

# **A Guide to Red Book Valuations**

**For Community Led Housing Groups**

**Authored by Michaela Bygrave**

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# What is a Red Book valuation?

A Red Book valuation is a valuation carried out in accordance with the guidance laid out in the Royal Institute of Chartered Surveyors (RICS) professional standards guide entitled 'RICS Valuation – Global Standards 2017' and 'RICS Valuation – Global Standards 2017 UK national supplement'. These professional standards guides are known colloquially as 'The Red Book'. This is because earlier editions of the standards had a red cover. Therefore valuations conducted in accordance with these standards are referred to as 'Red Book valuations'.

# Who can do Red Book valuations?

The Red Book forms part of the mandatory guidance that the RICS issues to its members and must be adhered to. The 'RICS Valuation – Global Standards 2017' must be complied with by all RICS members globally when conducting a Red Book valuation. In addition the 'RICS Valuation – Global Standards 2017 UK national supplement' must be adhered to by all UK RICS members. However, not all members of RICS (known by the initials MRICS after their names) are qualified to undertake Red Book valuations. Red Book valuations must only be carried out by a 'Registered Valuer'. This is a surveyor who has sufficient knowledge and experience of carrying out valuations and is registered with the RICS. **Only a Registered Valuer can carry out a Red Book valuation.**

# What are Red Book and non-Red Book valuations?

The Red Book covers most valuations carried out by surveyors. However, a notable example of a non-Red Book valuation is a valuation for internal purposes which carries limited or no liability.

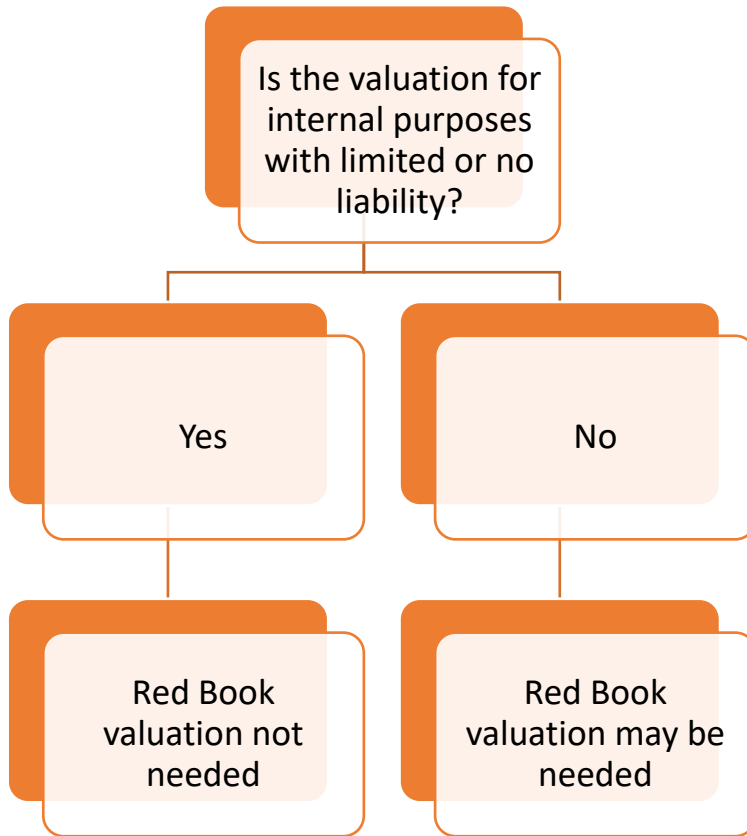
For community led housing groups the most common reasons to instruct a Red Book valuation are likely to be;

1. For loan security valuations
2. For purchase reports

The key deciding factor between choosing a Red Book or non-Red Book valuation is the purpose of the valuation. To help decide whether you need a Red Book or non-Red Book valuation consider whether the valuation is purely for internal use or whether at any point a third party will be expected to rely upon it to make a decision. If any third party (lenders, HMRC etc.) is expected to have reliance on a valuation then a Red Book valuation is likely to be needed



