

# European Valuer



## Welcome to our (early) summer edition of European Valuer

Whilst the pandemic delayed the launch in March of the 1st Edition of European Business Valuation Standards (EBVS), as reported in Ella Dunphy's article starting on page 2, the Standards were pre-launched at the beginning of May and may be downloaded on [www.tegoval.org](http://www.tegoval.org)

The formal hard copy launch of EBVS, as well as that of a new edition of European Valuation Standards (EVS 2020) coinciding with the presentation of TEGoVA's new corporate image will now take place in Brussels on 30th October, ahead of TEGoVA's General Assembly the next day.

John Roberts, Editor

## Work begins on European Plant & Machinery Valuation Standards: the indispensable third pillar of TEGoVA standard setting

by Konstantinos P. Pallis



Valuers' professional memories of 2020 will of course be dominated by the challenges of coronavirus confinement for a profession for whom "desk-top working" is the very definition of incomplete, imprecise valuation practice. We shall also remember how we dealt with the shock to real estate markets and how some of us saw opportunity in the jaws of crisis (for which I strongly recommend to you the article of my colleague Roger Messenger in this issue).

But I think that, at least over time, 2020 will also be remembered as the year that, confident in the EU-recognised

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## There is opportunity for valuers in this crisis

by Roger Messenger



Covid 19 is having a material effect on property markets all over the world. These effects are not uniform between countries or even regionally within countries and will vary across different types and uses of property.

Inevitably that brings discussions about valuation uncertainty, lack of data and a different pattern and quantity of work for many valuers. In due course, valuations will be required as we emerge from the immediate crisis and work will flow, however, I am going to focus on ways valuers might use their skills in the pursuit of other opportunities as a result of the current difficulties.

Across Europe, the financial pressure is on property end users, who as occupying businesses are often tenants, and who are also generally the employer of most staff.

The hardest hit, both now and probably also in terms of the speed of recovery, are those companies that rely on footfall in their premises; be they shops, leisure properties, cafés or restaurants, the **sudden and catastrophic drop in income** often resulting from government enforced closure. After staff costs, the greatest overhead for many businesses is the property they occupy and we have seen many default on regular rent payments to landlords.

All leases will generally have a mechanism to deal with rent default, but even then, some government interventions have curbed landlord intervention in some instances – and in others, landlords have recognised that forcing a tenant to go bust might not be the best outcome for anyone.

Valuers can help. We are trained property professionals. **My firm has won a number of instructions to negotiate solutions with landlords on behalf of tenants.** For many, that will be an unfamiliar dialogue. Landlords and tenants will need to agree on whether to defer, suspend, reduce, or re-gear leases to manage a tenant's cash flow and minimise the risk of tenant failure and subsequent voids for landlords. It is far better for the parties to engage in a proactive dialogue to avoid a catastrophe than to put back the pieces afterwards.

Different outcomes emerge from these discussions, with some tenants being allowed to delay rent payments for a short period,

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while some may be deferred to a much later date and possibly spread out with interest accruing (or not). Sometimes a rent reduction is possible – or even total rent suspension. Another possibility may be to re-gear a lease to allow for a rent reduction in return for a longer lease. There is no one size that fits all.

In the midst of this, timing is critical, because tenants are often faced with a real cashflow problem at critical payment dates. In the UK, some landlords have assisted in allowing monthly payments in advance rather than quarterly payments in advance, or even payment monthly in arrears.

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If the tenant needs some relief, the last thing the landlord needs is a tenant going bust, as the prospect of re-letting at a decent rent any time soon might be limited. Even if potential tenants are around, they would be likely to drive a hard bargain.

Landlords are seeking advice from us. If they have mortgaged a property on which rental income is now restricted or deferred, they may need to reconfigure their own loans and that has consequential valuation issues as does any lease re-gearing.

**Both landlords and tenants are engaging by using their valuers to find work-around solutions, or in some cases maintain a watching brief to see where this goes and for how long.**

Tenants with no income do not want to pay for premises that the government has directed them to close, whilst landlords do not want to be the only ones to suffer the losses. Not all tenants are at the same level of difficulty and not all landlords have the financial ability to be generous to their tenants.

