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Spanish technical architects are valuing energy efficiency ***now***.

Alfredo Sanz Corma, President of the Spanish General Council of Technical Architecture

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The Single Market

Cornerstone of everything real estate and valuation take for granted

The other day, the Single Market blew thirty candles and nobody noticed. The Commission issued a statement, but it read like ChatGPT.

At best, market analysts and players have some sense of the Single Market being "a good thing", but only generally, for all sectors of the economy, not especially real estate, perhaps especially *not* real estate because, even if the days are gone when British officials would argue that EU law didn't apply to public procurement for their "English Partnership" brown-field development schemes because "buildings don't cross borders", still real estate is perceived by many as a Single Market sideshow – Prosecco, yes, buildings no.

And yet, EU free movement of people, goods, services and capital is the life blood of every level of the construction/property chain, honed by Commission cartel busting in construction, cement, concrete, plasterboard, copper plumbing, bathroom fittings and lifts (the last twice, the second time with a then record € 900 million fine). Real estate and mortgage lending are a systemic part of financial markets governed by Single Market capital requirements and other banking supervision rules, and real estate investment is the second biggest capital flow in and into the Union after computer parts.

> *"Recent research shows that the EU is now more integrated than the U.S."*

In fact, the construction/property chain is subject to the same degree of integration as most sectors of the EU economy, and for all sectors it runs deep. Recent research shows that the EU is now more integrated than the U.S. from a regulatory standpoint with stricter requirements in the EU for member states to accept internal flows of goods and services than exist in the U.S. internal market[1], while intra-EU trade costs in goods are estimated to be lower than trade costs faced when trading products across U.S. federal states[2].

[1] Parsons, Matthijs, Springer (2021). Why Did Europe's Single Market Surpass America's? (cited in the 2023 Annual Single Market Report (ASMR) SWD(2023) 26 final, 31.1.2023)

[2] Head, K., & Mayer, T. (2021). The United States of Europe: A gravity model evaluation of the four freedoms. Journal of Economic Perspectives, 35(2), 23-48. (ASMR 2023)

This incremental thirty-year enterprise could seem pedestrian in the shadow of Europeans' new effort to face health, climate and security threats together, were it not that all those great projects are underpinned by the Single Market[3]. Without the Single Market, there would be no sharing of vaccines, no world-leading climate regulation, no effort to protect and bring home essential industries, even greater difficulties for cutting-edge start-ups, no power to stop EU imports of health or environmentally sub-standard foreign products... and no way of helping construction and real estate face new and exogenous challenges.

The Single Market may be near-complete for goods, but there's still plenty of room for progress on free movement of services needed for European Green Deal-mandated decarbonisation of the building stock. The current bottlenecks in installation of solar panels and heat pumps are as nothing compared to what's coming. At the very least, the EU must ensure that any remaining obstacles to provision of building services not make this even worse.

"The current bottlenecks in installation of solar panels and heat pumps are as nothing compared to what's coming. At the very least, the EU must ensure that any remaining obstacles to provision of building services not make this even worse."

Just as important for the construction chain is European repatriation of essential construction component production. For buildings, which need ever more electronic components, the European Chips Act comes just in time, and best not to think about how much wood and steel comes (came?) from Russia and Belarus but fortunately also from future EU member state Ukraine. Reliance on China for cooling and heating products, copper wire and plastics for sanitary use is very high but perfectly correctable as Europeans organise themselves.

For construction and real estate as for everything else, the world's greatest trading power has the muscle to repatriate or redirect sourcing of whatever it wants without fear of retaliation, just as it has peacefully imposed its own rules worldwide:

> "Today, few Americans are aware that EU regulations determine the default privacy settings of their iPhone or the type of speech that Twitter will delete as unacceptable. Americans are hardly alone in this regard. Examples of the EU's regulatory influence abound across global markets. EU laws determine how timber is harvested in Indonesia, how honey is produced in Brazil, what pesticides cocoa farmers use in Cameroon, what equipment is installed in dairy factories in China, what chemicals are incorporated in plastic toys in Japan, as well as how much privacy is afforded to internet users in Latin America."
>
> *Anu Bradford, "The Brussels Effect – How the European Union Rules the World", Oxford University Press, 2020*

To which can be added that the highest number of EU standards adopted by third countries in 2021 (16% of the total) concerned construction activities.

The Single Market is the cornerstone of "the Europe that protects", and the construction/property chain needs it now more than ever.

Michael MacBrien, Editor

[3] With one now very unfortunate exception: exemption from Treaty Single Market rules for production of or trade in arms, munitions and war material (TFEU Art. 346(1)(b))

REAL ESTATE VALUATION

Biak Numfor Regency, Papua, Eastern Indonesia

#01 European Valuation Standards Board interprets 'prudently conservative valuation criteria' that the amended Capital Requirements Regulation is set to introduce alongside Market Value

The legislative debate on revision of the Capital Requirements Regulation is not yet over, but all signs are that the Council of Ministers and the European Parliament will rubberstamp the European Commission's transposition of the Basel III concept of 'prudently conservative valuation criteria' into the CRR. We are to understand that the international and European banking supervision authorities consider this to be a necessary further safeguard against valuation-induced systemic bank risk.

