

E-Notes

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Best Practice in Valuation

Introduction

Implementation of some procedure in valuation processes which are not very complicated, those may be followed by a RVM to do as a part of Best Practice.

Ambiguous area ie which have lack of clarity, border lines are smudged. Best practice must be followed by a Registered Valuer Member to avoid the these areas. RVO cannot always have control on this unless it is tipped off or informed about the mal practice. So, this can be avoided by conscious endeavor by the Registered Valuer Members only.

Ethics are concerned with the way we conduct ourselves which in turn can affect how work is done. Ethical behavior is the ability to perform within standards without misleading others. Ethics or a code of conduct is the underlying foundation of standards. Without ethics there would be no standards.

RVO ESMA has discussed with clients/intended users as well as valuers or RVE and experience valuers, found certain areas which are smudged. And tries to identify the problems faced by the clients.

Ambiguous Area or the area in a valuation report, which cannot be interpreted properly may also called Grey area

- Grey area means a mixture of black and white ie
- which have lack of clarity,
- border lines are smudged.
- In some sense it is mixed with true and false.

- It is a situation or an area of activity where definition is not readily conforming to a category or set of rules.
- Which may be called as FUZZY

Other

- **Intentional biased report generated by a valuer**
- **inadvertent wrong done by a valuer**
- **Negligence by a valuer**
- **Result of which leads the clients to an uncertainty, ambiguous decision.**

INTRODUCTION of BEST PRACTICE

- To avoid the GREY areas Best practice can be followed
- Best practices are commercial or professional procedures that are accepted or prescribed as being correct or most effective.

This may be achieved by

- Pure technically handling the issue
- looking at the issue from different angle
- more awareness
- This practice maybe initiated from the trust of the public



Preconditions of accepting an assignment on Valuation for a Registered Valuer

1. A valuer Member must possess the appropriate academic /professional qualification and experience. The Valuation report and terms of engagement must confirm that the valuer possesses the necessary skills to undertake the task properly.
2. **Competence** : A Valuer shall not accept order in a matter where, based on a reasonable objective standard, the Valuer does not have the competence, skill and/or experience to complete the assignment, unless the assignment is completed by taking necessary steps after informing the client. Generally, Valuers must not accept instructions beyond their competence.
3. A valuer Can demonstrate technical competence while opine a valuation conclusion. Sometimes, Valuers operating in geographically special areas for which they do not possess the requisite skills but pose false claims and that becomes risk to the client. Firms and individual valuers should both ensure and document that the valuer is suitably qualified.
4. Valid membership of RVO, committed to the ethical rule/code.
5. Compliance with the state regulations.
6. No proceedings are pending or any action has been initiated against the Member.

Checking conflict of interest



The entire case file should show the complete unbiased and independence of the valuer. A valuer / firm may have a checklist format for this and keep a consistent approach to recording information.

1. Identifying the probable conflict of interest. In this case inform the client about

2. Conflict of interest immerges within the job performed
3. How the valuer/firm has taken steps to address the problem.

See the self-competence

If lack of competence

Alternatively

1. Disclose the lack of knowledge and/or experience to the job assigner before accepting a Valuation Job
2. Describe the lack of knowledge and the steps taken to fill the gap.
3. To complete the assignment competently the Valuer Member must take all steps which are necessary. These may be accomplished by various ways, including but not limited to personal study by the Valuer Member, association with a valuer who, reasonably believed to have sufficient knowledge in the matter.
4. In case, a Member Valuer employs another or a firm, client's approval is necessary before accepting the assignment.
5. If geographic competence is required, a valuer member preparing a valuation report for an unfamiliar site or location, must spend sufficient time to understand the nuances of the local market and economic factors of demand and supply.
6. The rule provides a safeguard to a valuer member, if at the mid of an assignment, any lack of knowledge or experience immerges which were not identified, unknowingly and eventually not notified, the Valuer Member is obligated to inform its client at the point of discovery and comply with point no. 2 & 3.

To Deal With Unacceptable Requests – Ethical Code

- Better understand the potential client's real needs
- Educate the client about valuation practice and explain other aspects of valuation.

