

European Valuer

ISSUE N°21
FEBRUARY 2021



EDITORIAL

**For real estate and valuation,
it was always clear where
Brexit would lead** _____ page 2

**#01 EU action for decarbonised
affordable housing**
Ciarán Cuffe MEP _____ page 4

**#02 What does it take for
'low transparency property
markets' to see the light?**
Nino Beraia and Sanja Radović _____ page 7

**#03 The virtual reality of
asset value diminution
and its compensation**
Magdalena Habdas _____ page 12

#04 The loss of hope
Krzysztof Grzesik _____ page 16



For real estate and valuation, it was always clear where Brexit would lead

The Brexit circus was true to itself to the very end and beyond; indeed it surpassed itself: endless hype about a 'bare bones', 'next-to-nothing' treaty. Exporters strangled by bureaucracy. European customs officials ripping ham sandwiches from British truck drivers' mouths. The reality is that the EU and the UK signed what is probably the most advanced, comprehensive and sophisticated trade agreement in modern history, probably even a shade more so than Canada-EU or EU-Japan.

It only seems modest if you compare it to being part of the EU, but that was hardly the point: this Treaty is in fact optimal from the point of view of a country seceding from the Union because anything even marginally more ambitious would have negated the whole purpose of Brexit: to escape the EU's 'lunar pull'.

That said, for real estate and valuation it's a game-changer.

Free movement of construction products emerges unscathed, not just because of zero tariffs and quotas, but because attic beams or bathroom tiles are not like squealing pigs or rashers of bacon: they are unlikely to prompt lengthy inspections at the border.

The freedom to buy and sell real estate anywhere in the Union changes nature. This absolute and inalienable right for all EU citizens becomes a facility for non-EU countries which, although enshrined in the EU Treaty, is peppered with loopholes. Though the loopholes apply to the free movement of capital in general, there is ominously specific mention of investment in real estate. That shouldn't be any threat to UK investors in EU property. This power is more likely to be used against, for instance, increasing Chinese purchase of EU farming land and of strategic assets including the real estate underpinning those assets.

It's from here on that it gets tricky.

Public procurement, which all national and local administrations in the EU must open to bids from anywhere in the Union, will now be closed to UK property companies and professionals, and the British government will be free to reserve tenders for its nationals as it had once tried to do for "English Partnerships" brownfield redevelopment schemes, making EU legal history in the failed attempt.

The freedom to provide services with or without establishment – including valuation services – is over, as is the recognition of professional qualifications, illustrated in the focus-enhancing [European Commission Communication on readiness for Brexit of 9 July 2020](#) which states that as of 1 January 2021, "*UK nationals, **irrespective of where they acquired their qualifications**, and EU citizens with qualifications acquired in the UK will need to have them recognised in the relevant Member State on the basis of that country's rules for third-country* nationals and/or third-country qualifications*".

* Means 'non-EU'

And that's just the tip of the iceberg, because UK valuers or estate agents, like almost all non-EU service providers, will need to apply for a work visa, even for a short job, and getting it won't be easy because, in dealing with non-EU service providers, each different EU member state is free to erect as many obstacles as it wants – and many do, inter alia:

- ▶ An 'economic means test' to see whether foreign help is really needed or whether, rather, there is enough local talent to provide for the need;
- ▶ 'Requiring special [local] knowledge relevant to the service being provided';
- ▶ Demanding the local professional qualification;
- ▶ Obligation on the EU company paying for the UK service to demonstrate that it can't find an EU citizen to do the work.

It's a great practical way to discover the ingenuity that countries deploy to protect their services markets, erecting obstacles that the EU took half a century to dismantle between its member states.

UK real estate service providers will also be impacted by EU treatment of their clients, for instance valuers in their relations with financial institutions. Banks and funds will have the freedom to offer their services in only a very restricted number of fields, and even those only if and so long as the European Commission decides that there is sufficient 'equivalence' between the way EU and UK financials are regulated in these specific areas. The Commission answers to no one on this and can end equivalence at any time, so there is no security. As the banks and funds will be doing much less cross-border work, so will their valuation service providers.

But again, that's the name of the Brexit game.

Michael MacBrien, Editor



#01

EU action for decarbonised affordable housing



Ciarán Cuffe MEP

"...buildings are responsible for about 40% of the EU's total energy consumption..."