For the UK, a large number of rents are now in arrears in part or whole following the March quarter, and a workable agreed resolution between the parties is desirable before the June quarter, which is likely to present much the same problem. Whether it goes on beyond that to a third or more quarters remains to be seen, but the reality check for tenants and landlords may make them a little more cautious in new lease structures going forward. In recent years we have seen a move towards shorter leases with tenants reluctant to sign up for too many years. The need to be more **flexible** and **agile** as a business is almost the opposite to a ten-year lease with a fixed rental commitment. Shorter leases with options to renew may become more prolific.

The valuer can be there for either party (but not both at the same time) to **“hold hands”** in a difficult time, whilst earning some fees in advising and negotiating agreed property outcomes on behalf of their clients. Once lawyers are involved and start to attempt to recover arrears and/or possession, agreement generally becomes more difficult – and someone will have to pay the lawyers come what may! That only adds to the overheads of both sides.

If valuers proactively engage, the agreements can be settled and costs of disputes mostly avoided. ●

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## TEGoVA pre-launches European Business Valuation Standards (EBVS) – the beginning of a great opportunity for members

by Ella Dunphy



I have no doubt that by the time you read this we'll be seeing the end of the tunnel and preparing to catch up lost valuation ground. There's nothing wrong with our economy or the European Union's, we have no systemic financial crisis, it takes more than a virus to curb housing demand and our skills will be key to reigniting the real estate and banking

economy.

But a return to normal means just that – the issues we had going into the health crisis will be there as strong or stronger when we emerge. Specifically, the pressure from banks to get us to do more work for less pay and the pretention of some – illusory and highly dangerous for the financial system in my view – that you can get an “oven ready” determination of value without a valuer if you toss enough algorithms at it, will go on cutting into some of our business.

***“... it takes more than a virus to curb housing demand and our skills will be key to reigniting the real estate and banking economy.”***

That's a good reason not to be complacent, and crisis is useful for that; it keeps us on our toes looking for opportunity and for many of us, business valuation fits the bill. It's a vast, complex and high-income service market, and our skill and experience at valuing property mean we already have the valuation mindset, the ease with different methodologies and the special capacity to value the buildings that are often a key part of a business's assets and that other business valuers have to sub-contract to us anyway. All that gives us major shoe-in to business valuation practice.

Again, it's the combination of property and business valuation that's so attractive, that meshes so naturally with our working environment. Having an established property valuation practice in your community leads to all sorts of situations where happy clients would like nothing more than to be able to rely on you to value their whole business as well. It's a shame that many of us are unable to seize those opportunities.

That's why at TEGoVA, in response to increasing member demand, we took the bull by the horns and designed the first ever European Business Valuation Standards. The layout underscores the synergies with property valuation and with European Valuation Standards:

- EBVS 1 Market Value and Bases of Value Other than Market Value
- EBVS 2 The Valuation Process
- EBVS 3 The Valuation Approaches and Methods

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- EBVS 4 Reporting the Valuation
- EBVG 1 Control Premium, Discount for Lack of Control and Discount for Lack of Marketability
- EBVG 2 Discount Rates in the Discounted Cash Flow Method
- EBVG 3 Valuation of Intangible Assets
- Business Valuation and Sustainability
- European Business Valuers' Code of Conduct
- European Union Legislation and Business Valuation.

The sustainability and EU law parts are no mere general culture add-on; they point to the cutting edge of business valuation.

***“... it's important for the valuer to be able to recognise the EU hand behind the national law when estimating the likelihood and timescale of possible changes to regulatory impacts on the business being valued.”***

Part III puts sustainability and valuation in their EU and market context, exploring the concept of “green value” and providing business valuers with an initial checklist of possible points for sustainability review of a business, covering current operations, attention to costs and preparing for the future:

- finance, risks and overall sustainability
- energy
- water
- waste
- procurement
- materials and storage
- transport
- staff
- compliance and emergency response
- products
- accountability and communication.

The part on EU law is important because, even more than for property, the Union is truly the business valuer's oyster. A single, ever more integrated EU economy creates exponential growth in business and valuation work permeated with EU regulatory aspects. Indeed, as the EU regulates mostly through Directives that are transposed into national law, it's important for the valuer to be able to recognise the EU hand behind the national law when estimating the likelihood and timescale of possible changes to regulatory impacts on the business being valued.