The CRR lays down that in valuation according to 'prudently conservative valuation criteria', "the value excludes expectations on price increases". The EVSB addresses the issues arising from this in the contexts of:

- *Valuation under the income approach*
- *Using the direct capitalisation model*
- *Valuations carried out by means of a DCF model*
- *Treatment of rental increases*
- *And the developer's profit in the residual method of valuation*

The second CRR requirement for appraisal according to 'prudently conservative valuation criteria' is that "the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan". Here the EVSB highlights issues of:

- *Distinguishing between 'market value' and 'market price'*
- *Assessing the sustainability of the value over the life of the loan*
- *The impact of oversupply of a particular type of property on prices and value*
- *The impact on future value of declining population of a given locality and other negative factors changing the surroundings of the real estate*

Briselē, 27.10.2021.
COM(2021) 664 final

2021/0342 (COD)

Priekšlikums

EIROPAS PARLAMENTA UN PADOMES REGULA,

ar ko Regulu (ES) Nr. 575/2013 groza attiecībā uz prasībām kredītriskam, kredīta vērtības korekcijas riskam, operacionālajam riskam, tirgus riskam un pašu kapitāla minimālajai robežvērtībai

(Dokuments attiecas uz EEZ)

{SWD(2021) 320} - {SWD(2021) 321} - {SEC(2021) 380}

LV LV

Appraisal of value using 'prudently conservative valuation criteria' under the amended regulation (EU) No 575/2013 (Capital Requirements Regulation) Article 229(1)

European Valuation Standards Board preliminary commentary pending final agreement on the Regulation by the Council of Ministers and the European Parliament

1 March 2023

Article 4 (74a) *'property value' means the value of immovable property determined in accordance with Article 229 (1)*

Article 229 (1) is replaced by the following:

The valuation of immovable property shall meet all of the following requirements:

> *a) the value shall be appraised independently from an institution's mortgage acquisition, loan processing and loan decision process by an independent valuer who possesses the necessary qualifications, ability and experience to execute a valuation;*
>
> *b) the value is appraised using prudently conservative valuation criteria which meet all of the following requirements:*
>
> > *i) the value excludes expectations on price increases;*
> >
> > *ii) the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;*
>
> *c) the value is not higher than a market value for the immovable property where such market value can be determined. The value of the collateral shall reflect the results of the monitoring required under Article 208(3) and take account of any prior claims on the immovable property.';*

Article 229 of Regulation 575/2013 on prudential requirements for credit institutions and investment firms is titled '**Valuation rules for recognised collateral other than financial collateral**'.

Sub-paragraph a) of paragraph 1 of Article 229 sets out the requirements to be met by the valuer of the property so that the valuation may be relied upon for mortgage loan purposes. Reference to a "valuer" indicates the need for a valuation performed by a physical person and not merely the result generated by an automated valuation model (AVM), albeit this does not exclude the possibility of the use of an AVM as a tool to assist the valuer with the necessary qualifications, skills and experience.

Reference to *necessary qualifications* suggests the need for a valuer to satisfy any legal requirements to practise as a valuer in an EU Member State. In the absence of such legal regulation, the valuer's qualification should be in accordance with prevailing market practice in the Member State concerned. The valuer should in such a case possess the qualifications that real estate valuers are typically expected to possess by participants in the relevant property market.

Article 229 emphasises the requirement that both the valuer and the valuation be independent of the mortgage loan application and decision-making processes. Thus, a valuer performing a real estate valuation for bank loan purposes can be neither involved nor interested in the outcome of the loan decision-making process. Any valuer employed by a company involved in the loan decision-making process must also be disqualified.

Article 229(1) a) b) and c) refer to the 'value' of the property, which is clearly distinguished from the 'market value' of the property in c). Whilst these are not identical concepts, the valuation methodology described in European Valuation Standards 2020, Section II – Valuation Methodology is applicable to the assessment of both types of value.

Paragraph b) requires the use of "*prudently conservative valuation criteria*" as follows:

i) the value excludes expectations on price increases;

This exclusion relates to asking prices quoted in the property market or forecasts at the date of valuation but which may be higher than supported by market evidence immediately prior to the valuation date. The valuer should therefore not reflect any such expectation of an increase in sale prices in the future. This does not, however, preclude the possibility of the valuer having regard to increasing prices, in a comparative approach valuation, as observed between the dates of recorded sales transactions of comparable properties and the date of valuation. However, such rising trends should not be forecast beyond the valuation date.

Under the income approach, the valuer will be aware that sale prices of properties generating or capable of generating an income are influenced mainly by the level of such income and yields, the latter reflecting investment risk. All other things being equal, an increase in income generally results in an increase in price. A similar effect is produced by a fall in market yield at a sustained level of income. However, changes in these two factors can cancel each other out (fully or partially) in their effect on a sale price. They may also exacerbate each other's effect leading to higher sale prices as in the case of rising incomes and falling yields. For this reason, valuers adopting an income approach should consider the overall impact of all their valuation assumptions in order to be able to assess whether those assumptions are leading to the inclusion in the valuation of an expectation of future increases in property sales prices beyond such expectations based on market evidence immediately before the date of valuation.

It should be recognised that an income approach valuation by its very nature does reflect the market's expectation of future rental and capital growth. Provided therefore a valuation does not reflect assumptions which are even more optimistic than supported by market evidence at the date of valuation, a valuer can safely assume that her or his valuation meets the exclusion of sub-paragraph i) above.

In using the direct capitalisation model, the valuer assumes a level of income equal to the level obtainable for the property at the valuation date. This level will not of course be expected to remain constant over time in the future. Therefore, the risk of it falling or the expectation of it rising is reflected in the so called *All Risks Yield*. As this rate is most often derived from market analysis, it represents the perception of the risk of declining value or expectations of increases common amongst market participants. In arriving at the '*value*' of the property, valuers should however ensure that their derived capitalisation rate (all risks yield) is indeed supported by the prevailing market sentiment and not over optimistic in anticipation of higher market prices in the future.

The situation is somewhat more complicated in the case of **valuations carried out by means of a discounted cash flow (DCF) model** whether in the form of an implicit or explicit cash flow. In both these cases, the expectation of market participants of future rent increases may be reflected in the valuation during the cash flow period. In an implicit cash flow, this will generally mimic a simple capitalisation approach by applying an '*All Risks Equivalent Yield*'. In an explicit cash flow, expected future rental growth is reflected in the cash flow projection. In the latter case, attention should be paid to the interrelationships between the individual valuation assumptions but again, in arriving at the '*value*' of the property, valuers should ensure that their projected cash flows, discount rates and exit yields are supported by the prevailing market sentiment and not over optimistic in anticipation of higher market prices in the future.