EVS 2020's ground-breaking Standard 6 "Valuation and Energy Efficiency" for the first time instructs valuers determining Market Value to take account of legal obligations to renovate buildings to a higher level of energy efficiency. This revolution was caused by EU law and EU-mandated national law creating those legal obligations and will be completed with a new package of EU law this year. The European Parliament, as usual, played an early and decisive role in raising the European Commission's ambition, and their key leader on this was Ciarán Cuffe MEP, (Greens) representing Dublin. In the article below, he sets out his vision of a European Renovation Wave tailored to local needs and leveraging decarbonisation to achieve better, safer and more affordable living environments.

In January 2020, I was fortunate to be selected as the European parliament's Rapporteur for its own-initiative report on "Maximising the Energy Efficiency of the EU building stock". It was my ambition that this report would send a clear, strong signal to the European Commission ahead of its planned Renovation Wave strategy.

Around the same time as I was selected as Rapporteur, the European Commission put forward its European Green Deal initiative. The Green Deal is the flagship policy of the EU. It is a legislative overhaul that will align our European rules and regulations to reducing our carbon emissions and become more environmentally friendly

in general. It's no secret that to achieve our ambitious climate goals (becoming a climate-neutral continent by 2050, for example), we have to address the environmental impact of buildings. Overall, buildings are responsible for about 40% of the EU's total energy consumption, and for 36% of its greenhouse gas emissions. As well as that, more than 220 million building units, representing 85% of the EU's building stock, were built before 2001, while 85-95% of the buildings that exist today will still be standing in 2050. These figures alone demonstrate that when it comes to tackling the climate crisis, improving the energy efficiency of buildings is a low hanging fruit.

The COVID crisis has made the need to address the energy efficiency of buildings all the more clear. For the first time in living memory, people are confined to their homes for increasingly long periods. Now more than ever is it essential that people have a safe place to call home. Over 40 million Europeans cannot keep their home adequately heated in the winter, and 98 million Europeans cannot keep their home adequately cool in the summer. Around 7 million Europeans receive disconnection notices per year, impacting physical and mental health, particularly in the current crisis and confinement period.

Incidentally, the day I submitted the first draft of the own-initiative report, Member States were due to submit their long-term renovation strategies under the Energy Performance of Buildings Directive. Unfortunately, only five Member States submitted their strategies on time. Undoubtedly, this is an issue that must be addressed. Despite the initiatives and the work of the European Commission and the European Parliament in promoting EU wide renovations, little can be done without Member State support. Therefore, I sought to promote a "neighbourhood approach" to renovations aiming to empower and enable local authorities to increase their renovation potential.

Renovations should be tailored to local needs, and ensure that local people, especially those at risk of energy poverty, be the primary beneficiaries of renovation programmes. We did not want to have a "top-down" approach whereby local municipalities might feel that this is just *another* directive coming from Brussels but rather try to encourage and facilitate local authorities in gaining access to EU funds and programmes that would facilitate an increase in local

renovations. This has the added benefit of providing local jobs and giving a community the final say over how their buildings are renovated.

The promotion of one-stop-shops is a great example of how the EU can really engage with local communities while ensuring that the Renovation Wave spreads across Europe. Another example is the introduction of minimum energy performance standards for the worst-performing buildings. They allow us to target buildings with poor energy ratings (such as housing etc.) and progressively raise the energy efficiency over time. I was delighted to see that the Commission took this recommendation on board in the Renovation Wave. We will see this introduced in the upcoming revision of the Energy Performance of Buildings Directive.

From an Irish perspective, it would be great to see the inclusion of renovation projects in the Country's national COVID recovery plan, which is due to the European Commission for 30 April 2021. This would give Ireland increased EU funds for renovation programmes and would have the potential to finance our National Retrofit Strategy. We would be able to increase the energy rating of hundreds of Irish homes while also lowering their carbon emission rate.



"Now more than ever is it essential that people have a safe place to call home."



Incentivising the private sector in Ireland to help finance renovation projects would really get the ball rolling in terms of *private* housing. We have seen some really successful examples of financing at a local level in other European countries that Ireland could take an example from like Lithuania and the Czech Republic and I think if you could get "commercial banks" interested in working on this level, it would do a tremendous amount of good. Now, there is a very slow rate of return on renovations; hence the reason why some banks are slow to invest.

