

CLIENT GUIDE



Valuations for real estate investment entities

A guide for clients and valuers

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About this guide

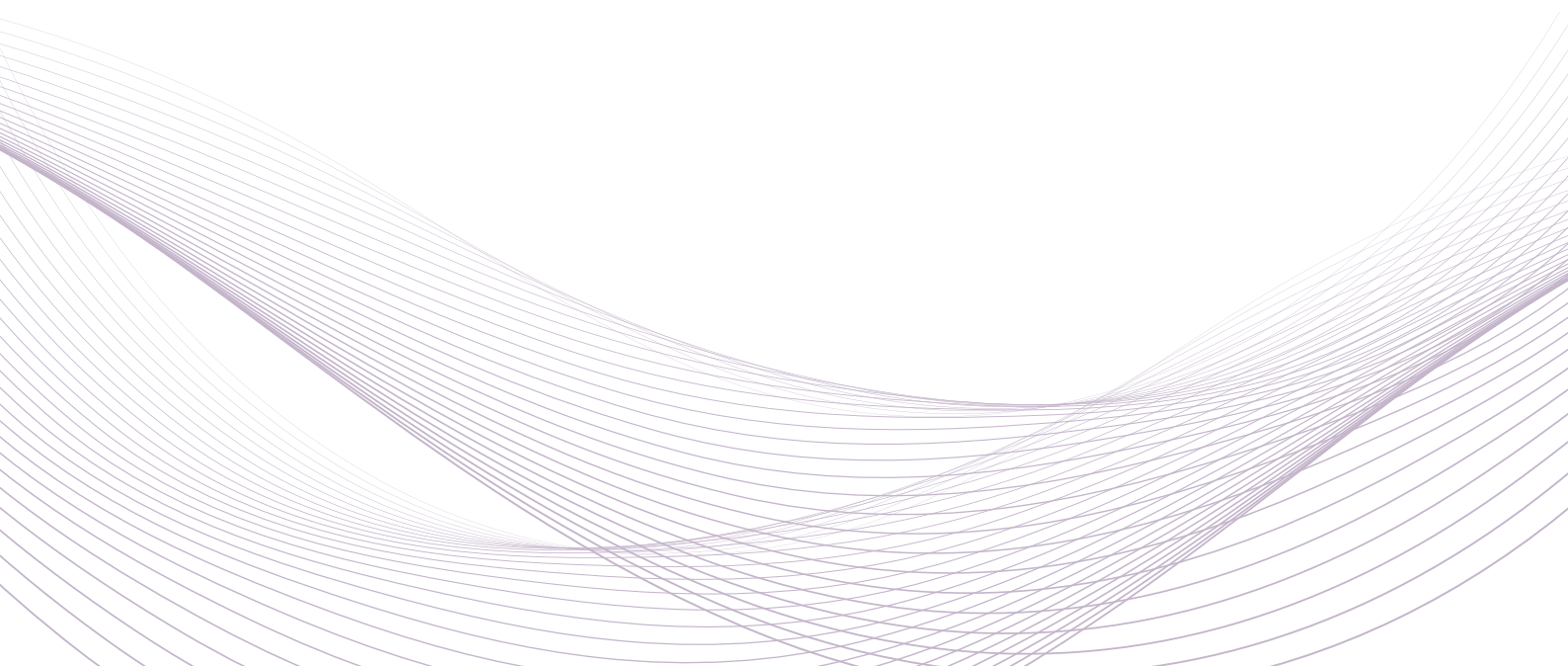
This guide summarises regulatory requirements and industry recommendations for commissioning and providing the regular valuations of real estate held by investment vehicles such as collective investment schemes, real estate investment trusts (REITs) and pension funds in the UK.

It provides:

- an outline of the regulations that apply to the valuations included in the reports issued by investment vehicles
- a summary of best practice procedures set by industry bodies for commissioning valuers and valuations
- a summary of the specific rules and professional standards that RICS-regulated firms and members must follow in accepting and undertaking the recurring valuations of investment property, and
- the expected behaviour of all parties involved in the valuation process.