Treatment of rent increases

When applying the income approach, the valuer should furthermore pay particular attention to any contracted indexation of rents or other income generated by the property, being another factor shaping the value of the property and sale prices. Since rental indexation is an element of the legal status of the property it should, in principle, be excluded from consideration of its possible impact on the expectation of price increases in the valuation. That said, a certain element of forecasting of the level of indexation over the remaining term of a lease will be needed. In eliminating the undesirable inclusion in the valuation of the expectation of an increase in the sale price of the property as a result of such indexation, the valuer may decide to adopt a future indexation at a level lower than (a) the inflation target of the relevant central bank or (b) the current level of the given index (if it is lower than the inflation target of the central bank).

A separate issue is the possible assumption in a projected cash flow of the rental indexation at the end of the term of the leases.

When projecting future rental increases at the end of lease terms, the elimination of the assumption of an increase in the sale price of the property in the market may be required. Again, the valuer should consider such an assumption holistically together with the other valuation assumptions made to assess, as described above, whether such a set of assumptions does not indirectly lead to the inclusion of an expectation of price growth in the valuation.

The developer's profit in the residual method of valuation

In the case of a residual method of valuation, it should be noted that the developer's profit taken into account in the valuation reflects the level of risk of running a given construction project. Part of the risk of this type of project is related to the risk of a decrease or the expectation of an increase in the Gross Development Value of the completed development between the date of the valuation and the date of the actual completion of the development. An example of this is the sale prices of apartments, which may vary in a local market between the date of valuation and the date of completion. If there is an expectation that the sales prices of the apartments will be higher in the future, thereby translating into a higher value of the completed residential development, market participants may, at the valuation date, commonly accept a level of developer's profit that is lower than would be the case in the absence of expected increases in the prices of the apartments in the future. In such a situation, in order to exclude expectations on price increases a valuer should consider the justification for increasing the level of developer's profit assumed in the valuation above that which is typically observed in the market on the valuation date.

ii) the value is adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan;

The second of the prudent valuation criteria refers to "*market price*". This should be understood as the price agreed or paid for the property. This criterion requires an adjustment to be made to the estimated '*value*' to reflect any risk that this '*market price*' may be significantly higher than the value that would be sustainable over the life of the loan. However there appears to be no need for the valuer to prove that the '*market price*' will indeed be significantly higher. What is important is the identification of the risk of this occurring, as indicated by the words "*may be significantly higher*". The required adjustment is mandatory if it is not possible to exclude such risk. This is likely to be difficult in most cases. Ultimately any '*adjustment*' made to the '*value*' is reliant solely on the well-argued expert opinion of the valuer based on her/his knowledge of the local market. Subparagraph ii) does not impose upon the valuer the need for a valuation which is separate from the assessment of "*value*" but an arithmetical '*adjustment*' to the latter.

For the purposes of analysing whether the prudent valuation criterion under this sub-paragraph is met, the valuer should be advised by the lending institution on **the length of the loan period**. It should be noted that, in most cases, as the term of the loan increases, the risk of changes in the value of the property occurring over time increases, hence the sustainable value of the property may be lower in the case of longer-term loans.

An assessment of the risk that the current 'market price' of a property may be significantly higher than the value that would be sustainable over the life of the loan may be based on an analysis of the market in the context of its cyclicality. If the market price of the property was agreed when the market was at the peak of the market cycle, there is likely to be a risk that the price will be significantly higher than the value that could be sustained over the term of the loan. By contrast, if the price was agreed when the market was at the bottom of the market cycle, there is probably little such risk.

Apart from the analysis of where the market is in the cycle, all other known factors should be taken into account in the assessment of the described risk. In particular, the oversupply of a particular type of property may lead to a decrease in prices in the future and thus to a decrease in the value of the assessed property in the future.

Another factor of this type may be, for example, the **declining population** of a given locality observed on the local market, which may translate into a weaker demand for residential real estate in the future and thus a decline in the value of the property being appraised. This group of factors also includes all **negative factors changing the surroundings of the real estate**, e.g. construction of a burdensome industrial plant in the neighbourhood, which may reduce the attractiveness and value of the assessed property in the future. The catalogue of such factors to be considered when performing a valuation is open-ended and may vary significantly depending on the local market or the type of property being valued. However, it is certainly crucial that the valuer have an understanding of the local market and analyse it for the purposes of the valuation being carried out. This analysis may be carried out personally by the valuer. However, it should also be considered reasonable to use reliable studies from reputable firms and research centres specialising in market analysis.

Pursuant to paragraph c) of Article 229(1), if a market value can be determined for a property, the '*value*' of the property described above must not exceed that market value. In order to comply with this condition, valuers should always assess both the "*value*" of the property and its "*market value*".

Members of the European Valuation Standards Board: Cédric Perrière (Chairman), Jeremy Moody (Vice Chairman), Julia Barrasa Shaw, Luis do Carmo Benedito, Nino Beraia, Sven Bienert, Marcin Malmon, Izabela Rącka, Federica Selleri

#02

Guidance on applying European valuation Standards in wartime circumstances

On 20th December, the European Valuation Standards Board submitted Guidance on applying European Valuation Standards in wartime circumstances to the State Property Fund of Ukraine, following its request. The work was conceived and led by EVSB Vice Chairman Jeremy Moody. In this article, he summarises the context, the challenge and the outcome.