I believe that increasing renovations can increase green employment, the quality and health of people's homes, and raise our environmental standards. This year in Brussels, we'll be revising three important pieces of

legislation; the Renewable Energy Directive, the Energy Efficiency Directive, and the Energy Performance of Buildings Directive to align them with our 2030 climate goals. This will be an opportunity for the EU to increase its ambition when it comes to ensuring that buildings become part of the climate solution and provide a healthy space for people. It is now up to the EU and its Member States to ensure that Europe reaps the benefits of increased renovations. If we work together on European, national, and local levels, we can make sure that the Renovation Wave is a success for all.

"...increasing renovations can increase green employment, the quality and health of people's homes, and raise our environmental standards."

#02

What does it take for 'low transparency property markets' to see the light?

European Valuer interviews Nino Beraia and Sanja Radović



Nino Beraia



Sanja Radović

At the TEGOVA General Assembly in Sofia on 12 October 2019, there was a very high level debate on whether the Comparable Method should be restricted to sales prices or whether it can accommodate asking prices, etc. That led to the report "Pricing to Market" by Nick French and finally, a major change to EVS which now states:

"6.2. Ideally the Comparative Method assesses Market Value through an analysis of prices obtained from sales or lettings of properties similar to the subject property followed by adjustment of the unit values to take account of differences between the comparable properties and the subject property. However, valuers should also have regard to other relevant market information and data upon which they may need to place greater reliance particularly

in those markets or situations where information about transactions is either unreliable or simply not available."

EVS 2020, Part II, Valuation Methodology, p.154-5

Professor French distinguished between 'highly transparent', 'transparent' and 'semi-transparent' property markets and was quite the diplomat:

"Each country will have a different hierarchy of comparable evidence and the fact that different countries use different sources of comparison as their principal signpost for determining market value is a natural consequence of varied market practices. Difference does not equate with less rigour."

Pricing to Market, p.24, paragraph 3

Nonetheless, global and European investors bring work and income for the whole local real estate value chain and they totemise transparency. Surely, having your market in the 'highly transparent' category is a competitive advantage in terms of investment attraction.

But how do you get there? European Valuer interviews two valuation authorities from 'semi-transparent' countries: Nino Beraia for Georgia and Sanja Radović for Montenegro:

"...having your market in the 'highly transparent' category is a competitive advantage..."

On Professor French's TABLE 1 (p.12) – A Hierarchy of Comparable Evidence, the first three are 'hard' evidence and the rest is increasingly 'soft'. The first 9 are:

1. Recent Sales/lettings where the valuer was party to the transaction and had access to all relevant information;
2. Recent Sales/lettings where a colleague in the same company was party to the transaction and the valuer has access to all relevant information;
3. Recent Sales/lettings where a colleague in a different company was party to the transaction and they provide the valuer with details of the transaction;
4. Publicly available information of recent transactions listed in a professional magazine;
5. Publicly available information of recent transactions listed for free on the internet Database;
6. Government information of recent transactions listed on the internet;
7. Government Listing or Cadaster – information of transactions listed for free on the internet;
8. Government Listing or Cadaster – information of transactions listed for a fee on the internet;
9. Market information on the reported sale/letting price of the property being valued.

Why is it so difficult on your market to get the information listed in 1-9 above? What are the reasons for this 'opacity'? "Different market practices"? as Prof. French writes, but if so, how is that? What does it mean?

Nino Beraia:

The valuer is only very rarely directly informed about the details of the deal, as the law does not require valuation prior to sale/letting of the property. There are no such services as "Publicly available information of recent transactions listed for free on the internet Database" or "Private Subscription Service". These last two don't exist because estate agents are keeping their information (even information of prior periods) private and the answer of one agent on this topic was: "The only asset I have to sell is information – so why should I have to disclose it for any reason?". Even though transparency is very much promoted by the government, the inertia of distrust persists.

Since 2010 in Georgia, we've had the Government listing (Cadaster) of transactions of real estate. Information is not free, but readily accessible. The database includes information about the date of transaction, price, cadaster code and type of the property, total area. Quality of information is improving year by year, but the valuer has to apply a lot of skills and conduct additional research to verify and use this information, i.e.

was the deal done under market conditions (unrelated parties, no additional obligations, etc.)? The database contains no information on the quality of the improvements. It's a handy tool for gauging the dynamics of the real estate market, but it's difficult to retrieve information about price index changes. Bottom line: the database is inadequate because it was not initially designed with information for independent valuers in mind.