It's been an honour and a pleasure designing these Standards with my colleagues in the European Business Valuation Standards Board. We had valuable input from some of the shining lights of business valuation in Europe and beyond, but it is significant that the core group are real estate valuers with business valuation practice.

We shall now turn to education and qualifications, so that TEGoVA valuers will soon have all they need to master the subject and attain market recognition. ●

**Ella Dunphy REV MRICS is a Member of the European Business Valuation Standards Board.**

## TEGoVA's special role on the EFRAG Advisory Panel on Intangibles

by Ivars Strautiņš



The virus sadly forced us to cancel the formal launch of European Business Valuation Standards (EBVS) planned for Warsaw in March and to reschedule for Brussels on 30 October, but that has not stopped a pre-launch and availability of the standards on the TEGoVA website.

The main driver for the creation of the first-ever such standards specifically for Europe was demand from valuers, their clients and regulators and now that we have the Standards, we have lost no time in re-entering the regulatory sphere, our first step being to join the **European Financial Reporting Advisory Group (EFRAG)'s Advisory Panel on Intangibles**.

***“Intangible asset valuation is a far cry from real estate valuation, as value arises not from any physical substance, but from rights, relationships, synergy of grouped intangibles and intellectual property rights. They are in fact of immense economic importance because the intangible assets created through innovation represent a major share of the value of today's businesses.”***

EFRAG is strategic, as the European Commission relies on its advice as to whether newly issued or revised IFRS Standards meet the criteria in the IAS Regulation for endorsement for use in the EU, including whether endorsement would be conducive to **the European public good**.

As a member of the European Business Valuation Standards Board which drafted EBVS, I have the honour of being the TEGoVA delegate to the EFRAG Advisory Panel on Intangibles, a subject well covered by EBVS's Guidance Note 3 on Valuation of Intangible Assets:

1. Introduction
2. Scope
3. Commentary on intangible asset categories
4. Data, documentation and information sources
5. Usual bases of value
6. Income approach
7. Market (Comparison) approach
8. Asset-based approach
9. Reconciliation processes
10. Legal aspects in valuation of intellectual property (IP).

### **The nature of intangible asset valuation**

Intangible asset valuation is a far cry from real estate valuation, as value arises not from any physical substance, but from rights, relationships, synergy of grouped intangibles and intellectual property rights. They are in fact of **immense economic importance** because the intangible assets created through innovation represent a major share of the value of today's businesses. The intellectual

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precedence of its real estate valuation standards over all others, TEGoVA spread its wings to business valuation and plant and machinery (P&M) valuation.

It is a very welcome fact that in recent years, TEGoVA has changed pace and geared up to cover more aspects of valuation, creating new products expected by its members and their customers becoming the prevailing standard-setting body in the EU. A stellar start was made with the superb **European Business Valuation Standards**, the first of their kind, filling an immense need among European valuers, businesses and regulators. I take this opportunity to congratulate Danijela Ilić and her colleagues on the European Business Valuation Standards Board for setting such a high bar for us to follow.

***“Environmental protection, energy conservation, health and safety and relevant topics are becoming drivers for the depreciation of assets and valuers need uniform guidance in dealing with such issues.”***

The *raison d'être* of European Plant and Machinery Standards shares a lot with business valuation:

- many valuers in a significant number of TEGoVA countries already practice P&M valuation and are not happy to follow standards from faraway places that do not take account of the European P&M environment
- in a mutating economic and professional environment where no source of activity is permanently guaranteed and new opportunities arise, P&M valuation offers high demand, high margin, AVM-free work and revenue flows
- and even more than business valuation, it is closely linked with valuation of the buildings containing the P&M, giving competitive edge in P&M valuation to valuers who already master real estate.

I remember, back in 2008, when I first attended TEGoVA's General Assembly and tried to explore the possibility of planning a standard for P&M, that I received a very definitive “no”, and of course there was good reason for that at the time because TEGoVA needed first to establish European supremacy for its mother ship real estate valuation standards. Yet the need was certainly already there: P&M is an inseparable asset class, intimately connected with manufacturing and construction activity, not to mention the logistics/transportation sector and practically every aspect of the financial cycle.