This is to ensure that the required valuations are provided independently without undue influence from any interested party. The objective of this guide is to highlight these provisions to assist those commissioning and providing valuations to ensure that markets and investors are given objective information. It may also be helpful to those having an oversight role on this process, such as auditors and audit committees.

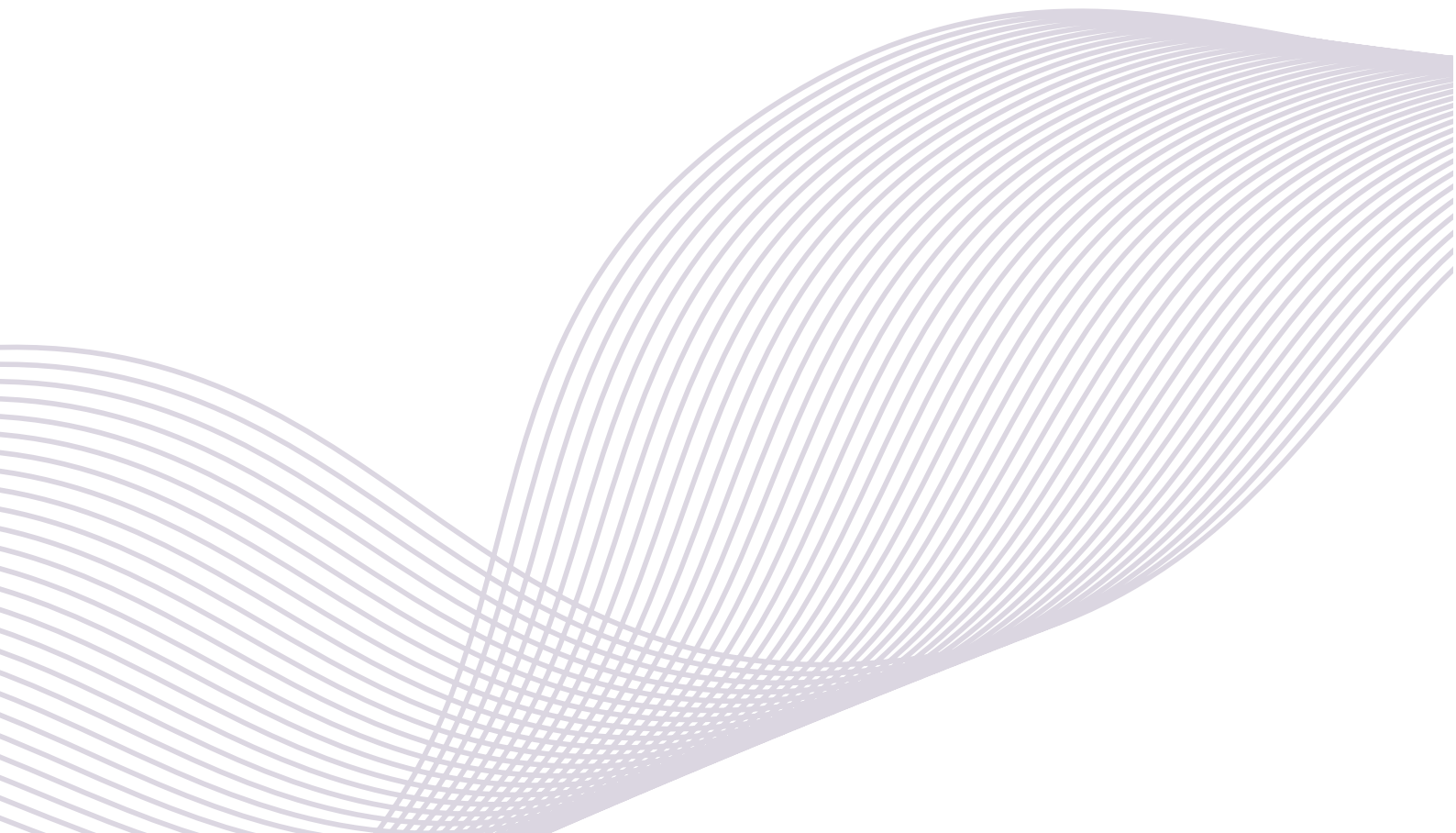
While this guide relates to law, regulations, best practices and professional standards in the UK, some of these or similar provisions may apply in other jurisdictions.