Sanja Radović:

In Montenegro there is no central systemised database of realised transactions for real estate sales. Valuers rely predominantly on information available through asking prices (sale adverts and articles in media, social networks and the like), as well as their own databases consisting predominantly of client contracts.

Even when the contracts of transactions are available, there is always some uncertainty as to their accuracy, because quite often the sales price in the contract is lower than the actual sales price (tax avoidance).

"The database is inadequate because it was not initially designed with information for independent valuers in mind."



This situation makes work quite challenging for the tax office, courts, banking sector and valuers as well as reputable investors who may endeavour to invest in Montenegro. It gives way to a 'grey economy', foments corruption, weakens the role of institutions and creates legal uncertainty.

***Is this limited transparency a problem?
Do you consider that the means at your disposal
(asking prices, etc.) enable valuation reports
that are as rigorous as in countries with readily
available sales prices or is it a real handicap?***

NB:

We have to pose the question: Limited transparency is a problem for whom?

For investors, for sure. It's an axiom that "A more transparent market can attract more investors".

For estate agents, not at all, this is their biotope, where their exclusive information is for sale.

For valuers, the scale of the problem of working in a limited transparency environment is an open question – for sure, working with 100% reliable sales information with all data needed for valuation is an advantage, knowing that the agreement was completed in market conditions – one can perform desktop valuations without any additional effort. But the quality of the valuation report can also be very high

when a skilled valuer combines the relatively limited sales information with the offer information, the latter being more complete: sellers and agents have a vested interest in bringing full information about the property to the market place.

SR:

Limited transparency is a problem, but not always. Sometimes 'hard evidence' of a transaction may lead to the wrong conclusion, not only because of an inaccurate sale price, but also due to other impacts related to frequent changes to the law. On the other hand, Montenegro as a small country (13,800 km², population of around 650,000) has strong 'informal communication channels' where information circulates quite quickly by word of mouth.

However, such informal information, though it may be accurate, cannot fully compensate lack of official data, raising a particular challenge, for example in court proceedings and the like, where official evidence of transaction is required as proof.

Although the weaknesses and deficiencies of the statistical public data system do not undermine the credibility of valuations in Montenegro, they do cause a significant challenge for real estate valuers and court experts and require significantly more experience in making valuations.

***"Limited transparency is a
problem, but not always."***

What are the obstacles to improving the situation? Are there vested interests holding reform back? Who gains from the status quo? Is corruption a factor? The black economy with transactions reported under the real price? Is there a nomenclatura of valuation companies who monopolise the information?

NB:

The real estate market in Georgia has many similarities with the Eastern European and post-Soviet countries, but there are some significant differences as well. Georgia in the last decade has witnessed the strengthening of democratic institutions and elimination of bureaucracy. The land cadaster was reformed more than a decade ago and is performing very well. Just one example regarding real property: when purchasing property in Georgia, registration of property rights takes just one day. Information about real property ownership of any person or any property can be obtained online and data is absolutely transparent. The national agency of public register does provide a limited but improving database of transactions as described earlier.

In 2016, a reform in the audit sector encouraged legal entities to be more transparent. Valuers could feel the effect of the reform immediately

– sales prices in the database of transactions can be considered reliable if at least one party to the agreement is a legal entity. Annual financial reports of companies are published online for free.

Corruption is not a factor in Georgia. Nobody benefits directly from the lack of transparency. Probably some inconsistencies in implementation and a need to upgrade systems are factors.

The fact that some physical persons do not indicate the sales price correctly can be put down to cultural and historical inertia and will probably be eliminated.

SR:

I see the main obstacle to improving the situation mainly in the lack of coordination between relevant government institutions and insufficient quality of regulations relating to this problem.

In my opinion, incompetent and unskilled staff in relevant government institutions frequently cause more problems in area of legal framework and practice than monopoly and corruption. Vested interests, monopoly and corruption are significant but not the key factors in the equation. It cannot be said that there are companies or organisations that monopolise this type of information/data, because this information, even where it exists, is not adapted to valuation purposes (it is not systematised, and searching for it is a Sisyphean task).