Jeremy Moody

On 24th February 2022, Russia opened a large scale invasion of Ukraine from the north, the east and the south. This followed its seizure of land in Ukraine's Donbas and Crimea in February 2014. The brutal and destructive war of the last year has killed and maimed large numbers of people, displacing millions, and caused vast damage to homes, businesses and property across great areas of the country. Among the many issues to be considered is the economic impact of the devastation, including:

- the costs of remedying it, not only as the basis for any post-war reparations but also as part of understanding the position from which Ukraine will rebuild and helping the polices for that;
- the possible costs of reconstruction to modern standards.

These are very large tasks whose results might have to face close and sometimes hostile scrutiny by auditors and in courts. They are best tackled as soon as possible.

While modern reconstruction costs may be a matter for international aid, international law on reparations is almost a century old, crystallised as "full compensation" by the then Permanent Court of International Justice in a case concerning a fertiliser factory:

> "The essential principle contained in the actual notion of an illegal act… is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed." (*Germany v Poland* [1928] PCIJ Ser A No 17 – "the *Chorzow* case")

That principle has informed later decisions, was adopted by the International Law Commission in its 2001 session and was followed by the UN Compensation Commission in assessing the damage caused by the 1990 invasion and occupation of Kuwait by Iraq.

The State Property Fund of Ukraine (SPFU) approached TEGOVA for advice and support on applying European Valuation Standards (EVS) in these extreme circumstances. The SPFU was aware that this work must be professional, able to withstand scrutiny and possible hostile cross-examination. The European Valuation Standards Board (EVSB) took up the challenge which had to be completed by Christmas to be of greatest use.

The EVSB first reviewed a detailed methodology paper sent over by the SPFU and then discussed issues with Yulya Byelova, deputy director of the SPFU, at TEGOVA's Athens Assembly in October 2022. Those opening stages made it clear that the best help was not reviewing the detail of Ukrainian law, practice and circumstances from the outside but giving guidance on the application of professional principles of EVS. While that could be done by drawing on the experience from Kuwait, parallels with compulsory purchase and, for reconstruction, the work on assessments for insurance cover, the important point was that valuation standards are not and must not be a casualty of war.

The focus of the work was on valuations for businesses in all their variety, from docks to farms, from factories to forests. The Ukrainian government was making separate arrangements for destroyed and damaged dwellings; businesses would need to be ready to make their own claims supported by valuers.

A series of Zoom calls reviewed the work as it developed, bringing together the EVSB, the SPFU and TEGOVA's two Ukrainian member associations assisted by EVSB member Nino Beraia of Georgia. Those calls included valuers in Kyiv, with clients in Mariupol, in offices without electricity and from the front line, all helping the work forward.

The valuations had to be prepared as at the day immediately before the invasion (and so an earlier date for those areas invaded in 2014). That calls for the best appreciation of the evidence available for values as at that those dates as the basis for preparing valuations and assessments.

Each property needs to be described and defined accurately with the nature and extent of the destruction and damage to it as well as other losses, as by looting. Those losses must have been caused by or flow from miliary action. Some claims may be for losses that prove to be too remote to be sustainable as war damage.

Contemporary evidence of each property and business will ordinarily be more useful and effective in supporting valuations before time passes, firm evidence becomes harder to collect or verify and memories risk confusion. Objective and independent evidence will have more weight. Photographs and records, including business accounts, can help show the condition of the property and business before the damage or destruction as well as after it.

Inspection in wartime conditions can have its own challenges. It is unlikely to be possible for properties under hostile occupation, save perhaps from satellite photographs. Even when available, the property may be too damaged to be safe. Some will be mined or have undetonated explosives and only inspectable by drone. Such constraints and consequent necessary assumptions will need to be recorded clearly. Some properties may be capable of restoration; others will be damaged beyond repair. Land may need remediation for contamination and other damage, such as to drainage. Losses of machinery, goods, money and other moveable assets will need to be verified and assessed.

As with compulsory purchase, the assessment is only of what was lost as a result of hostile action. The principle, set out in the *Chorzow* case, is of restoration to the position before the damage, not to improve the property.

Assessing reconstruction costs is likely to be more efficiently done at the same time as assessing the valuation of loss. Again, this should be a contemporary assessment based on the building standards that then prevailed. In reality, as and when reconstruction is actually set in hand it may well be to higher EU standards, such as for energy efficiency, but this initial assessment would give a baseline of data.

Claims for the assessed losses, when made, should in addition be for the professional costs of these assessments, as necessitated by war damage, and for interest accruing from the damage. Those two elements are part of the impact on the owner of the property and business from having sustained war damage.

There is no escape from recognising the sheer scale of the task. Ukraine is a large country in which all areas have been racked by war damage. Parts are under current occupation or have been recovered from occupation. Even now, the war front is hundreds of kilometres long and land mines cover large areas. Missile strikes have caused significant damage and loss in all areas. Any valuation in such circumstances makes extreme calls on the valuers involved; that is magnified by this scale.

The need for professionalism stands and will be essential as claims for loss come to reviewed. The role of the valuer as an expert, providing evidence and opinion as to value to a tribunal or court and then being cross-examined on it calls on that professionalism. The EVSB's work last autumn has produced guidance on applying EVS to support that professionalism when applied to the law, practices and circumstances of wartime Ukraine as one contribution to the country's future and success.

Jeremy Moody Hon REV is Vice Chairman of the European Valuation Standards Board, Chairman of the EVSB Sub-group on War Damage Assessment Methodology and Secretary and Adviser, Central Association of Agricultural Valuers (CAAV) (UK).

#03

Valuation and energy efficiency. NextGenerationEU[1]

By the autumn, EU energy performance standards triggering rapid mandatory renovation will be agreed, so it is now urgent for valuers to learn to incorporate the cost of renovation into their determination of market value, as EVS 6 mandates. The European Valuation Standards Board is working on guidance, but it can learn from valuer initiatives on the ground. Spanish technical architects are showing the way.