# Deciding on a Red Book or non-Red Book valuation?

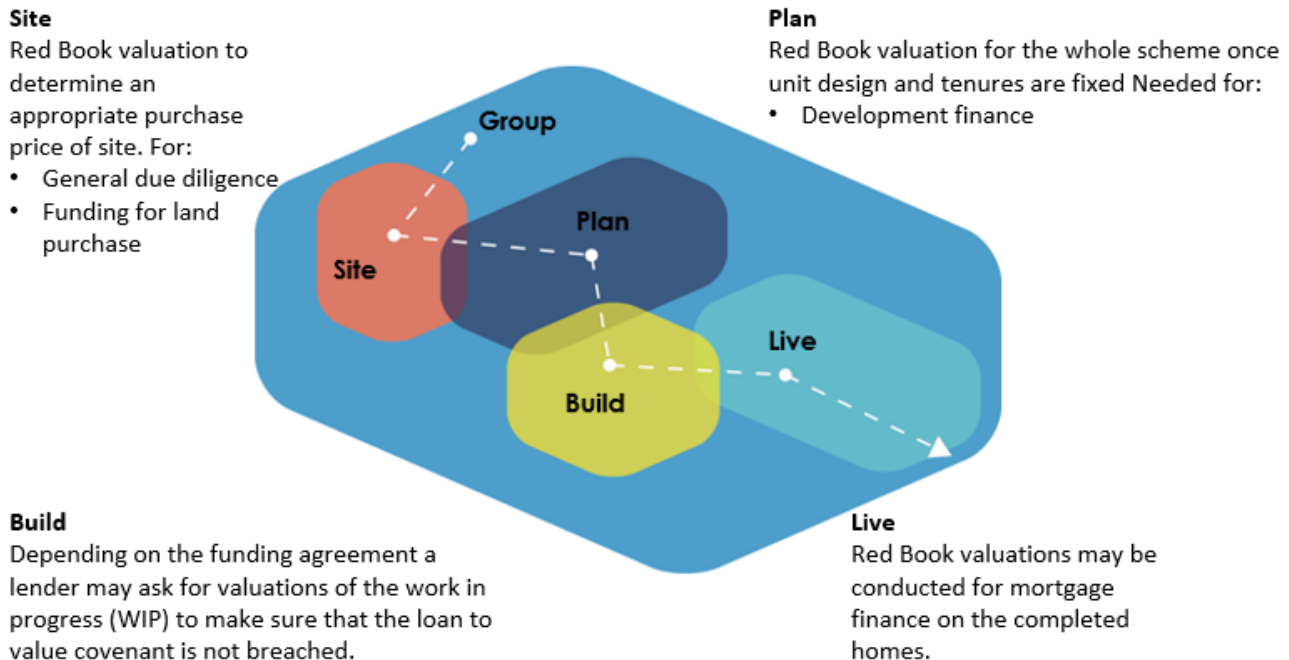


*The decision tree is for generalised information purposes only. Please consult a qualified valuation surveyor on your need for a Red Book valuation based on your individual circumstances.*



# When are Red Book valuations needed?

There is no one-size fits all approach to when a group might need to instruct a valuer but the diagram below outlines at which stage in the Total Process diagram that groups might consider commissioning a Red Book Valuation.



It is important to remember that different circumstances may require different approaches and the above is a guide rather than a definitive order.

## Content of a Red Book valuation report

There are several headings and checks which should be included in a Red Book valuation report. These include;

1. Inspection – whether the property was inspected and what was observed during the inspection
2. Title – the interest being valued
3. Conditions of the buildings – a Valuer will not undertake a building survey but will either give a general opinion of the buildings condition or state their assumption on condition.
4. Services – The efficiency and availability. These will usually not be checked and it is usual for an assumption to be made that they are present and in working order if no information to the contrary is given to the valuer.
5. Planning – any current or historic planning permission for the site and for adjacent sites (where appropriate).
6. Environmental matters – This will not be an in-depth environmental survey by will include checks for flood risk or if the property is in an area of high radon gas. The surveyor may also comment on the presence of Japanese knotweed or the likelihood of site contamination.