Objectivity and Independence

- A valuer Member, who under takes a valuation job must act with independence, Objectivity and Integrity.
- It is imperative to maintain high standard of ethics and code of conduct all the time.
- Unbiased and truly professional.

Format for valuation instruction

The valuer may write a **format for valuation instruction or Assignment** which can be designed to enable the valuer to obtain from the client all the information necessary in order to carry out the valuation **even before the actual job commences**. The minimum content of assignments are

1. INSOLVENCY PROFESSIONAL NAME & REGISTRATION NO :
2. REGISTERED VALUER NAME & REGISTRATION NO :
3. CORPORATE DEBTOR'S & CREDITOR'S NAME, ADDRESS & OTHER DETAILS :
4. ASSIGNMENT DATE & NUMBER :
5. DATE OF VALUATION (As the date of insolvency commencement to be given by RP/IF)
6. COPY OF THE ORDER OF THE ADJUDICATING AUTHORITY
7. ASSET CLASS :
8. PURPOSE OF VALUATION :
9. SCOPE OF WORK WITH DETAILS : Any **Changes to Scope of Work** Some of the items *may* not be determinable until the valuation assignment is in progress, or changes to the scope *may* become necessary during the course of the assignment due to additional information becoming available or matters emerging that require further investigation. As such, whilst the scope of work *may* be established at the outset, it *may* also be established over time throughout the course of the assignment. In valuation assignments where the scope of work changes over time, and any changes made over time *must* be communicated to the *client* before the assignment is completed and the valuation report is issued.

10. IDENTIFICATION OF INTENDED USER
11. IDENTIFICATION OF THE PROPERTY :
12. FEE FOR VALUER :
13. LIST OF DOCUMENTS SUBMITTED (As necessary)
14. SPECIFIC TERMS & CONDITION OF THE ASSIGNMENT i.e TIMELINE ETC. (After negotiation):
15. NON-DISCLOSURE OF CONFIDENTIAL INFORMATION :
16. ACCEPTANCE OF ASSIGNMENT WITH DATE / IN CASE OF REFUSAL REASON BE GIVEN :

Valuer has to understand the client's real need

While appropriating the real need, a Registered Valuer needs to consider the actual market need.

SPECIFIC INFORMATION to be sourced from the relevant authorities (e.g. relevant seismic registered information) if any.

17. SPECIFIC INFORMATION to be sourced from the relevant authorities (e.g. relevant seismic registered information) if any.
18. WHAT CLIENT wants to achieve from the inspection and report.
19. SAFETY AND ACCESS ISSUE which may affect the nature of the inspection.

A Valuer has to understand the client's real need

- WHAT CLIENT wants to achieve from the inspection and report.
- The real qualities and efforts a Registered valuer needs to develop or utilize that lead to the results they desire.
- While appropriating the real need, a Registered Valuer needs to consider the actual market need.
- SPECIFIC INFORMATION to be sourced from the relevant authorities (e.g. relevant seismic registered information) if any.
- *SAFETY AND ACCESS ISSUE which may affect the nature of the inspection.

Stages

Meetings This involves general planning with the client, the process of data validation including to identify the risk involved. The workplan will detail how the staged outputs are achieved and payment points.

Analysis - inspections, data accumulation, sales analysis It is the data collection and analysis stage. It comprises; collection of sales and leasing data, property inspections of sales (outliers and specialist properties/high risk properties), confirmation or collection of property attributes and any remedying of data gaps identified.

Confirming the instruction

1. The valuer should ensure that a clear scope of works is established and that a contract exists before each Technical Due Diligence process even starts. Misunderstandings can be eliminated or at least minimised by establishing clear terms of engagement at the outset and confirming all of the client's instructions in writing. The disputes are more often if it is not based on a clear understanding of the terms at the outset.
2. It should be remembered that once those terms of engagement have been agreed, they cannot be amended without the client's agreement.
3. It is advisable that the valuer requests that the client signs a copy of the property professional's letter of confirmation to ensure that the terms and conditions of engagement are understood and agreed by both parties.