Alfredo Sanz Corma

European Valuation Standard 6 on Valuation and Energy Efficiency is of vital importance to valuers because it relates directly to properties' growth in value and market attractiveness. The cost of the renovation work needed to obtain these energy improvements has to be quantified financially.

In Spain, buildings account for more than 30% of CO_2 emissions. Over 81% of the housing stock falls into one of the three worst energy performance categories and the deficiencies do not concern energy consumption alone, as they are also highly relevant to, inter alia, accessibility, health and comfort. Energy renovation will generate significant reductions in buildings' energy consumption and bills and in energy poverty, which in Spain affects more than 8% of households.

EU "Next Generation" funds, applied in Spain through the government's Urban Rehabilitation and Regeneration Plan, are a great opportunity to improve the residential building stock and progress in complying with European energy efficiency directives.

Amounting to more than 3.4 billion euros, these funds are focused on seeking the greatest energy improvements at the lowest possible cost and can cover up to 80% of the cost of the work. In addition, there are other grants available, to improve accessibility, for example, or produce the Existing Building Record or logbook (Libro del Edificio Existente), which will enable detailed analysis of a building's potential for improvement, enabling measures to ensure proper maintenance. This will serve as the building's digital passport in the future.

Consejo General de la Arquitectura Tecnica de España

[1] A € 806.9 billion temporary instrument to power the recovery, Ndlr

Beyond energy consumption and bills, energy renovation also improves comfort in general, enabling more appropriate indoor temperatures and correct relative humidity, as well as reducing uncontrolled air infiltration. It can also improve other aspects such as accessibility, together with the health and conservation of the building itself, encouraging comprehensive works, improving occupants' health and wellbeing in the environment where we spend more than 80% of our time.

Due to their specific training in construction and rehabilitation, technical architects are specialists in managing and proposing these types of work.

What valuers need to do

Valuers have to sound out the market and detect the growth in value of properties caused by their energy characteristics and performance.

They also need to be able to estimate the reduction in energy bills as well as the cost required to make the energy improvement. They do so by considering aspects such as grants in addition to tax breaks and the possibility of financing energy improvement work.

For example, VAT is now eligible for subsidy for the first time and the sums received will not be included in the amount treated as taxable income. In addition, tax deductions of up to 60% of the amount contributed by the owners will be permitted.

One example: if the owners of a 10-dwelling building in Madrid manage to reduce non-renewable primary energy consumption by more than 60% and heating and cooling demand by more than 35% by improving their façades, roof and installations with a total investment of around EUR 220,000 (incl. VAT), they will achieve not only a significant improvement in comfort but also a structural renovation of the building and significant savings in their energy bill, as well as a revaluation of their homes. Bearing in mind that the grants in this case would cover 80%, the residents would have to pay around EUR 4,400 each, coming down after the 60% tax relief to less than EUR 1,800 per resident, which they would recover in less than two years through their reduced energy bills. In addition, they would see the value of their property increase by 24%. On the basis of an initial value of EUR 200,000 per dwelling, this would be almost EUR 50,000. There is no better or safer investment.

This example fits well with recent studies quantifying the average growth in value of energy-renovated properties at 24%, a conclusion reached after conducting a sensitivity analysis of building quality, based on real data. This determined the average increase in value which, for each city and for the same kinds of building, would be produced assuming that they were in a pre- and post-renovation situation.

It can be concluded that, for EVS valuers, it is as important to know how to apply all the technical aspects in order to provide an impeccable valuation service as it is to know how to explain the economic feasibility of energy improvement work. Clients will then be able to make the most of the "Next Generation" funding opportunities, and we shall have contributed our grain of sand to the achievement of Europe's 2030 and 2050 climate objectives.

> *"Valuers…need to be able to estimate the reduction in energy bills as well as the cost required to make the energy improvement. They do so by considering aspects such as grants in addition to tax breaks and the possibility of financing energy improvement work…"*

Alfredo Sanz Corma is President of the Spanish General Council of Technical Architecture.

#04 Highest and Best Use analysis for underutilized state-owned assets in remote areas

Rizka Hutami

Tomy Jonatan

A "state-owned asset" is property or resources that are owned, controlled, and managed by a government or state entity. This can include a wide range of assets, such as land, buildings, infrastructure, natural resources, and financial assets. The management and control of state-owned assets can vary depending on the country and the specific asset in question. In some cases, state-owned assets may be managed by government agencies or state-owned enterprises (SOEs) that operate like private companies, while in other cases they may be directly managed by government officials. The purpose of state-owned assets can also vary, from generating revenue and economic growth to providing public services and fulfilling social welfare objectives. The way the assets are managed, the transparency, and the accountability for the state-owned assets can also vary between countries.

In Indonesia, "state assets" refers to property or resources that are owned, controlled and managed by government at the national, regional, or local level in line with national development goals such as poverty reduction and economic growth and working to improve transparency and accountability.

The high value of government fixed assets (53.84% of the total state wealth (of IDR 11,098.67 or ~ EUR 67.7 billion) necessitates prudent management, yet many state assets are underutilized or idle, with potential for waste of the state budget due to ongoing asset maintenance costs and a decrease in asset value due to building depreciation.

> *"The high value of government fixed assets... necessitates prudent management, yet many state assets are underutilized or idle, with potential for waste of the state budget due to ongoing asset maintenance costs and a decrease in asset value due to building depreciation."*

There are several ways to decrease the number of underutilized assets:

a. Selling or leasing the assets to another organization or individual that can put them to better use, helping generate government revenue and free up resources for other investments.

b. Consolidation of multiple underutilized assets into a single, more efficient facility, helping reduce costs and improve the overall use of the assets.

c. Repurposing for a different use such as affordable housing or a community centre.

d. Improving the management and maintenance of the assets (including better marketing or access) can also help to increase their utilization.

e. Reviewing and revising the strategic plan and the use of the assets on a regular basis, in order to ensure that they are in line with the current priorities, and if not, to redirect them to other areas where they are needed.