In addition the following information will be included;

1. The purpose of the valuation



2. Date of the report (which may differ to the date of valuation)
3. Name of valuer
4. Statement that the valuer is qualified to carry out the valuation
5. Declaration of valuer's independence
6. Date of valuation
7. Date of inspection
8. Assumptions and special assumptions
9. Size of the property
10. Value of the property

Due to the amount of mandatory information which must be included in a Red Book valuation report these reports tend to be far lengthier than non-Red Book valuations as they include a lot of additional information about the property and the area. For example they will usually include a planning history for the property as well as flag any future planning applications in the immediate vicinity which may affect the property value. Checks will usually also be carried out on flood risk or chancel repair liability and the valuer will check the title or lease documents for any liabilities which may affect the value of the property in the future.

For a non-Red Book valuation for internal purposes, for example, far fewer detailed checks will be undertaken on the property or the property history. Often the surveyor will conduct a 'desktop' valuation on the property (i.e. they will not visit the property but use the information provided to them as well as publically available sources to come to an opinion on property value). While this approach leaves a wider margin for error it is often the preferred approach for those who want a quick valuation to allow them to quickly make an internal decision.

## Liability

A valuation conducted in accordance with the Red Book carries with it a very high level of liability for the Valuer and for many this will be the highest risk work that they undertake. There have been various court cases since the Global Financial Crisis on how accurate a valuer can reasonably be expected to be in their valuation, especially in a rapidly changing market. Although this changes with each new ruling it is generally accepted that the reasonable margin of error for values is a maximum of 15%.

There is far less liability attached to a non-Red Book valuation with some even being nil liability. This must be accepted and understood by the client. For this reason non-Red Book valuations cannot be accepted by decision-making third parties such as lenders or HMRC. **Meaning that groups cannot secure loan agreements from funders based on non-Red Book valuations.**

## Cost

Due to the additional property checks and content within a Red Book valuation report as well as the higher level of liability a Red Book report is typically more costly than a non-Red Book report for the valuation of the same property.



# Registered Providers of Social Housing and Red Book Valuations

## Registering with the Regulator

The Regulator of Social Housing requests that for the preliminary application for those wanting to become a Registered Provider of social housing (RP) they ‘show evidence that all the valuations upon which the application relies have been prepared by an appropriately qualified professional in accordance with a RICS-approved methodology and using RICS definitions’.

This means having a Red Book valuation for;

- Market Rent of the area where the RP intends to operate
- The low-cost rents that the RP intends to charge

## Registered Providers and Red Book valuations

In certain circumstances Red Book valuations are compulsory or deemed prudent for Registered Providers. This includes (but are not limited to);

- Financial statements
- Loan security
- Acquisition
- Disposal
- Buildings insurance

Although not exhaustive these are some of the reasons when an RP may consider instructing a valuer to carry out a Red Book Valuation. In addition RPs often instruct valuers to carry out many non-Red Book valuations to help them with their internal decision-making.

## What are the different bases of valuation relevant to community led housing?

In the Red Book different types of valuation are referred to as the bases of valuation. Although the Red Book recognises many different bases of valuation for most community led housing groups the most common bases will be;

1. Market Value
2. Market Rent
3. Existing Use Value – Social Housing
4. Market Value – Shared Ownership Leases

Market Value and Market Rent are defined in the Red Book and all valuers must adhere to these definitions. Existing Use Value – Social Housing is defined in the UK national supplement to the Red Book.



## Market Value

‘the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.’

### IVS 104 paragraph 30.1

Based on the above definition the Market Value is the amount that could reasonably be expected if the property were to sell on the valuation date. As long as the sale were to take place between two unconnected parties who are free of any obligation to buy and after the property was marketed for an appropriate period.

For example the price that a connected or highly motivated buyer (known as a ‘special purchaser’) would pay or a distressed seller accept is not considered to be the Market Value of the property.