Scope of work

Sometimes, it is seen that the valuation report does not conform to the scope of work of the assignment or the valuer couldn't identify the issue. The **scope of work** is acceptable when it has rationale with the expectations of market participants for the same or similar valuation services. The scope of work should be an important part in the valuation report which should have the professional competence. Scope of work to be well determined while accepting an assignment.

A Valuer should accept the assignment with clear indication on the scope of work and should ensure that the report conform to those scope of work ie all the jobs done as per scope of work written in assignment and the documents are accurate and that the writing is specific and thorough

- 1 Determining the **scope of work** is sometimes ongoing process, it may also happen in the course of doing an assignment, the valuer might need to change the scope of work. In this case client must be well informed in case of change of **scope of work**. The client should agree on this before further process.
- 2 In case changes in scope of work, do not comply with the requirement of standard adopted. Departure is to be considered.

Cognition of Purpose of valuation

Purpose wise the valuation of an asset gets change. In doing valuation, it is sometimes seen that the confusion in addressing the issue. The purpose cognition, linked with the assumption or valuation process (ie adopting appropriate basis, approach/methodology) are lacking. A peer review can correct these types of mistakes in future.

It is also seen that valuers are providing only one method of valuation while multiple methods are feasible and reasonable. The valuers must show all the possible methods which suit the valuation job.

Due diligence reasonable steps taken by a person to avoid committing a tort or offence. a comprehensive appraisal of a business undertaken by a prospective buyer, especially to establish its assets and liabilities and evaluate its commercial potential.

The Need for Technical Due diligence

Technical Due Diligence is required, which detail the physical condition of a property, are increasingly in demand throughout the world as financial institutions, investors and owner-occupiers look ever more closely at the risks of buying and selling property. It is

therefore critical. Both valuers and their clients have to understand the issues, which may be considered in such reports and client/ intended users should have confidence in the due diligence process adopted by a Valuer.

The benefits of Technical Due Diligence may include

1. Gaining an understanding of the technical condition and design of the property through a thorough examination of all available construction documents, including identifying defects, poor performance and opportunities for improvement.
2. Quantifying future costs and other liabilities.
3. Establishing the suitability of the property for its intended use or users.
4. Try to provide a good foundation for price negotiations and
5. Try to provide a level of protection for institutional investors. As, it is seen that the majority of large property owners are institutional investors who manage a portfolio of property assets on behalf of their beneficial owners.

Three key types of Technical Due Diligence processes for commercial, industrial and residential property, each of which will have a slightly different emphasis.

These processes are :

1. Purchase, including financing and purchase of development projects
 - a. Whether the site or surrounding area have any adverse effect on the technical aspects of the asset.
 - b. There shouldn't be any deficiency like estimating the remaining life of the asset.
 - c. Whether significant defects exist in the structure and building services installed in the property.
 - d. Whether any legal implications of the defects which is considered as non-compliance with statutory standards.
 - f. Whether the property is suitable for the client's intended use;

g. The valuer has to consider the technical characteristics of the asset whether suits with the use classification of the building and likely tenant requirements.

h. The valuer has to consider the technical characteristics of the asset whether suits with the use classification of the building and likely tenant requirements.

i. The valuer has to consider also the projected capital expenditure (CAPEX) are in line with the client's budget.

1. Occupation

If occupation by the client is for long time or contemplated, the Technical Due Diligence process would advise on any restrictions or problems likely to be encountered in adapting the property for the intended use.

2. Disposal

Identification of significant physical defects or any statutory non-compliance which might affect the value of the property in the market. If it is not done or a new avenue for a purchaser to extend negotiations may open regarding certain technical issues.

Third party consultants and their appointment if any

A Technical Due Diligence investigation to be undertaken when particularly a large commercial, industrial or residential property are involved and there may be need for a number of different consultants and experts covering their specific area of expertise and requirement.

Health and safety for Valuer

Areas to consider include caution when:

1. Entering premises that have been vacant for a long time;
2. Working close to plant or machinery

3. Working high up or in confined places
4. There are traffic movements
5. There is excessive noise, excessive heat or cold, or vibration
6. In the presence of microwaves, radiation and electromagnetic fields
7. Chemical emission
8. Increased hygiene needs (e.g. food preparation areas)
9. Biohazards
10. Time restrictions
11. Unoccupied areas, one-way opening doors
12. Entering security areas.