The most appropriate solution will depend on the specific circumstances and the nature of the underutilized assets. A thorough analysis of their current use and potential alternative uses is needed in order to make an informed decision. In order to optimize state assets, a comprehensive analysis is required that benefits the state not only economically but also socially due to the function of state assets as a public good.

Highest and best use (HABU) analysis is one of the analyses that can be performed to determine the most profitable and feasible use for a piece of property. It is commonly used for underutilized assets, such as vacant land or underperforming buildings. The analysis typically involves identifying all potential uses for the property, evaluating the economic feasibility of each use, and determining the use that would generate the highest value for the property. This can include factors such as market demand, zoning regulations, and the cost of development. The results of a HABU analysis can be used to guide investment decisions, such as whether to develop the property, hold onto it, or sell.

“The results of a HABU analysis can be used to guide investment decisions, such as whether to develop the property, hold onto it, or sell.”

The following steps can be used to conduct a HABU analysis for an underutilized asset:

1. Identify the asset, including its physical characteristics, location, and any relevant zoning or land use regulations.

2. Assess its current use and financial performance, including analysing the income and expenses associated with the asset, as well as any potential opportunities or constraints.

3. Identify potential uses for the asset that align with market conditions, zoning regulations, and other relevant factors.

4. Evaluate the potential uses comparing their financial feasibility, including projected income and expenses.

5. Determine the highest and best use: Select the use that is most profitable and beneficial for the asset, considering factors such as market demand, profitability, and feasibility.

6. Develop a plan of action for implementing the HABU identified, including any necessary renovations, marketing, or other steps.

This process should be undertaken with a multidisciplinary team of experts, including experts in the field of the asset (real estate), finance and, legal. Also, it is important to consider the long-term viability and environmental and social impacts of the potential uses.

Case Study

The underutilized asset in question is a sports field located on one of the islands in eastern Indonesia. It was originally intended to be a fitness centre for government employees living on the island, but due to the field's remote location and the presence of sports facilities closer to the workplaces, the asset is rarely used and thus classified as underutilized. Despite renovation last year, it remains underutilized as it doesn't meet the standard of comfort for sports fields. This condition motivates asset managers to seek optimization solutions that are both profitable and socially beneficial to the surrounding community.

The sports field is located in Biak Numfor Regency located in Papua Province and consisting of 19 districts spread across two islands as well as an archipelago consisting of 42 small islands with a total area of 2,601.998 km^2. Biak Kota and Samofa are the most populous districts and economic and urban development hubs, with Biak Kota District covering 42.94 km^2 and Samofa District covering 230.54 km^2.

The two districts are extremely secure and have excellent growth potential. In addition, a substantial number of office workers are non-natives, with average incomes exceeding the minimum wage. Tourism is an additional opportunity for Biak Numfor Regency. Many attractive tourist destinations remain undeveloped.