Without doubt, this unregulated situation mostly suits the construction lobby and multi-property owners who profit from unregistered and un-taxed properties.

For real improvement in the accessibility of true, complete and speedy public data/information, the key is competent, expert staff. In Montenegro, ignorance often trumps bad intentions.

Is the problem at the level of the public authorities? Is the cadaster inefficient? Can the EU help, for instance in terms of demanding regulatory/administrative changes and/or subsidising modernisation of processes? (NDLR: the EU helps candidate EU member states and Eastern Partnership countries)

NB:

From a valuation point of view, cadaster inefficiency is more a technical issue, an issue of communication between valuers and public authorities, than a problem of public authorities themselves. Valuers need to show the authorities how small changes can benefit valuation practice and enhance market transparency.

The EU has already helped a lot in supporting public administration reform in Georgia. Subsidising the process of upgrading the transaction database would be very welcome.

Changing the law to require valuation prior to real property transactions would give a huge boost to market transparency. That way valuers can be parties to the transaction, have access to all relevant information, and can organise and share this information so that the French Report's so-called 'hard information' becomes accessible in Georgia as well.



SR:

It's primarily a public authority problem at both state and local level in Montenegro, but it's not recognised as a priority. There is no required level of communication and coordination between key institutions (Chamber of Notaries, tax administration, local governments, Central Bank, statistical office...) and professional organisations. The sidelining of professional valuers and their associations leads to non-effective solutions.

The European Union could significantly help to overcome these problems, primarily by supporting training, improving the legal framework and by subsidising the modernisation of technological aspects of the process.

What needs to be done and in your opinion how important – or not – is it for your market to shift to greater transparency?

NB:

It is very important to complete and sanctuarise the process of upgrading the public registry database of transactions. And legal reform requiring valuation of real property prior to any market transaction would be a game-changer.

I would add that the experience of Georgian experts involved in land and cadaster reform and then invited to 'export' this experience and knowledge to other countries proves that there is no general theory of how a 'copy-paste' approach to regulation will affect the markets of under-developed countries. Every country needs to be considered separately, on a 'case-by-case' basis.

SR:

What needs to be done to make this happen? In my opinion, it is necessary to:

- ▶ Adopt a unique strategy for development and implementation of this project;
- ▶ Institute lead partners to continue the work on the establishment of the real estate cadaster;
- ▶ Harmonise connected tax policy, notarial services, local government, spatial organisation, etc. to clearly indicate the individual roles of all actors in this work;
- ▶ Provide the necessary resources for those directly engaged in the work, as well as for the development of software solutions and the necessary licensing system for the construction of the registry information system;
- ▶ Design and organise workshops and provide professional training to all actors who will provide the centralised system with the necessary information through their web applications;
- ▶ Perform monitoring and evaluation.

All these processes should be managed by the state, through its line ministries with continuous cooperation with the association of valuers in Montenegro. This is the only way to reach a quick and comprehensive solution to the problem.

"The European Union could significantly help to overcome these problems ..."

Nino Beraia PhD MRICS REV is Vice President of the Independent Valuers Society of Georgia.

Sanja Radović MSc REV is President of the Institute of Certified Valuers of Montenegro.

#03

The virtual reality of asset value diminution and its compensation



Magdalena Habdas

1. Introductory comments

The loss of market value of an asset is a frequent occurrence that most, if not all, owners would rather not experience. Unfortunately, this phenomenon is usually unavoidable and happens for a plethora of reasons. Some of them stem from the laws of nature (e.g. physical depreciation of material objects), but others may be connected with legal relations arising from tort (e.g. nuisance), contract (e.g. improper performance of repairs), or public law (expropriation/condemnation, environmental protection/permits, other forms of public intervention). The question that inevitably arises is whether loss of market value qualifies as legal injury that can be compensated. Bearing in mind that opinions about value provided by professional valuers are indispensable in resolving disputes regarding value impairment of real estate or business interests, understanding legal and economic challenges of compensating loss of market value is important.

At first sight the issue may not seem very complicated. If someone's action or inaction has caused the loss of value of someone else's property, it seems logical that a possibility to claim damages should exist. The matter at hand is, however, not that simple, because compensation will only be due if the premises of liability set out in the law are fulfilled and these always require that a number of conditions be met. Different requirements will be set out in the law when liability is fault based, risk based, no fault based, equity based, concerns wrongful acts, or legal acts that adversely affect the market value of property. Depending on the above, claiming damages may or may not be possible and if it is allowed, compensation may be limited in scope or time.