Inspection notes

A dedicated inspection structured note template may be used to avoid the future confusion.

1. An inconsistent note would lead to a problem.
2. If possible, check list template can be used.
3. The notes should be complete and competent to answer questions on appropriateness, basis etc in future. Always an unstructured or insufficient notes lead the valuer/firm to potential risk for future questions relating to the scope of the inspection.
4. Record, reference and analyse Having all records clearly documented and referenced, together with the analysis and record of how they had influenced the valuation, support the valuation if there is a claim in the future.

A valuation shall not be performed by a Valuer without an inspection of the Real or any tangible property concerned.

Report Writing : as per IVS 103

Finally a valuer has to satisfy the client by writing its value opinion.

Quality of reports: meet any international standards and/or clients' specialist requirements
A valuer may use a framework or template for reports and establish a robust quality assurance procedure to ensure that all reports meet minimum requirements those have been postulated in the report writing.

1. Identity of the *valuer*
2. Identity of the *client(s)*
3. Identity of other *intended users*
4. *Asset(s)* being valued
5. *Purpose of the valuation*
6. Basis/bases of value used
7. Valuation date This may be insolvency commencement date as per IBC
8. The nature and extent of the *valuer's* work and any limitations thereon
9. The nature and sources of information
10. *Significant* assumptions and/or special assumptions
11. The type of report being prepared
12. Restrictions on use, distribution and publication
13. The *valuation report* will be prepared in compliance with the standard and that the *valuer* will assess the appropriateness of all *significant* inputs
14. Declaration by the valuer, who takes the responsibility of the valuation report.
 - A robust format on quality assurance for report writing can be used
 - A report should be Complete,
 - Adequate,
 - Reasonable,
 - Relevant and
 - Appropriate.
 - A report should be unambiguous and unnecessary jargon free. Unnecessary jargons and which does not create a false impression. A complicated report sometimes leads to

charge success fee or contingent fee. Even it can lead to bad decisions by clients and their lenders Furthermore, arises unnecessary complications.

DEPRECIATION / OBSOLESCENCE

- **A valuer should consider not only the depreciation schedule of MCA**
- **In valuation, the depreciation consideration comes from Obsolescence**
- (a) Physical obsolescence: Any loss of utility due to the physical deterioration of the asset or its components resulting from its age and usage.

Considerations in Physical Obsolescence

- *Curable physical obsolescence, ie, the cost to fix/cure the obsolescence, or*
- *Incurable physical obsolescence which considers the asset's age, expected total and remaining life where the adjustment for physical obsolescence is equivalent to the proportion of the expected total life consumed.*
- (b) Functional obsolescence: Any loss of utility resulting from inefficiencies in the subject asset compared to its replacement such as its design, specification or technology being outdated. Cannot fit in the changed scenario.
- *Considerations in Functional Obsolescence*
 - *Excess capital cost, which can be caused by changes in design, materials of construction, technology or manufacturing techniques resulting in the availability of modern equivalent assets with lower capital costs than the subject asset, and cannot fit in the changed scenario.*
 - *Excess operating cost, which can be caused by improvements in design or excess capacity resulting in the availability of modern equivalent assets with lower operating costs than the subject asset.*
- (c) External or economic obsolescence:

- Any loss of utility caused by economic or locational factors external to the *asset*. This type of obsolescence can be temporary or permanent.
- *Considerations in Economical Obsolescence*
 - adverse changes to demand for the products or services produced by the *asset*,
 - oversupply in the market for the *asset*,
 - a disruption or loss of a supply of labour or raw material, or
 - the *asset* being used by a business that cannot afford to pay a market rent for the *assets* and still generate a market rate of return.

HIGHEST AND BEST VALUE

- The concept HABU is embedded with the MARKET VALUE concept as per IVS 104.
- HABU should be considered in a valuation report where it is applicable
- Use of HABU concept must be adhered with mainly Economic, Technical feasibility and cost to change use.

Degree of certainty

This paper identifies mainly three main sources of valuation uncertainty:

Market uncertainty,

Model uncertainty and

Input uncertainty.

