS and TEGoVA Position

- RICS first recognised the American concept of HABU in the Red Book 2014. Before then there were only references to the British **Hope Value which went beyond HABU**
- RICS Valuation Standards – Global 2011 (7<sup>th</sup> Edition):  
*“... where the price offered by prospective buyers generally in the market would reflect an expectation of a change in the circumstances of the property in the future, this element of ‘hope value’ is reflected in Market Value...”* (NB: RICS Red book no longer uses the words “Hope Value” whilst recognising the concept).
- TEGoVA’s EVS 2016 recognises the concept of Hope Value indicating that HABU is not necessarily Market Value

# Hope Value

Future Value of Property assuming a change to a more valuable **use not currently legally permitted**

minus

Value of Property assuming Highest and Best **legally permitted Use**

X

Appropriate percentage (Valuers' Expertise and Intuition)



# Highest and Best Use and Hope Value – An Example

Land for Shopping Centre  
EUR 100 per sq m



Land for Warehousing  
EUR 50 per sq m



Agricultural Land  
EUR 1 per sq m



Not yet legally permitted

$100 - 50 = \text{Euro } 50 \times \% = \text{HOPE VALUE}$



Per Local Master Plan  
Highest and Best Use

# Highest and Best Use, the New IVS Position

IVS 2017 has now expanded the highest and best use concept with these words:

*“To reflect the requirement to be legally permissible, any legal restrictions on the use of the asset eg. zoning designations, need to be taken into account **as well as the likelihood that these restrictions will change.**”*

# New TEGoVA Definition of Highest and Best Use Incorporating Hope Value

## European Valuation Standards 2020:

**5.3.4** *The concept of ‘highest and best use’ (HABU) is integral to Market Value and is characterised as the use of a property that is physically possible, reasonably probable, legal or likely to become so, and that results in the highest value of the property at the date of valuation. (NB: The words “or likely to become so” = Hope Value)*

**5.3.5** *In most cases valuers will quickly ascertain that HABU is the same as existing use. Sometimes they may identify a more valuable use but conclude that the costs of such change of use would be too great and therefore HABU would still equal value in existing use at the date of valuation.*

# Highest and Best Use – the EU IFRS 13 Definition

IFRS 13 Paragraph 28 states *“The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:*

- (a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).*
- (b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property). **Comment: Thus Hope Value Excluded***
- (c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.*

# Thank You!

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