This guide covers actions that need to be taken to ensure that:

- valuations are provided only by suitably qualified valuers with no material connection with fund manager, directors or depositary
- the valuers and valuation firms are rotated regularly to bring fresh eyes to each valuation and avoid overfamiliarity
- the valuer's fees are not structured in a way that is linked to the value reported
- pressure is not applied on valuers to change draft valuations unless the facts on which they are based have changed and that all parties exchange information in a professional manner, and
- valuations are undertaken and reported in accordance with internationally recognised standards.

The summaries provided in this guide of relevant provisions in the various regulations, best practice documents and professional standards are provided as high-level guidance should not be relied upon without reference to the relevant source document. The regulations, best practice documents and RICS standards referenced were correct at the time of publication but are subject to change. The summaries are provided as high-level guidance but should not be relied upon without reference to the relevant source.



Background

The valuation of real estate investments held by investment vehicles has long been an area of focus for both financial regulators and professional bodies with members involved in providing the valuations. As long ago as 2002, RICS commissioned a review into valuations for investment purposes led by a former director of the Office of Fair Trading, Sir Bryan Carsberg. This led to a number of changes to [RICS Valuation – Global Standards](#) (Red Book Global Standards). However, over the past 20 years regulations and standards in the financial markets have had a greater focus on governance principles and consumer protection. There have also been changes in the structure of the real estate investment markets and changes in public expectations about the independence of professionals generally, most notably statutory auditors.

In 2020 the RICS Standards and Regulation Board (SRB) appointed Peter Pereira-Gray, then managing partner and CEO of the Wellcome Trust, to lead a further review into the conduct of investment property valuations. The focus of the review was primarily on the UK, although some of its findings and recommendations may be applicable in other jurisdictions.

Mr Pereira-Gray [issued his report in late 2022](#). His recommendations were accepted by RICS and have been implemented, or are in the course of implementation. His recommendations included the following, in relation to the commissioning and receiving of valuation reports:

‘RICS should work with appropriate stakeholders in standardising governance arrangements for commissioning and receiving valuation reports for high-risk and regulated valuations.’



In the UK, the stakeholders include those who commission and receive regular real estate valuations from RICS-regulated firms. These include collective investment schemes, REITs or pension funds, often acting through an intermediary fund manager.

Many of these investment vehicles also belong to trade associations that issue codes of best practice that their members are expected to follow. These include principles for the commissioning of valuations, aimed at ensuring investors and their advisors adopt the highest possible standards of transparency and corporate governance around this process. This guide references the:

- [European Public Real Estate Association \(EPRA\) BPR Guidelines](#)
- [Association of Real Estate Funds \(AREF\) Code of Practice](#) and
- [European Association for Investors in Non-Listed Real Estate Vehicles \(INREV\) Guidelines](#).



Statutory requirements

Financial reporting

In the United Kingdom, all listed entities are required by law to prepare financial reports in accordance with the [International Financial Reporting Standards](#) (IFRS). This includes all REITs. The IFRS standard that sets the specific requirements for reporting on investment property is [IAS 40](#). This includes the provision that all investment property should be reported at fair value or cost less depreciation, although if the latter option is adopted, the fair value must still be disclosed in the notes to the accounts unless it cannot be reliably determined. This would be very unusual for investment property held in a fund or REIT.