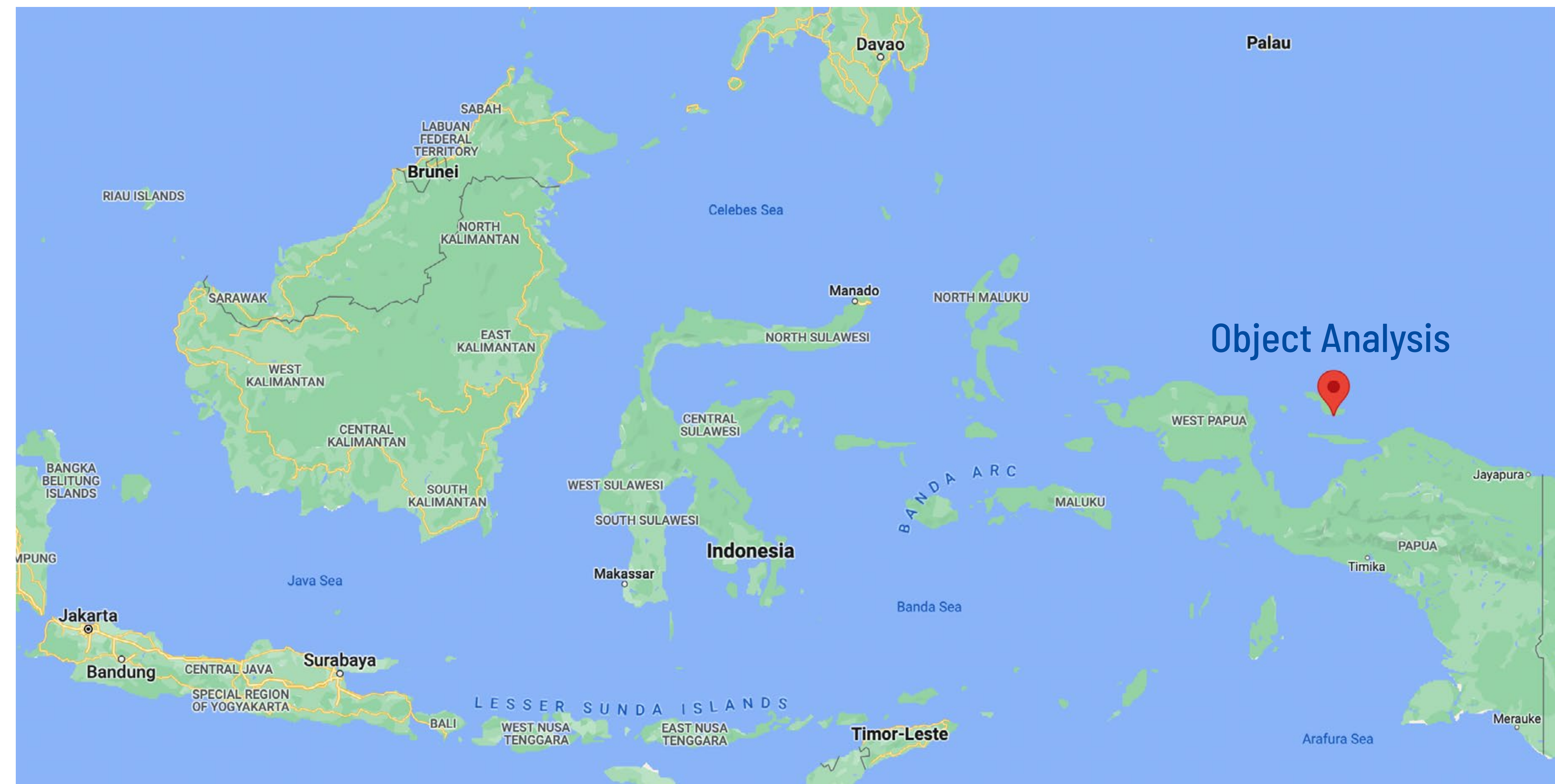

Figure 1 State Owned Asset Location · *Source: Google Maps*

According to the field survey, the predominant property uses in this area are commercial and residential, including office areas, trade areas, and residential areas. The object may be developed as a housing complex or a sports facility, based on legal and economic analysis of the surrounding property uses and the needs of the surrounding market, taking into account that there is a new trend for employees to engage in sports after their daily activities. Besides that, residential demand in Biak Numfor Regency remains high, particularly if the home has a clean legal record and is situated in a secure area.

Biak Numfor Regency has not published a spatial plan or regional plan, so analysis is conducted based on observations of the surrounding area's use and the existing objects of analysis, which are residential, sporting facilities, and social service centres (religious sites, health, etc.). The existence of these various offices and residences presents a potential need for adequate sports facilities, especially for employees who are generally immigrants. Samofa district also has many public and social facilities that are quite complete, as well as shopping centres.

From the results of the analysis of the legal and physical aspects, three development scenarios can be made with the following details:

Table 1 Futsal Mix Scenario Building Specification

Total Land Area	1,400 m^2
Building Area	980 m^2
Building Specifications	Type 3.1
Frame Structure	Steel
Roof Structure	Steel
Roof	Zinc Wave saddle roof
Wall	Celcon/Hebel 7.5 cm, Wooden Frame
Floor	Parquet (according to the area of the futsal and badminton courts with a 5 cm reinforced concrete pavement base for the entire building floor).
Facilities	Lighting, Goalposts, Futsal field retaining net, Sound System, Net Badminton, Referee Pole and Chair, Water Supply, Electricity
Futsal Court	1 Unit (15 m x 30 m) /parquet based
Badminton Court	2 Unit (6 m x 14 m) / parquet based
Development Cost	**IDR 2,933,547,000.00**
Existing Facility Value	**IDR 231,625,000.00**
Land Market Value Before Development	**IDR 1,178,590,000.00**
Total Initial Outlay	**IDR 4,343,762,000.00**

Site Plan

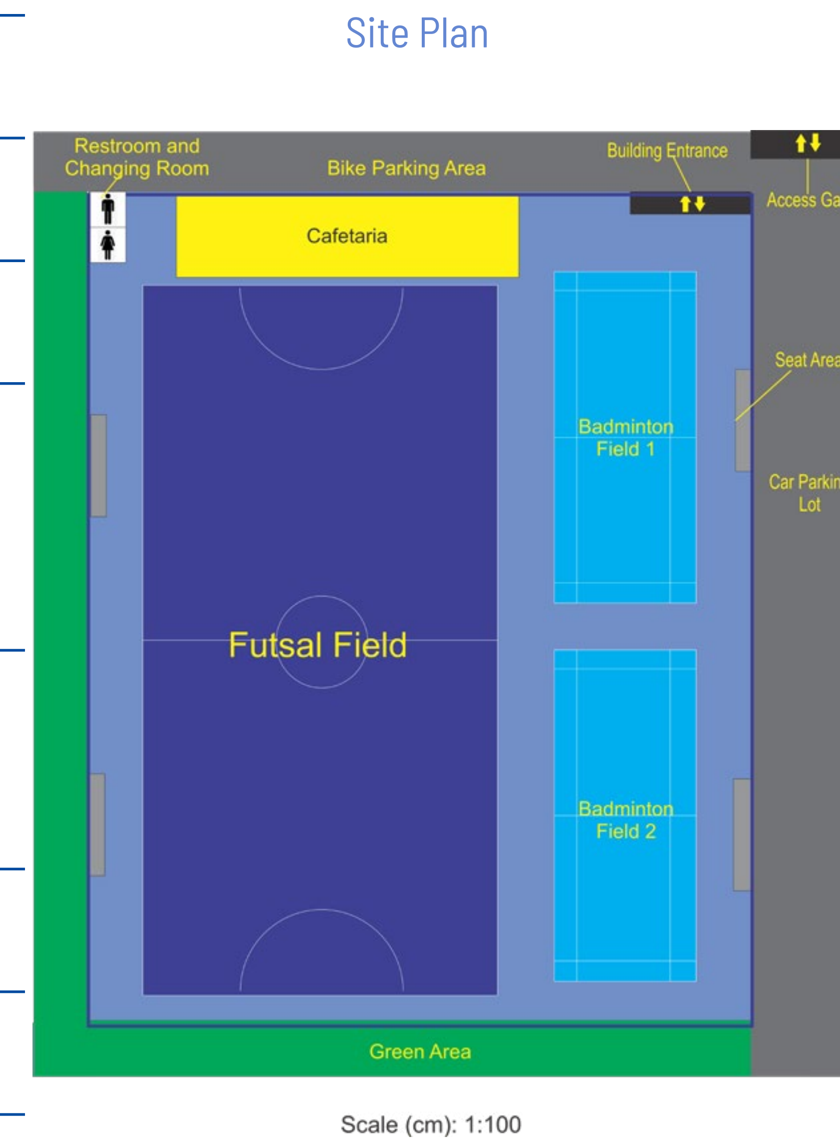

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Table 2 Badminton Scenario Building Specification