In most cases, its value is higher than the real estate assets that house it.

Therefore, it is only natural that P&M valuation attracts the interest of the banking sector, financing P&M acquisition with a multitude of financial instruments (from loans to leasing),

even though it is treated differently from real estate assets being used primarily as collateral. Regulators also have an increasing interest in this asset class, which is affecting our lives in many ways, financially, environmentally and from a health and safety perspective as well.

Many practising valuers throughout Europe are asked to assess the value of both real estate and P&M for lending purposes, financial reporting and business purposes. They are very capable of doing so, despite the lack of a set of standards covering the P&M valuations, but European standards make it easier and are key to high-level European congruence and progression of P&M valuation practice. The gap created by the lack of such standards is becoming ever more obvious as the EU regulatory framework evolves and new issues emerge.

Environmental protection, energy conservation, health and safety and relevant topics are becoming drivers for the depreciation of assets and valuers need uniform guidance in dealing with such issues.

Furthermore, harmonisation is needed throughout Europe regarding the treatment of specific plants and other structures in the context of a valuation project.

As an example, when P&M is required as collateral, a set of criteria is needed in order to determine which parts are considered as building facilities and included in a real estate valuation, and which are treated as separated, individual assets that can act as collateral on their own.

In a P&M valuation, the basic three valuation approaches (cost, market and income), although maintaining their core principles, vary significantly in their implementation compared to a real estate valuation. Concepts like “fixed assets” and “in situ”/“ex situ” values, scrap value and the three types of obsolescence (technological, functional and economic) and many more particular to P&M have to be defined, standardised and delivered to the public, in order to set a common language for everyday business conduct in this field.

So now TEGoVA is ready to tackle this topic as well and fill the void for European valuers, their customers and regulators. The Board of Directors of TEGoVA has founded the European Plant and Machinery Valuation Standards Board (EPMVSB) with a mandate to produce European Plant and Machinery Valuation Standards (EPMVS) for 2022, building on the legacy of EVS and EBVS.

TEGoVA is gearing up and many important initiatives will come to life in the forthcoming months, not only in standard setting but also regarding the training and professional upgrade of valuers. EPMVS will be one of them.

Stay tuned. ●

**Konstantinos P. Pallis REV, Dipl. Mech. Engineer, DEA is Chairman of the European Plant & Machinery Standards Board, Member of the Board of Directors of TEGoVA and Treasurer of the Association of Greek Valuers (AVAG).**

## The Art of Valuation in Times of Crisis (a personal view)



by Krzysztof Grzesik

No sooner had the world become engulfed in a crisis of an uncharted nature, than many valuers, on the advice of their professional associations and international recognised valuation standard

setters, including TEGoVA, sought comfort in so-called “valuation uncertainty” disclaimers. Perhaps as we move out of the current crisis, we should review the justification for such disclaimer clauses, which in most cases render a valuation unfit for purpose.

On the question of valuation uncertainty, European Valuation Standards 2016 (EVIP 2) state that, “The security of the valuation depends on the valuer’s application of professional skills to clear instructions and good evidence, acting in accordance with valuation standards. The better the evidence and the more professional the

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property rights associated with those assets are the legal underpinning for potential returns on investment in that innovation.

Intangible asset valuations may be required for a number of possible purposes, including acquisitions and disposals of businesses or parts of business, mergers, sales of intangible assets, loan guarantees, obtaining licences, establishing royalty payments, litigation, setting of compensation to the rightsholder for the damages as a result of the infringement, etc.

As most intangible assets, and IP in particular, are by their nature innovative and therefore different, each valuation case requires investigation, rather than an automatic calculation. As a result, IP valuation of a company's assets is an opinion, at a particular point in time. There are many factors involved and evidence can have a substantial impact on value conclusion. This is therefore a major high-value workstream for the valuation profession.