However, the Market Value can be reported with certain assumptions and special assumptions which can have an impact on the reported Market Value of the property (see section on Assumptions and Special Assumptions below).

**The Market Value can also be affected by things such as whether groups or the Local Authority have put any restrictive covenants over the units especially those affecting re-sale.**

## Market Rent

The definition for Market Rent follows a similar pattern for Market Value but with some necessary distinctions;

‘the estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.’

It is important to remember that the assumed lease terms will have an effect on the Market Rent for the property. As will factors such as duration of the lease, the frequency of rent reviews and the responsibilities of the parties for maintenance and outgoings. This could be why two similar properties have different Market Rents.

Market Rent is usually reported assuming that the property is vacant or as the value if the current lease were to end and the property were to be re-let. However, it cannot be used for the rent reviews of existing tenancies as rent review valuations must be based on the terms of the lease agreement and not market assumptions.

## Existing Use Value – Social Housing

The ‘RICS Valuation – Global Standards 2017’ is an international standard which must be followed by all surveyors. However, intricacies in the UK property market mean that there is an additional standard which UK-based Registered Valuers must adhere to. This guide is called the ‘RICS Valuation – Global Standards 2017 UK national supplement’ and covers social housing valuation in the UK among other things. The basis of valuation for social and affordable housing is referred to as the ‘Existing Use Value – Social Housing’. Again this is similar to Market Value but with various additional assumptions. Chief amongst these is that the property will continue to be used as social housing. It is possible to insert a mortgagee in possession clause where upon default to the mortgagee the home can be resold/re-let on the open market. In this case when conducting a Red Book valuation for the mortgagee a valuer may value the properties at Market Value rather than EUV-SH.





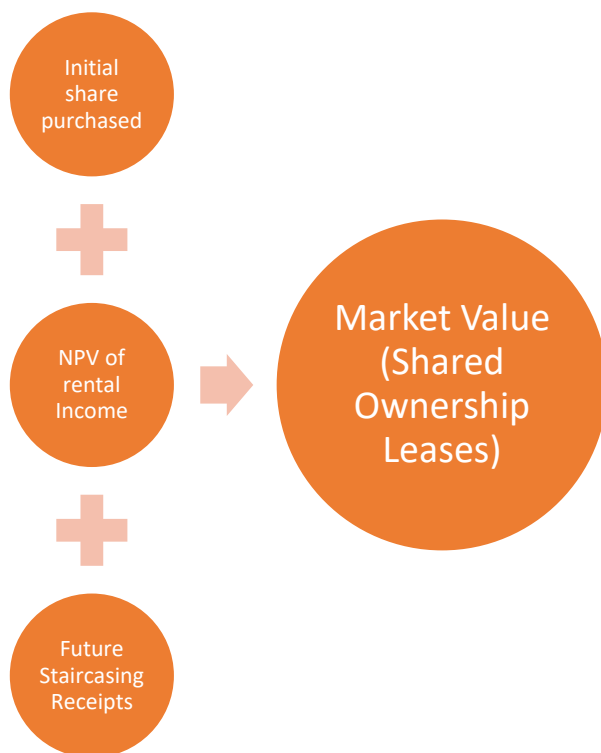
A valuer may ask to see the lease or title documents for an affordable housing property to determine whether it must be valued at EUV-SH or MV.

## Market Value – Shared Ownership Leases

The basis of valuation for shared ownership properties is Market Value which can be referred to by valuers in the following ways;

- Market Value – Shared Ownership Leases (MV-SOL)
- Market Value – Subject to Tenancy (MV-STT)

There is currently no consensus on the method of valuation for shared ownership. The UK National Supplement of the Red Book advocates using the Market Value of the property with vacant possession and simply valuing shares at the proportionate share of Market Value (i.e. a 25% share would be equal to 25% of the full Market Value). Although this is a sufficient way to value the share being purchased in practice many valuers will depart from this approach when valuing the provider’s retained share. This is because simply valuing the proportional shares ignores the rental income that the provider will also receive from the purchaser. This rental income can be converted into a Net Present Value (NPV) for the property. Therefore shared ownership properties are more usually valued as the initial share + the NPV of the rental income over the lease term + any future staircasing assumptions (i.e. the lessee purchasing more shares).