Unlisted companies and other entities such as trusts and charities also have to produce financial reports but can choose whether to base these on IFRS or the UK financial reporting standards ([FRS 102](#)). Whichever standard is used, both require investment property to be revalued at each financial reporting date after its acquisition. Although there is no requirement in the financial reporting standards to appoint an independent valuer, they do require the reporting entity to disclose if the valuation reported was provided by a valuer with no connection with the reporting entity.

FCA regulations

Certain vehicles, in particular collective investment schemes or alternative investment schemes, also have to comply with regulations issued by the [Financial Conduct Authority](#) (FCA). Both the collective investment schemes sourcebook (known as the COLL regulations) and the investment funds sourcebook (known as the FUND Regulations) have provisions relating to the valuation of real estate investments, referred to as immovable assets, including when valuations are required and who may carry them out.

In summary, where a fund holds immovable property, the authorised fund manager has to appoint an appropriate valuer who:

- has knowledge and experience of the valuation of the type of property in the area concerned
- is qualified to be a standing independent valuer (SIV) (defined in COLL 5.6.20 in [COLL 5](#)), and
- has knowledge of, and experience in, the valuation of immovables of the relevant kind in the relevant area.

The SIV has to be independent from the fund manager, directors or depositary and not have been involved in introducing the property to the scheme or fund.

Appointing the valuer

Who may value?

Neither IFRS nor the UK accounting standards stipulate who should make the required fair value estimates of investment property on either acquisition, or at each reporting date thereafter. However, both sets of standards do require the reporting entity to disclose the extent to which the reported fair value of investment property is based on a valuation by an independent valuer who:

- holds a recognised and relevant professional qualification, and
- has recent experience in the location and category of the investment property being valued.

If there has been no such valuation, that must also be disclosed. There is, therefore, a strong expectation that a suitably qualified independent valuer will be appointed in most cases.

The COLL and FUND regulations require the authorised fund manager to appoint an appropriate valuer. This is a person who:

- has knowledge and experience of the valuation of the type of property in the area concerned
- is qualified to be a SIV and
- has knowledge of and experience in the valuation of immovables of the relevant kind in the relevant area.

The SIV has to be independent from the fund manager, directors or depositary and not have been involved in introducing the property to the scheme or fund.

The EPRA Guidelines encourage the use of external valuations, explaining that the credibility of valuations will increase when an external valuation is carried out and the external valuer is independent and objective.

The AREF Code of Practice requires property valuations to be undertaken by professionally qualified independent valuers, with transparent investor reporting.

The INREV Guidelines require the appointment of external valuers. The investment manager should ensure that these external valuers comply with applicable laws and recognised valuation standards.

RICS requires all members providing valuations for financial reporting and collective investment schemes to comply with [valuer registration](#), which means that they have not only undergone the appropriate training and tests of professional competence but are also subject to regulation to ensure compliance with the required standards.

An RICS member or regulated firm can only accept a valuation instruction if they:

- have sufficient current local, national or international (if appropriate) knowledge of the asset type and its particular market, and the skills and understanding necessary to undertake the valuation competently, and
- have no conflict of interest or significant risk of a conflict of interest, unless all of those who are or may be affected have provided their prior informed consent. Informed consent may be sought only where proceeding is in the interests of all of those who may be affected and is not prohibited by law.



Who appoints the valuer?

To provide assurance that valuers appointed are independent, the managers of a collective investment scheme or REIT will normally have processes for the oversight of valuer appointments.

The Pereira-Gray review found that not all conflicts lie with the valuer, citing the widespread example of fund managers instructing valuations when they are individually rewarded directly on the outcome of those valuations.

A specific example that RICS has noted is where valuers are appointed after being asked to provide sample valuations as part of a tender process. Such valuations can give the impression that the instruction will be awarded to the firm providing the highest value. This presents a threat to the valuer providing an unbiased and objective value. This can be avoided if clients focus on the firm's experience, service record and the resources available to support the instruction.