If appropriate, the valuer should draw attention to, and comment on, any issues affecting the degree of certainty, or uncertainty, of the *valuation* . Commentary on any material uncertainty in relation to the valuation where it is essential to ensure clarity on the part of the valuation user. For this purpose, ‘material’ means where the degree of uncertainty in a *valuation* falls outside any parameters that might normally be expected and accepted..

RICS.

A *valuation report* is a professional opinion on a stated *basis of value*, coupled with any appropriate *assumptions* or *special assumptions*.

A *valuation opinion* is not a fact. Like all opinions, the certainty, involvement will definitely vary from case to case, **as in the degree of ‘certainty’** – for example, for all the probability that the valuer’s opinion on the *Market Value as per IVS* or *Fair Value as per IBC* would exactly coincide with the price achieved on an actual sale at the *valuation date* or *inspection date*, even if all the circumstances envisaged or covered by the definition of *market value as per IVS* or *Fair Value as per IBC* and the *valuation assumptions* were identical to the circumstances. On an actual sale, most *valuations* are subject to a degree of variations (that is, a difference in professional opinion). This is principle probably well-recognised by the various jurisdictions.

Implementation

Normally, *valuation reports* are not necessarily covers the additional explanation or clarification beyond the general requirement. But an additional explanation statement with the report to cover those uncertainty to be given. It is required to see that how much explanation and detail is necessary concerning the supporting evidence, the valuation approach and the particular market context is a matter of judgment in individual cases.

In some cases there may be a higher degree of uncertainty concerning the valuation figure reported than usual. and where that uncertainty is material – which should be elaborately explained. In this case further proportionate commentary must be added in order to ensure that the report does not create a false impression.

User/intended user/Valuer must not treat such a statement as a sign of less confidence in a *valuation* than usual as an admission of weakness. This disclosure is a matter where the client’s interest is involved. Indeed, a failure to draw attention to material uncertainty may give a client the wrong impression.

File Management

The best files show an audit trail of information. A suitable file checklist approach ensures that this happens on every file.

Quality assurance processes by Individual / Firms

Individual / Firm should use a suitable framework or file checklist approach to ensure all their valuers or a hired valuer are working to the same standard. Every task/job complies with both the firm's and RVOs protocols / code and byelaws.

Computation and / or methodology

This should always be the final part in providing an audit trail for the valuation figure. The best files set out a clear valuation calculation, including reasoning and process. This will assist in defence against any future claims.

- **Threats to avoid**
- **Influence threat** – financial or other interest will inappropriately influence the professional valuer's judgement or behaviour;
- **Previous involvement threat** – A previous involvement made or service performed, or by another individual within the same firm.
- **Conflict of clients threat** – the threat that two or more clients may have opposing or conflicting interests
- **Advocacy threat** – A registered valuer can not promote a client's or employer's position to the point that their objectivity is compromised.
- **Intimacy threat** – the threat that due to a long or close relationship with a client or intended users.
- **Pressure Threat** - A valuer will be deterred from acting objectively because of actual or perceived pressures

The overall requirement for Best Practice in Valuation

- *Professional standards* – Based on ethics and code of conduct in addition with the knowledge, competence, skill and experience.
- *Technical standards* – Based on common definitions and conventions, in addition with the consistent application through recognised approaches and methods.
- *Performance* or in addition with the appropriate documentation and clarity on report.

GENERAL: The principle of professional Valuer

- The principle of professional behaviour imposes an obligation on all professional valuers to act diligently in the service of their clients and to ensure that the service provided is in accordance with all legal, technical and professional standards that are applicable to either the subject of the valuation, the purpose of the valuation or both.
- Professional behaviour includes acceptance of a responsibility to act in the public interest.
- A professional valuer's duty is not limited to satisfying the needs of a particular client or employer.

There is also a need to consider if professional decisions have a wider impact on unidentified third parties. For example, valuations are frequently undertaken that can directly impact upon third parties such as stockholders in a company or investors in a fund. While the client's needs are normally paramount, a professional valuer should avoid knowingly accepting any instruction that appears to be prejudicial to the interests of the wider public, and which could discredit their own reputation and that of the profession generally.



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