*A common approach to Shared Ownership Valuation for the provider*

## Valuations Bases and Tenure Types

The following bases of valuation are usually applicable to the corresponding tenure types:

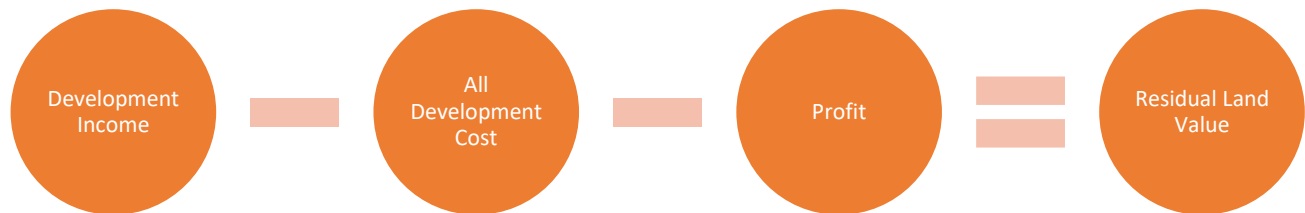
Bases of Valuation	Unit Tenure Type
Market Value	Open Market Sale
Market Rent	Private Rent
Existing Use Value – Social Housing	Social Rent and Affordable Rent
Market Value – Shared Ownership Leases	Shared Ownership



# Key terms in Valuation

## Residual Land Value

Sometimes valuers will arrive at a Market Value for land using the residual method of valuation. Simply put this is represented as;



This can sometimes lead to a nil or negative land value. This does not necessarily mean that the land has no value but that with the assumed development income and assumed profit requirements the land has little value as development land. If the residual land value is high it is a more desirable development prospect. However, residual valuations are based on a series of assumptions around development incomes, costs and timings and a small change in assumptions can have a big impact on the residual land value.

### The Case of the Petrol Station

The valuation of petrol stations when using the residual method of valuation will often give a nil value. This is even when the petrol station is trading as a profitable business which would have a high value in its existing use. This is because the costs of remediation of the ground contamination along with the standard profit assumptions usually produce a negative or very small land value. This example shows the limitations of only using the residual method of valuation to come to an opinion of land value.

## Net Present Value

The Net Present Value is used to show today's value of a future income stream. This is arrived at by using the discount rate (i.e. the expected rate of return each year). 'Net' refers to the fact that it is the net income being discounted back to Present Value as future costs (management, maintenance etc.) have been deducted from each year's income.

The NPV is based on a series of assumptions which are key to arriving at the value of the unit. Chief among these are:

- Discount rate
- Inflation rate
- Management and maintenance costs
- Rent increases
- Voids and bad debts
- Major repairs

The NPV is the method of valuation used for arriving at the EUV-SH for social and affordable rent properties. This is done by discounting the net annual rental income. As mentioned above the NPV is also used on the rental portion of the shared ownership income.



# How to read a Red Book valuation report?

## Executive Summary

Most Red Book valuation reports will start with an executive summary outlining the main points of the report and setting out the valuation figure. Usually this will not include all the caveats, assumptions and special assumptions and so it must be read in conjunction with the report as a whole.

## Assumptions

The assumptions used by the valuer in arriving at their opinion of value will be clearly stated in the report. Assumptions must be reasonably expected to be true. For example, if a certain part of the property cannot be safely accessed, such as the loft space, the valuer may assume that although not inspected it is unlikely to have any issues affecting the value of the property. In a standard residential house they may assume that the property is connected to all mains services without actually testing these. Where it would be unreasonable to make certain assumptions the valuer may seek additional information about the property from the client (i.e. what is inside an inaccessible loft space) and then rely on this information in coming to their opinion of value.

## Special Assumptions

A special assumption is a term used to describe an assumption which is untrue at the time of valuation. For example a property without planning permission could be valued on the special assumption that it has planning permission. The value attributed to it then is not the current Market Value but the Market Value if the property were to achieve planning permission for a specific scheme which will be described in the report.