The AREF Code of Practice requires a fund to disclose to its investors who appoints the valuer and to whom the valuer reports or has its fiduciary duty. The INREV Guidelines provide that the investment manager should effectively engage with the governing body of the vehicle to enable it to effectively monitor its activities related to the valuation function.

Pereira-Gray's review stated that he felt strongly that where share prices or unit prices are derived from valuations, the valuation report should be instructed by and submitted to the independent chair of the audit committee of the client or its equivalent. This is while acknowledging that this responsibility was in the hands of the client and outside the remit of their review.

Following the Pereira-Gray review, RICS now requires its members advising funds based in the UK to ask clients in writing if the instruction has been approved by:

- a non-executive director
- an independent chair of their audit committee or equivalent, or
- a corporate compliance officer or equivalent.

It also requires the client's response to be expressly detailed in the terms of engagement and clearly stated within the valuation report, including in any published version.

Rotation of valuers

To avoid threats to the valuer's independence through overfamiliarity with either the properties they are instructed to value or the fund managers, it is common practice to limit the length of the continuous period for which the same valuer can value the same assets.

The AREF Code of Practice indicates that the valuer's appointment should be reviewed at least once every three years. The INREV Guidelines recommend the governing body of the vehicle should review the continuing appointment or reappointment of the external valuer on a regular basis and at least once every three years.

For more than 20 years, RICS has recommended that its members should have a rotation policy limiting the length of time for which they provide recurring valuations of the same asset for valuations on which parties other than the instructing client may rely.

Following the Pereira-Gray review, in the UK it is now, with few limited exceptions, a requirement that the valuer must be able to confirm that the period for which their valuation firm has valued the asset(s) for the same regulated purpose does not exceed ten years and will not have exceeded ten years by the end of the current contract. Where the ten years limit has been reached, there has to be a break of three years before the firm can accept another contract to value the same assets for the same purpose (see UK VPS 3 in [RICS Valuation – Global Standards: UK national supplement](#)).

There is also a new requirement that a firm cannot enter any new contracts to value the same assets for the same purpose for a period of more than five years and can only renew such a contract if it does not breach the total ten-year period referred to above.

This rule became effective on 1 May 2024. There is a transitional period of two years following this where RICS-regulated firms may continue to value under an existing contract, or where this is necessary to allow the client to organise an orderly transfer to a new valuation firm. The detail of the new rule, which has limited exceptions, can be found in UK VPS 3 of the RICS Valuation – Global Standards: UK national supplement.



Valuation fees

It has been widely recognised that the method of calculating the fee paid to the valuer can be perceived as a threat to the valuer's impartiality if it is related to the amount of the valuation, i.e. the higher the value, the higher the fee. Such a link could be seen as disincentivising the valuer from accurately reporting a reduced estimate of values in a market downturn.

RICS requires the amount of the valuation fee or the basis on which it is calculated to be agreed with the client in the terms of engagement. However, unless there is a fee basis prescribed by an external body that binds both parties, this is a matter to be settled between valuer and client. Like most UK professional bodies, RICS does not issue recommended fees for its members' services because of competition law. However, the Pereira-Gray review made a clear recommendation that valuation fees should be set in absolute terms, independent of an index or the value of the asset, or the change in the value of an asset over time.

The fee basis agreed with the valuer is addressed in industry best practice guidelines. The EPRA Guidelines recommend that companies should disclose the fee basis agreed with independent valuers to investors. The INREV Guidelines state that the investment manager should ensure that the compensation of the external valuer fairly reflects the services provided and should not be directly linked to the outcome of the valuation.

Discussion of valuations

In the case of the recurring valuations required at regular intervals under the FCA Regulations, or for financial reporting, it is usual for the appointed valuers to discuss draft values with the client before finalising. There are practical reasons for this given that the valuer needs to confirm that the information they have on every property is as up to date as possible on the relevant valuation date and that the impact of any changes is properly reflected in the reported value.