"The question [...] is whether loss of market value qualifies as legal injury that can be compensated."

Assuming that all of the above factors have fallen neatly into place, the last obstacle remains, namely establishing whether loss of market value is an actual injury. Damages can only be awarded for sustained and not theoretical or future injury. Their role is to put the injured party in a position s/he would have been in if it weren't for the event causing loss. The latter thus needs to be real and definite as opposed to virtual and temporary.



2. Market value loss and compensable injury

Calculating loss of market value may be necessary in three types of situations. The first involves an asset which has been damaged physically (contamination of land, car damage in a road accident). In order to express the extent of damage in monetary terms, one may either calculate the costs of repairing the asset or, alternatively, the loss of that asset's market value, depending on which is easier to perform and allows for a more precise calculation.

The second situation concerns legal damage to the asset, e.g. introducing land use restrictions, downzoning, etc., in which expressing loss as a monetary amount will usually involve calculating the loss of market value. The first situation is not problematic, however the second one poses challenges, because "legal damage" cannot be calculated as costs of remedial activities, but through recourse to market value. The latter, however, is subject to fluctuations and may therefore be argued not to be definitive.

A similar complication arises in the third situation, where the only injury is loss of the asset's market value. An example of this is loss of market value of land which itself is not contaminated but which is in a neighborhood that has the potential to contaminate it or compromise the use and enjoyment of the land and thereby negatively influences market value. Recourse to market value as both the proof and measure of legally compensable loss is questionable because, as has already been mentioned, that loss may be temporal, fluctuate over time and therefore be theoretical for as long as it has not been confirmed in a market transaction.

Courts across all jurisdictions struggle with the problem of when the loss of an asset's market value deserves compensation and is legally justified. The matter concerns various types of assets beginning with financial

securities, through movables, to real estate. Depending on the type of liability applicable in a given case it may be argued that:

- ▶ The preservation of market value is not a part of the contractual bargain;
- ▶ Stigmatisation of land requires a third party's fear for which the defendant cannot be held liable;
- ▶ Or loss of market value may be a measure of damage, but not damage itself.

An important explanation as to why loss of market value unaccompanied by other damage to the asset may still be classified as compensable injury is the difference between the economic lifetime of an asset and the investment horizon of its owner. The closer the economic lifetime of an asset to the investment horizon, the less reason to argue that loss of market value constitutes legal injury. If a given asset, whether financial, immaterial or physical is usually held until its maturity or end of legal/physical utility, then it will not be resold on the market and thus its loss of market value is irrelevant and does not constitute legal injury. In other words, loss of market value may be a loss, but not one that classifies as legal damage (*damnum absque injuria*).

On one end of the spectrum one can place typical consumable goods and on the other, selected financial securities and real estate, both of which usually have a significantly longer economic lifetime than the investment horizon of their consecutive owners. Cars could be an example located somewhere in the middle of this spectrum as they are usually resold, however depending on the type of the car, the investment horizon may or may not approach its economic lifetime.

The above justification of considering loss of market value as compensable injury usually coincides with an intuitive understanding of damage that deserves reparation, however it is not always consciously understood by courts and lawyers. This is unfortunate, because determining

when one is dealing with legally significant loss enables rejection of all cases of market value loss that are beyond the scope of legal interest. Once that is accomplished, the last obstacle that remains is considering whether the legally relevant injury has actually been sustained.

3. Unrealised loss

The obvious question is whether loss has actually been sustained when an asset, meeting the criteria mentioned above, has not yet been traded on the market and it may even be questionable whether the owner will in fact sell it before the end of its economic lifetime. As stated in the introductory comments, the loss must be real and not virtual. In order to award damages for loss of market value, courts will often require proof that it is permanent and cannot be corrected by the application of remedies provided in special regulations. For example if market value diminution of land is caused by an easement of necessary way, provisions entitling the landowner to demand adequate remuneration for such an easement will be seen as also resolving the issue of any loss of market value of land caused by the existence of that easement. Nevertheless, even when one is satisfied that loss is permanent and has not been

remedied, its level needs to be ascertained and this becomes complicated due to the fact that market value fluctuates.

