SCSI MATERIAL VALUATION UNCERTAINTY – CRITERIA, REQUIREMENTS AND CONSIDERATIONS FOR DECLARING AND RESCINDING MATERIAL UNCERTAINTY

1. Introduction

Situations giving rise to material valuation uncertainty may be fast changing, with new government, regulatory and market requirements capable of appearing daily or sometimes hourly. This summary will be updated regularly to reflect current advice and each version will be dated.

Declarations of material valuation uncertainty should only continue for as long as the criteria set out in section 2 below apply. But while market disruption can occur suddenly, market correction and adjustment will generally occur more gradually. It is particularly important that generalisation is avoided – it is theoretically possible, but in practice unlikely, that a single moment in time will be recognisable as the point at which all, or even most material uncertainty clauses can be removed. It is more likely that an approach to lifting the clauses reflecting, for example, different sectors, markets and jurisdictions will be justifiable, probably supported by an emerging consensus of opinion and market sentiment, even if data remains limited.

2. Principles for inserting material uncertainty declarations

A valuer should refer to the following criteria when considering whether to declare material uncertainty.

1: There is evidence of disruption to markets because of one or more unforeseen events, accompanied either by

a. ‘inconsistent, or an absence of, data’ or
b. ‘an unprecedented set of circumstances on which to form a judgement’ (VPGA 10 Section 2 paragraph 2.4).

2: There is a ‘degree of uncertainty in [the] valuation [that] falls outside any parameters that might normally be expected and accepted’ (VPS 3 Section 2.2 (o) paragraph 1).

3: The valuer's concerns about the greater degree of subjectivity involved in the valuation need to ‘be expressly signalled in the report’ (VPS 3 Section 2.2 (o) paragraph 4).

The ‘overriding requirement is that a valuation report must not be misleading or create a false impression’ (VPGA 10 paragraph 3.1). ‘If a failure to draw attention to material uncertainty gave a client the impression that greater weight could be attached to the opinion than was warranted, the report would be misleading' (VPS 3 Section 2.2 (o) paragraph 4). The key point is that it signals a cautionary note to anyone relying on, and in particular making decisions based on, the value reported, i.e. that less reliance can be placed on the figure than would normally be the case.

3. Principles for removing material uncertainty clauses

In addition to continued reference to the criteria for declaring material uncertainty at 2 above, The SCSI Material Valuation Uncertainty Forum consider that the following general principles should be highlighted in the consideration of the removal of a material uncertainty clause.

- A focus on the particular asset(s) rather than generalising. Much depends on the individual circumstances in the jurisdiction, the sector, and the location. It is common for these circumstances to continually change and evolve.
- Clarity about the causes of the material uncertainty. In the case of the COVID-19 pandemic, while the threat of a pandemic developing was identified some time ago, it is in large part the responses to it which may lead to disruption, e.g. government imposed restrictions or alleviating economic measures, and their various consequences, direct or indirect, which may or will have different durations and impacts on different market sectors.

Although material uncertainty is generally expected to be of relatively short duration, the 'immediate aftermath' in VPGA 10 paragraph 2.4 terms is not time limited.

In practical terms, the concern may be slightly less orientated to 'inconsistent, or an absence of, empirical data' and rather more with the 'unprecedented set of circumstances on which to base a judgement'.

It should be emphasised that an opinion of value is exactly that – an estimate, not a fact. And the reference to data above is not confined to direct sale price comparisons – cashflow projections, discount rates, yields and other factors may also be highly relevant. In some instances, e.g. for financial reporting, a value may need to be provided to comply with statutory requirements notwithstanding, and in such instances, it is still possible for a skilled and experienced valuer to form a valuation judgement.

4. Client communication

Where a valuation is accompanied by a material uncertainty declaration, a continuing dialogue between valuer and client may be appropriate, and indeed might be seen as both good practice and potentially beneficial, as the client is likely to have been advised (or have personally decided) to keep the matter under regular review and thus be closely interested in changes in market conditions and in particular when the material uncertainty proviso can be lifted (which may well be accompanied by a change in the valuation figure, although this would not be automatic).

The challenge for members is to provide the necessary assistance to clients while maintaining their independence and objectivity: this is recognised in Red Book Global PS 2 Section 3 paragraph 3.10, which acknowledges that a discussion may be beneficial before a valuation assignment is completed.

That benefit of discussion may be mutual, in that the client may have access to information or data that may be of assistance to the valuer, and the valuer needs to be clear not only about the purpose, and intended use of advice but also when and how any review or update may be required.

Specifically, the Red Book Global recognises that a valuer may wish, or be requested, to provide a client with 'preliminary advice, or a draft report or valuation' before completion of the assignment – see Red Book Global PS 3 Section 3 paragraph 3.12, which emphasises that the valuer must state that:

- 'the opinion is provisional and subject to completion of the final report
- the advice is provided for the client's internal purposes only
- any draft is on no account to be published or disclosed.'