A problem arises in that such discussions can also present a threat to the valuer's objectivity. The Pereira-Gray review found evidence that they were used by some fund managers to put pressure on the valuers to change their initial valuations. While such discussions may be necessary to ensure the facts used in a valuation are current, they also present a significant threat to the independence and objectivity of the valuer.

To help counter this threat, transparent record keeping of such discussions is required. The AREF Code of Practice states that:

'Record keeping is key to auditing the independence of the valuer and the valuation process. Records should be retained of all correspondence between the valuer and the manager, all valuation changes should be recorded together with a rationale/ explanation for the change.'

The INREV Guidelines require all parties involved in the valuation process to meet the highest professional standards of ethics and integrity including adapting how they conduct themselves to ensure the achievement of appropriate and unbiased market values.

RICS requires its members to keep a written record of any discussions with clients that could lead to a provisional valuation being changed and, if they decide to alter their valuation as a result, the grounds for doing so must also be carefully noted. This record must be made available to auditors or any other party with a legitimate and material interest in the valuation.

The Pereira-Gray review recommended that meetings between valuers and their client should be monitored, minuted and recorded and that these should be made available to compliance officers, non-executive directors, or their equivalent, as well as internal and external auditors.

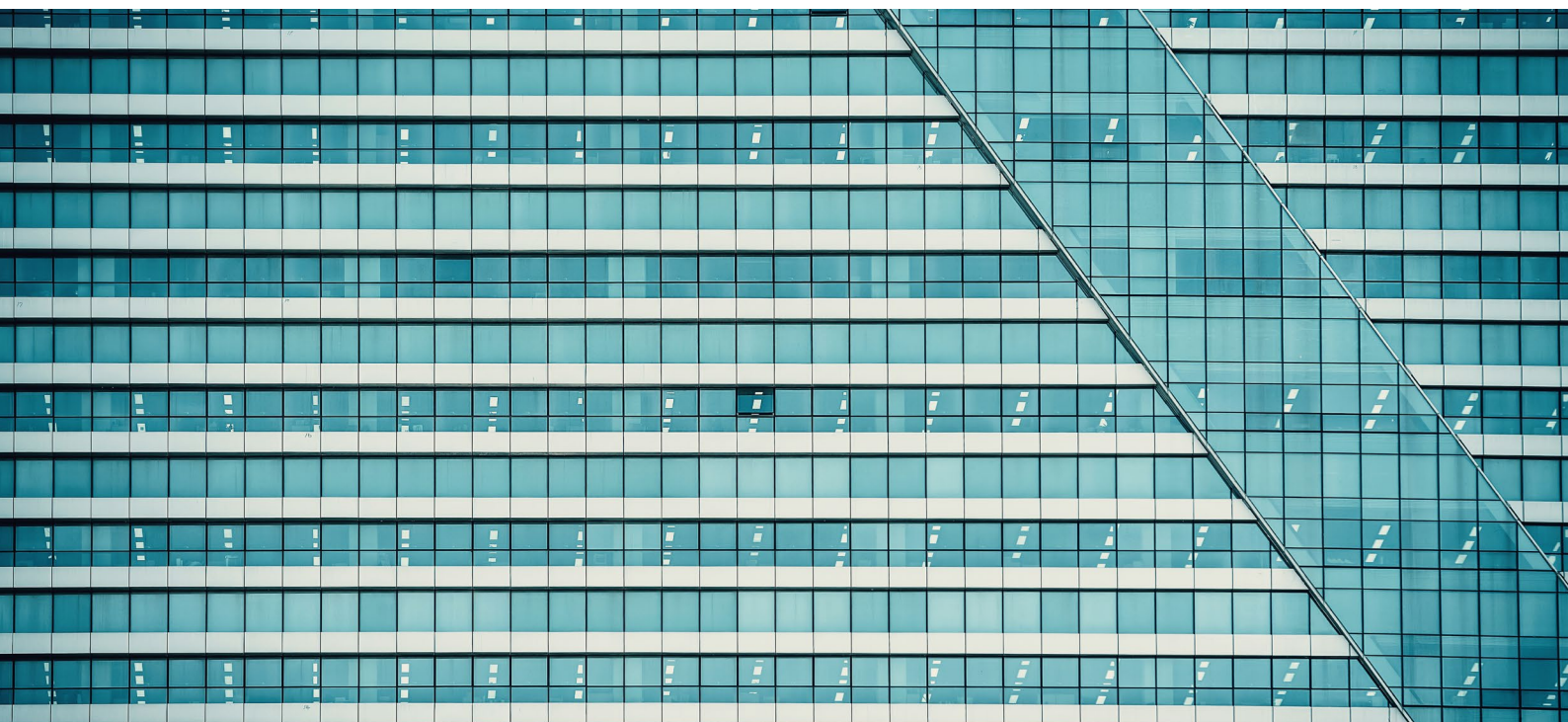
The valuation process

Frequency of valuations

IFRS and UK financial reporting standards require full financial reports to be produced at least annually and also allow for condensed interim reports for shorter periods. Under UK law, public companies are required to issue semi-annual reports after the first six months of each annual period. Although the statutory requirement to produce quarterly reports ended in 2014, many real estate investment vehicles continue to do so voluntarily. These interim reports will include information for investors on movements in the value of investment properties over the previous quarter.

In addition to complying with the accounting standards, the funds or other investment schemes subject to the COLL or FUND regulations must also ensure that a SIV undertakes a full valuation of all properties with a physical inspection, including the interior of any building, at least once a year and further reviews the valuations at least once a month. If the fund manager or depositary becomes aware of any matter that may affect the value of a property, they must inform the SIV immediately.