If loss for which damages are awarded is to be real, then it must somehow be fixed in time and verified. It seems that since one is relying on a loss of market value, then the market is where verification of sustained loss and its amount should take place. Surely the verification of the sustained loss cannot depend on when litigation is brought to court as this would, depending on luck or lack thereof, create either windfall payments or deprive the plaintiff of compensation if the market is volatile or undergoing changes. Therefore compensating loss of market value is least controversial when it has been confirmed on the market, by an objective event such as a sale, mortgage loan, contribution in kind to a company, exchange, etc.



If special legislation that deals with loss of market value exists, such as compensation for regulatory takings (i.e. restrictions introduced on use of land in local development plans) or for value impairment caused by expropriation of only a part of real estate, it should be carefully drafted to ensure that compensation does not concern illusory loss, but damage that has been realized, verified and fixed in time.

An example of the above dilemmas at work is an English judgment that concerned compensation for loss of value caused by nuisance created by military aircraft flying over the plaintiff's estate (Dennis v Ministry of Defence, 2003). The valuations provided by four valuers (two valuations presented by each party to the dispute) led the court to conclude that loss of capital market value amounted to 4,000,000 GBP, however the court

was not satisfied that injury had actually been sustained. In the case at hand, noisy aircraft were to cease operation within 10 years from the year the case was being decided, which meant that the value would be restored. In the event that these planes were replaced by other ones and excessive noise continued, the plaintiff would have a new cause of action. Consequently, the court concluded that since the plaintiff was not planning to sell the estate (indeed the estate was a historical one that had been in the plaintiff's family for many years) and wasn't under obligation to sell within the next 10 years, loss of capital value was to a large extent virtual. The court agreed to consider it only in the context of a risk that unforeseen circumstances may cause the need to sell before value was restored, but assessed that risk as low, between 5-10% of the calculated loss of market value. This resulted in awarding damages of 300,000 GBP which reflected the plaintiff's risk of having to sustain capital loss if extraordinary circumstances arose, but was not designed to cover market value diminution, which was classified as temporary and illusory. This case demonstrates the various legal and economic aspects that come into play, when damages for the diminution in market value are to be awarded.

4. Conclusions

Although the loss of market value may be real and possible to calculate, it is important to remember that in itself it is not a sufficient reason to claim damages. As discussed, the law contains various requirements that must be met in order for loss or damage to qualify as legal injury that may be compensated. That injury must be real and sustained, otherwise there is great risk of plaintiffs recovering unjustified gains (windfall).

When the law in force contains special regulations which specify when and to what extent loss of market value is to be compensated, their aim should be to exclude the possibility of being compensated for illusory losses, which are not permanent or which fluctuate over time. Particularly in cases which are resolved pursuant to general legal provisions, courts experience difficulties in deciding when loss of market value should be compensated. In effect, inconsistent judgments are issued with explanations that may be questionable both from a legal and economic perspective. Another aspect that cannot be neglected is differentiating between correlation

and causation, since only the latter triggers liability. Correlation only indicates that occurrences are somehow linked and demonstrate a certain amount of interdependence, however it does not prove that one occurrence causes a given event. Correlation is therefore not sufficient to prove that a specified activity of the defendant was the cause of loss and this is necessary if liability is to be assigned.

As always, in cases concerning compensation of market value loss of an asset, the devil is in the detail, however being aware of the challenges in properly applying the law and economic principles is the first step to avoiding unwarranted transfers of wealth through compensation payments. That is why professional valuers who assist the parties to the dispute or the court should be aware not only of the various aspects to be considered in calculating the diminution of market value, but also of the implications and limitations of such calculations.

"... the loss of market value [...] in itself [...] is not a sufficient reason to claim damages."

Magdalena Habdas PhD is a qualified real estate valuer, attorney-at-law and Associate Professor at the Faculty of Law and Administration, University of Silesia, in Katowice.

#04

The loss of hope



Krzysztof Grzesik

Valuers will have noted that those familiar yet often misunderstood words "Hope Value" have disappeared from TEGOVA's 9th Edition of European Valuation Standards (EVS 2020). At the same time the definition of "Highest and Best Use" has been amended to incorporate that very concept.