This may well provide an opportunity to signal that material uncertainty may no longer apply.

Care is required to ensure that the valuer's liability to the client does not go beyond what the valuer intends – the position will depend on the precise circumstances and indeed the jurisdiction to which the assignment is subject. See Red Book Global VPS 3 Section 1 paragraph 1.4.

It should also be noted that the safeguards concerning the maintenance of objectivity set out in PS 2 Section 3 paragraphs 3.13 to 3.15 must be strictly observed

Valuers are also discouraged from referring to any valuation or report as ‘formal’ or ‘informal’ as these terms may give rise to misunderstanding (see Red Book Global PS 2 Section 8 paragraph 8.4). It is preferable to be explicit about the nature of the advice and the restrictions or limitations accompanying it.

5. SCSI/RICS Output:

SCSI/RICS will publish on their website(s) the output of the SCSI Material Valuation Uncertainty Forum in a form such as the following:

The SCSI Material Valuation Uncertainty Forum (Ire) met on XX XX XXXX [DATE] to discuss material valuation uncertainty in Ireland real estate markets. The forum assessed this against the published criteria – link here. There was a consensus that reporting material valuation uncertainty may no longer be appropriate for:

XXXXX [ASSET TYPE(s)]

The outputs of the SCSI Material Valuation Uncertainty Forum (Ire) are based on a high-level overview of market conditions, and necessarily cannot take into account factors applying to specific assets, regions or markets. SCSI/RICS reminds regulated members that the decision whether to insert, maintain or remove commentary that a valuation is materially uncertain is that of the valuer, considering the specific attributes and performance of the individual asset and its market. Regulated members should consider on a case-by-case basis whether it would be appropriate to include commentary that a valuation is materially uncertain. They should have a sound rationale for the decision they reach upon such consideration and should maintain a record of that rationale for future reference. The views of the Forum are not a substitute for that process.

***Neither SCSI/RICS or any member of the Material Valuation Uncertainty Forum (Ire) accepts any responsibility, duty or liability to any party in respect of the contents of the Forum output. Any such responsibility, duty or liability is expressly disclaimed. SCSI/RICS and the Forum shall therefore not be held accountable, either collectively or individually, for any losses relating to or arising out of a valuer’s decision to insert, maintain or remove any declaration of material valuation uncertainty**.*

Appendix 1: Suggested discussion points when considering the lifting of a material uncertainty declaration specific to the impact of the COVID-19 health crisis in Ireland.

The factors set out below are subject to judgements at various levels i.e. individual assets, separate asset classes, the wider market and jurisdictional considerations. In general terms these might include but are not limited to the following.

- For assets where the market approach is the principle basis used for valuation, contemporary price discovery indicates a sufficient number of completed market transactions which have been instigated since significant government restrictions were implemented for the relevant jurisdiction. Note that relevant evidence may also be gleaned from other forms of market activity in addition to completed transactions, such as aborted transactions.

- There is contemporary evidence of a sufficient number of willing sellers, buyers and where relevant occupiers of a reasonable covenant for a normal functioning market.

- There is evidence from economic indicators relevant to the particular market to support valuation. This might include, for assets principally rented, rent and service charge collection levels and the extent and knowledge of revised landlord and tenant rent provisos for the asset(s) in question and the sector (or sub-sector where more relevant).

- Government, institutional, private, fund or lender finance is available in the relevant sector, sub-sector, asset type or typical occupier in order to facilitate liquidity, property transactions and the immediate financial security of occupiers.

- There is no sector or sub-sector specific statute, government advice or other relevant regulation that materially prevents the operational use of an asset, for example closure of licensed premises, the hospitality sector and non-essential retail outlets.

- Significant government-imposed restrictions, such as on the movement of people have either been released or government has set out a plan to do so that allows a better understanding of the market. This includes but is not limited to restrictions on public congregation, travel, logistics, work practice and leisure.

- Valuation is either capable of being undertaken without inspection, or with limited inspection or where inspection is essential, government and public health regulation restrictions have been lifted to the extent that inspection is allowed.

- It is agreed that the asset or assets being valued have greater certainty around security of occupational income due to, for example, being long dated annuity income with at least 20-years unexpired term certain with a secure covenant such as government or very strong investment grade.
- Where market trends for the asset(s) have run counter to the general trend because of them remaining operational and/or their essential nature during the crisis.

The above are not cumulative and their weighting may be more or less relevant dependent on the individual asset and market. As with all valuation, the judgment and expertise of the valuer, backed by evidence, is paramount.

Valuer discretion should again remain in all cases and if it is felt that any investment in the valuer's opinion remains materially uncertain, the clause should remain in place.

DATE: 4th September 2020