## Valuer Recommendations and Limitations

Issues at some properties may require further investigation by other professionals such as building surveyors or environmental officers. Often this is because issues have been seen at the property by a valuer but they are not qualified to recommend appropriate action and will instead recommend that the client contact the appropriate specialists. In cases like this the valuation figure is often pending the advice on the issue from the specialist and therefore an assumption for the stated valuation figure might be used such as “on the assumption that the cracks in the walls are not structural”.

The valuer will clearly state any limitations with the valuation. These may include;

- No internal inspection of the property carried out
- Property not fully measured
- Areas that were inaccessible at the time of inspection
- If the valuation is pending additional reports on issues by other professionals



# How does a viability report for the planning department differ to a Red Book valuation report?

A viability report is a type of non-Red Book report. However, it is governed by its own guidance known as 'Financial Viability in Planning- 1<sup>st</sup> Edition' and 'Financial Viability in Planning: Conduct and Reporting – 2<sup>nd</sup> Edition'. In addition a viability report uses a basis of value known as the Current Use Value (CUV) or Existing Use Value (EUV) (not to be confused with the EUV-SH). The CUV/EUV is defined as;

Current use/existing use is the current way an asset, liability, or group of assets and/or liabilities is used. The current use may be, but is not necessarily, also the highest and best use.

**IVS 104 paragraph 150.1**

In a viability report the CUV/EUV will often form the benchmark land value, the value at which below the scheme is considered unviable and above which the scheme is viable. This is not to be confused with the Market Value which may take into account the development potential of the land beyond its current use.

A financial viability report is for local planning departments to determine out how much affordable housing a developer should have to provide onsite if they are proposing to provide less than the minimum amount stipulated in the local plan. This figure will then be legally binding in the S106 agreement. Although many community led housing groups want to maximise their level of affordable housing they also sometimes want to provide their own types of affordable housing more suited to their member profile. An example of this is groups who reject shared ownership as an affordable tenure and so wish to provide other affordable tenures in its place. Bespoke affordable tenures are not always recognised as affordable tenures by the local planning authority so it may seem as though groups are providing less than the proscribed affordable housing. For this reason they may need to demonstrate the viability of their version of affordable housing to the local planning authority via a viability report.

## Conclusion

Red Book valuations are valuations done in accordance with the 'RICS Valuation – Global Standards 2017' and 'RICS Valuation – Global Standards 2017 UK national supplement'. Red Book valuations have higher levels of liability, are usually more detailed and as a result more costly than non-Red Book valuations. They can be carried out only by Registered Valuers and are either the mandatory or prudent valuation choice in most circumstances except for internal purposes where little or no liability is required. The Red Book also describes the bases of valuation which must be used to value property. These include definitions for Market Value, Market Rent and EUV-SH. These definitions must be adhered to by valuers. Common methods of valuation in community led housing include the residual valuation method and using the NPV to arrive at the EUV-SH. Red Book valuation reports should be clearly laid out with any assumptions or special assumptions very clearly stated within the report. In addition any recommendations of further investigations which need to be undertaken and any limitations in the valuation due to a lack of access to the property or a lack of relevant data need to be stated in the report. A viability report is a non-Red Book valuation which is itself regulated by RICS guidance. It relies on a separate basis of valuation known as the CUV/EUV which is then compared against the Market Value for the property as a development site to determine whether a scheme is viable.



*This guide has been prepared by Michaela Bygrave of [Pointe Michel](#). It is for information purposes only and is not intended as a definitive guide to Red Book valuation. The information in this guide is given without liability.*



# Contact Community Led Homes

**Web:**

[CommunityLedHomes.org.uk](http://CommunityLedHomes.org.uk)

**Tel:**

020 3096 7795

**Twitter:**

[@CommLedHousing](https://twitter.com/CommLedHousing)

**Facebook:**

[facebook.com/groups/CommunityLedHousing](https://facebook.com/groups/CommunityLedHousing)