#### TEGoVA's role on the Panel

TEGoVA has an important specific role to play in the EFRAG Advisory Panel, as just about the only member with an SME focus, as the users and preparers on the Panel are from big public companies (ROCHE, PIRELLI, VIVENDI, BAYER, Galp Energia, etc.), who have to report under the IFRS and most of the valuer panellists represent investment advisors from companies like Duff & Phelps, PwC, Eurizon Capital, Newton Investment Management, APG Asset Management and DELOITTE. The most important issues that I have identified regarding reporting of intangibles are:

- lack of common understanding on the categories of internally created intangible assets important for the business entity being valued
- lack of measurement systems for most of the internally created intangible assets as well as value assessment methodologies
- absence of a legal framework ensuring transfer of proprietary rights on the subject assets.

Going forward, I want the Panel to produce **practical advice** for valuers on:

- identifying those currently non-reported internally generated assets of highest importance in forging investors' opinion on the value of the company
- applying the commonly accepted definitions of the individual assets under consideration and of the measurement principles
- providing a clear roadmap for how the generally accepted valuation methodologies set by the valuation standards and described in IAS 38 are to be applied to the subject assets.

Through European Valuer, I shall keep you periodically updated on the progress of the Panel's work and now, or at any other time, do not hesitate to input directly to me at [ivars@bkgriga.lv](mailto:ivars@bkgriga.lv) with copy to the TEGoVA Secretariat at [info@tegoval.org](mailto:info@tegoval.org) ●

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*appraisal, the more secure should be the valuation. The potential certainty of a valuation is challenged where markets are non-existent, dormant, thin or volatile."*

The problem I have with the above statement, which will not be repeated in the soon to be published EVS 2020, is that it implies that valuation is a science which strives towards certainty and provides a strong hint that in challenging times when markets are *non-existent, dormant, thin or volatile*, valuations are unreliable. In my view, this ignores the fact that valuation is not only science but also an art performed on the basis of the valuer's market knowledge and experience. It is exactly in times of economic crisis that a valuer's intuition and experience come into sharp focus and this should not be downplayed by a "valuation uncertainty" disclaimer clause.

Some recent cases help us draw conclusions on the nature, extent and relevance of "valuation uncertainty".

***"It is exactly in times of economic crisis that a valuer's intuition and experience come into sharp focus and this should not be downplayed by a "valuation uncertainty" disclaimer clause."***

Just a few weeks before markets were hit by the pandemic, valuers were being put under the spotlight in connection with their valuation of shopping centres, for example, following the sale of one prominent retail portfolio in the UK at more than 20% below the valuation. Such perceived "uncertainty" around valuations had led investors to withdraw money from open ended property funds.

"Valuation uncertainty" is also highlighted in the negligence cases so prevalent in the UK. A case in point is **Titan vs Colliers** (2014). In 2005, a good year for the real estate market, Colliers valued a group of warehouses in Germany for Credit Suisse at €135 million. On the strength of this valuation, Credit Suisse lent €110 million to the property owner. The loan was acquired by Titan, an SPV created by Credit Suisse to issue commercial mortgage backed securities (CMBS). A single tenant, Quelle, occupied the property. Quelle became insolvent, causing the borrower to default on the loan. Titan was unable to make payments to note holders under the CMBS and issued proceedings against Colliers for negligence.

In the High Court (1st instance), the judge found the valuer guilty of negligence. His finding that the **"True Market Value"** was €103 million had the effect of putting Colliers's valuation of €135 million outside of what the court considered to be a permissible margin of error of +/- 15%. On appeal, however, the Court of Appeal found that the 1st instance court's valuation of the property was incorrect. The Court of Appeal determined that the **"true value"** of the property was in fact €118.3 million. This brought Colliers' valuation within the 15% margin of error and Colliers was therefore held not negligent. The case is interesting not only because it seems to allow for a significant margin of error or **"variable certainty"** in the valuation of large commercial properties of +/- 15%, but also because "uncertainty" flows from the differences between the valuations of eminent valuers appearing as expert witnesses on both sides. One such valuation was as low as £76.6 million.

These cases underscore the degree of "valuation uncertainty" that is inherent in all **"opinions"** of value and to my mind, a health-cum-economic crisis does not necessarily make them even more uncertain. That being the case, what is the justification for crying "valuation uncertainty" during a crisis? ●

**Krzysztof Grzesik REV FRICS is Chairman of TEGoVA.**