"Hope Value" which featured in some depth in previous editions of EVS was nevertheless interpreted in a variety of ways and often mistaken for a value in the future, which it is not. It has always been a part of the market value of the property at the date of valuation being an element of that market value lying somewhere between the value of a property for an optimal legally permissible use and its value for an even more valuable use likely to become legally permissible in the future. The actual amount of hope value was a matter of valuation judgement depending largely on the extent of the perceived likelihood of a non-permitted use or development becoming reality in the future.

The key to understanding this British concept lies with an equal awareness of the American concept of "Highest and Best Use" and its evolution.

Highest and Best Use

EVS 2009 stated that Market Value is "...in principle based on the highest and best use of the property" defined as "The most probable use of the property which is physically possible, appropriately justified, **legally permissible**, financially feasible, and which results in the highest value of the property being valued". The latter definition was taken from IVS 2007 (8th Edition) published by the IVSC.

However, the words "**legally permissible**" gave rise to problems of interpretation. In particular, valuers in countries with local master plans and formal zoning systems became uncertain about the assumption to be made about the value, of a use which whilst not legally permissible through lack of zoning, at the date of valuation, was likely to become legally permissible sometime in the future. For example, in the case of a site suitable for office development but zoned residential, or land zoned agricultural but suitable for warehousing or retail development.

In response, TEGOVA in its 7th (2012) and 8th (2016) editions of EVS moved away from endorsing the concept of Highest and Best Use in favour of a less restrictive interpretation of the definition of market value which could reflect so called Hope Value.

EVS 2016 paragraph 5.3.5 explained that "**Hope value** is used to describe an uplift in value which the market is willing to pay in the hope of a higher value use or development opportunity being achievable than is currently permitted under development control, existing infrastructure constraints or other limitations currently in place. It is an element within the Market Value of the property being considered... It will reflect an appraisal of the probability that the market places on that higher value use or development being achieved, the costs likely to be incurred in doing so, the time scale and any other associated factors in bringing it about. Fundamentally, it will allow for the possibility that the envisaged use may

not be achieved. While descriptive of that uplift, it does not exist as a separate value but helps explain the Market Value of the property which must be judged from the available evidence just as much as any other part of the valuation. Hope value is not a special value as it represents the market place's reasonable expectations as to the opportunities offered by the property".

EVS 2020 now seeks to eliminate any misunderstandings arising out of the definition of highest and best use on the one hand and hope value on the other by simplifying, streamlining and combining the two concepts in a single definition as follows;

"5.3.4 The concept of 'highest and best use' (HABU) is integral to Market Value and is the use of a property that is physically possible, reasonably probable, legal **or likely to become so**, and that results in the highest value of the property at the date of valuation.

'physically possible': There can be a reasonably probable and legal use which offers the highest value for the property, but is inoperable if, for instance, poor soil quality means that the foundations could not bear the size of the construction envisaged.

'reasonably probable': disregarding specialist uses that might occur to a single bidder. **It also allows consideration of uses thought likely to become possible, as for example, where existing infrastructure constraints or other physical limitations are currently in place but are likely to be eased in the future (for example by the building of a new road or a flood alleviation scheme).**

'legal or likely to become so': **potential buyers perceive that a planning authority is likely to allow a change of use or permit a proposed development in the foreseeable future, or legislation is likely to change to render a currently illegal use or development legal. Other situations might concern a use thought likely to be decriminalised or where a licensing regime is considered likely to become more or less stringent.**

'the highest value': It will reflect an appraisal of the probability that the market places on the highest value use or development being achieved, the costs likely to be incurred and, where relevant, the

return on investment likely to be earned in doing so, the time scale and any other associated factors in bringing it about.

A valuation taking into account a 'likely' or "reasonably probable" use will only reflect an element of the uplift in value that is expected to result once such use is fully permitted or where relevant, other constraints have been lifted.

5.3.5 In most cases valuers will quickly ascertain that HABU is the same as existing use. Sometimes they may identify a more valuable use but conclude that the costs of such change of use would be too great and therefore HABU would still equal value in existing use at the date of valuation."

The above text fragment from EVS 2020 – particularly the wording shown in bold – effectively incorporates the concept of hope value in an expanded definition of highest and best use.

"EVS 2020 now seeks to eliminate any misunderstandings arising out of the definition of highest and best use on the one hand and hope value on the other by [...] combining the two concepts in a single definition."



To contribute an article or to send
a letter to the editor commenting on one,
contact info@tegova.org