

## APPENDIX 2 BASIS OF VALUE (FROM RICS RED BOOK)

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### *Basis of value*

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You must determine the *basis of value* that is appropriate for every valuation to be reported.

#### *Commentary*

1. A *basis of value* is a statement of the fundamental measurement *assumptions* of a valuation, and for many common valuation purposes these standards stipulate the *basis (or bases) of value* that is appropriate.
2. Paragraphs 27–29 of the IVS Framework outline the common *bases of value* and distinguish them from the approach or method of valuation, the type and state of the asset, and *special assumptions*.
3. It will almost always be necessary to couple a *basis of value* with appropriate *assumptions* or *special assumptions* that describe the assumed status or condition of the asset at the *valuation date*. A typical *assumption* might concern occupation, for example, ‘the *market value* subject to a lease’. A typical *special assumption* might be that a property has been altered in some defined way, for example, ‘the *market value* on the *special assumption* that the works had been completed’. The use of *assumptions* and *special assumptions* is described in detail in Appendices 3 and 4.
4. For most valuation purposes it will be appropriate to use one of the bases recognised in the IVS Framework and identified in these standards. RICS does not encourage the use of a basis that is not recognised by these standards. However, if no recognised *basis of value* is suitable for a particular assignment, *you* should clearly define the basis adopted and explain in the report why use of a basis recognised by these standards is considered inappropriate. *You* are cautioned that the use of an unrecognised or bespoke *basis of value* without good reason could result in breach of the requirement that the valuation report should be not be ambiguous or misleading (see VS 2.1).
5. The following *bases of value* are recognised in these standards:
  - *market value* (see VS 3.2);
  - *market rent* (see VS 3.3);
  - *worth (investment value)* (see VS 3.4); and
  - *fair value* (see VS 3.5).
6. *Market value* is the *basis of value* that is most commonly required. Because it describes an exchange between parties that are unconnected and operating freely in the marketplace, and ignores any price distortions caused by *special value* or *synergistic value*, it represents the price that would most likely be achievable for a property across a wide range of circumstances. *Market rent* applies similar criteria for estimating a recurring payment rather than a capital sum.
7. However, *you* may be legitimately instructed to provide valuation advice based on other criteria, and therefore other *bases of value* may be appropriate. A valuer may be required to provide advice on the value of a particular property to a specific client, and may therefore need to account for criteria that are particular to that client, rather than those applicable in the market at large. This will involve the assessment of the *investment value*, or *worth*, of the property to that client. *Fair value* (except in the context of the *International Financial Reporting Standards (IFRS)*) may be used where *You* needs to estimate the price that would be fair in an exchange between two specific parties, without necessarily having to disregard criteria that would not be replicated in the wider market – for example, where *special value* or *synergistic value* would impact that price.
8. It is important to note that these *bases of value* are not necessarily mutually exclusive. The *worth* of a property to a specific party, or the *fair value* of a property in exchange between two specific parties, may match the *market value* even though different assessment criteria are used.
9. Because bases other than *market value* may produce a value that could not be obtained on either an actual sale, or on a sale in the general market, *you* must clearly distinguish the *assumptions* that are different from, or additional to, those that would be appropriate in an estimate of *market value*. Typical examples of such *assumptions* are discussed under the appropriate heading.

#### *Market value*

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Valuations based on market value shall adopt the definition and the conceptual framework settled by the International Valuation Standards Council (IVSC):

**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.**

## Commentary

1. In applying *market value*, regard must also be had to the conceptual framework set out in paragraphs 31–35 of the IVS Framework, including the requirement that the valuation amount reflects the actual market state and circumstances as of the effective *valuation date*.
2. The basis of *market value* is an internationally recognised definition. It represents the figure that would appear in a hypothetical contract of sale at the *valuation date*. You need to ensure that in all cases the basis is set out clearly in both the instructions and the report.
3. *Market value* ignores any existing mortgage, debenture or other charge over the property.
4. Notwithstanding the disregard of *special value* (see definition in paragraphs 44–47 of the IVS Framework) 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*. Examples of where the hope of additional value being created or obtained in the future may have an impact on the *market value* include:
  - *the prospect of development where there is no current permission for that development; and*
  - *the prospect of synergistic value (see definition in paragraph 48 of the IVS Framework) arising from merger with another property, or interests within the same property, at a future date.*
5. GN 2, GN 4 and GN 5 contain guidance on the application of *market value* to the specified types of asset.

## Fair value

Valuations based on fair value shall adopt one of two definitions:

**1. the definition adopted by the IVSC:**

**‘The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties’.**

**2. the definition adopted by the International Accounting Standards Board (IASB):**

**‘The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date’.**

## Commentary

1. It is important to recognise that the two definitions of *fair value* are not the same. When adopting the basis of *fair value* it is essential that you establish the correct definition for the purpose and set it out in full in the *terms of engagement* and the report.
2. In applying the IVS definition, reference should be made to paragraphs 39–43 of the IVS Framework.
3. The guidance in IFRS 13 includes:

### THE FAIR VALUE MEASUREMENT APPROACH

B2 The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:

- (a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account)
- (b) for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)
- (c) the principal (or most advantageous) market for the asset or liability
- (d) the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

© IASB, IFRS 13

4. The references in IFRS 13 to market participants and a sale make it clear that for most practical purposes, *fair value* is consistent with the concept of *market value*.