The industry best practice guidance issued by EPRA, INREV and AREF does not stipulate specific intervals at which valuations are required; this is usually the subject of statutory regulation.



Basis of value

Both IFRS and UK financial reporting standards require investment property to be reported at its fair value on each reporting date, as defined in the respective standards. The COLL regulations require valuations at market value as defined in Red Book Global Standards (which is the same definition as appears in the International Valuation Standards). All these definitions use different words but, in most circumstances, mean the same thing. The value is an estimate of the price that would be obtained in an exchange of the property on the valuation date between informed and willing parties.

Valuations on the basis of fair value or market value should reflect the expectations of a typical buyer and seller on future market trends at the valuation date, so should be as much forward looking as they are backwards. Nevertheless, investors should be aware that markets can and do change suddenly as the result of unexpected events, so even a valuation that is a few days old could be out of date. However regular the reporting or review of valuations required under the relevant regulations is, the risk of unforeseeable events making the most recent valuation unreliable is unavoidable.

Both bases of value required for regulatory purposes, fair value and market value, are estimates of the value to a typical market participant. They do not necessarily reflect the value to a specific market participant, who may have a different perception from others of the opportunities or risks arising from ownership of a particular asset. It should be noted that in Red Book Global Standards 'investment value' is the basis used to measure the value of an asset to a specific party, which may be different from its market value.

The Pereira-Gray review found that there is some confusion between property risk advice and valuation. It is important to understand that while valuers are well equipped (through their knowledge of market trends) to provide input into the assessment of future risks as they may affect a specific owner, this is a very different exercise to providing an estimate of the value that could be realised in the market on a specific date.

Reporting the valuations

The FUND and COLL regulations require the fund manager to obtain reports from an appropriate valuer before acquiring real estate assets for a fund, or from an SIV for recurring valuations of the fund's properties at each reporting date. With the exception of [material valuation uncertainty](#), the regulations do not set out in detail what should be disclosed to investors apart from the valuation figure.

The EPRA BPR Guidelines recommend that companies should include in their financial reports either a summary of the valuation report approved by the valuer or a table that reconciles the amounts provided by the valuer to the amounts included in the financial statements. In practice, most REITs will have multiple properties and use different valuers across their portfolio, so the second of these options is more usually adopted.

Neither AREF nor INREV explicitly recommend that the independent valuer's report be disclosed to investors, although do require disclosures about the valuations obtained. For example:

- the AREF Code of Practice requires disclosure to investors of the methods of valuation used, if this has changed since the previous periodic statement and, if so, the reasons why; if any reported valuation was undertaken internally this should be clearly highlighted, with reasons why, and
- INREV Guidelines provide that the governing body of the investment vehicle should ensure that communication with investors about the valuation is balanced and fairly represents the activities of the vehicle. Examples of the information that would achieve this include the valuation standards that have been used, the methods used and if these differ across different asset types, or any limitations made by the external valuer. Most significantly, the guidelines provide that where, in exceptional circumstances, there may be disagreements between the fund manager and the external valuer, this should be reported to investors, including full justification for the different value being reported.

If the valuations are undertaken by a member or an RICS-regulated firm, their report has to comply with Red Book Global Standards. This lists matters that must be included in reports, such as what is being valued, the purpose for which it is being valued, the basis of value used and any limitations that apply. It also requires a rationale for the valuations, together with an indication of the methodology adopted and the date from which the valuation is effective.

Large portfolios or complex single properties can lead to valuation reports being lengthy, which means that fund managers or investment companies may consider it impractical to include these in full in their financial reports to investors. Red Book Global Standards does provide that where the valuer is aware that their valuation report is to be directly referenced by their clients in their reports to investors, they may approve a summary.



Material valuation uncertainty

All valuations are estimates based on what price would have been agreed in a hypothetical transaction on a specified date. Particularly for real estate, which is among the most heterogenous and illiquid of assets, adjustments are required from observed prices for similar properties to allow for differences in: location, design, age, tenant quality, lease terms, etc. A degree of uncertainty is therefore inherent in all investment property valuations.

However, unexpected or unforeseen events that have macroeconomic consequences can cause uncertainty in many markets while buyers and sellers come to terms with the extent the impact on the prices they would be willing to pay or accept. Examples of such market shocks include the 2001 terrorist attacks on the World Trade Center and the lockdowns in many countries due to COVID-19 in 2020. Following each of these events there was a period of a few weeks during which previously agreed sales were cancelled and no new deals were agreed until markets adjusted and the impact on prices could be observed.

RICS recognises the risks of relying on any valuation provided following such an event until there is either evidence of post-event sales, or other pricing evidence is available that would be significantly greater than for a valuation provided under normal market conditions. Since 2003, RICS has required its members to disclose if any reported valuation is subject to material valuation uncertainty.

The FCA also recognised the problem faced by open-ended funds invested in illiquid assets, such as real estate, following such events. In some cases, dealing was being suspended, meaning investors wishing to redeem their holdings could not access their investment. Unless dealing was suspended, a sudden increase in withdrawals could lead to assets having to be sold quickly into a market that was still not functioning normally, to the detriment of investors who had invested for the long term.

In 2019, the [COLL regulations](#) were amended to provide for situations where the SIV reported that their valuation of at least 20% of the value of the fund's property was subject to material valuation uncertainty, in accordance with the RICS Red Book Global Standards. In such a case, and as soon as possible, the fund manager must temporarily suspend dealing in the fund unless the fund manager and depository agree that this would not be in the interests of all the unit holders in the scheme.

Delivering confidence

We are RICS. As a member-led chartered professional body working in the public interest, we uphold the highest technical and ethical standards.

We inspire professionalism, advance knowledge and support our members across global markets to make an effective contribution for the benefit of society. We independently regulate our members in the management of land, real estate, construction and infrastructure. Our work with others supports their professional practice and pioneers a natural and built environment that is sustainable, resilient and inclusive for all.

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