Total Land Area	1,400 m^2
Building Area	980 m^2
Building Specifications	Type 3.1
Frame Structure	Steel
Roof Structure	Steel
Roof	Zinc Wave saddle roof
Wall	Celcon/Hebel 7.5 cm, Wooden Frame
Floor	Parquet (according to the area of the futsal and badminton courts with a 5 cm reinforced concrete pavement base for the entire building floor).
Facilities	Lighting, Goalposts, Futsal field retaining net, Sound System, Net Badminton, Referee Pole and Chair, Water Supply, Electricity
Badminton Court	6 Unit (6 m x 14 m) / parquet based
Development Cost	**IDR 2,902,805,000.00**
Existing Facility Value	**IDR 231,625,000.00**
Land Market Value Before Development	**IDR 1,178,590,000.00**
Total Initial Outlay	**IDR 4,313,020,000.00**

Site Plan

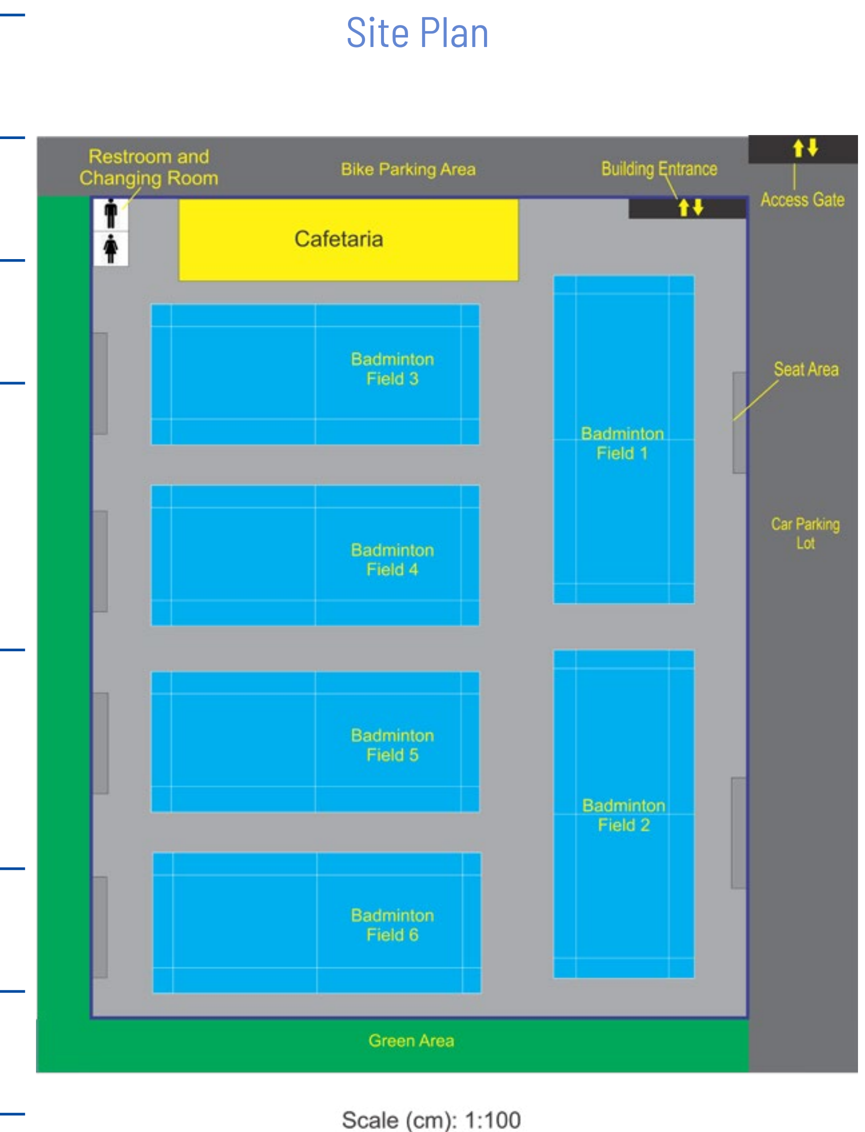

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Table 3 Residential Scenario Building Specification

Total Land Area	1,400 m^2
Building Area	200 m^2 per unit. Total 600 m^2
Building Specifications	Residential Type
Frame Structure	Concrete
Roof Structure	Wood
Roof	Zincalume
Wall	Red Brick, Wooden Frame
Floor	Ceramics
Facilities	Water Supply, Electricity
Residential Complex	3 Unit Houses
Development Cost	**IDR 2,406,221,000.00**
Existing Facility Value	**IDR 231,625,000.00**
Land Market Value Before Development	**IDR 1,178,590,000.00**
Total Initial Outlay	**IDR 3,816,436,000.00**

Site Plan

Scale (cm): 1:100

Based on the DCF projection for each alternative scenario, the financial analysis gives:

Table 4 Financial Analysis Result

	Financial Analysis		
	Futsal Mix	**Badminton**	**Residential**
Total Initial Outlay (IDR)	4,343,762,000.00	4,313,020,000.00	3,816,436,000.00
Market Value After Development (IDR)	5,255,779,570.84	5,013,781,998.46	3,855,690,358.64
NPV (IDR)	912,017,570.84	700,761,998.46	39,254,358.64
Discount Rate	13.79%	13.79%	13.79%
IRR	17.97%	17.09%	14.23%
MIRR	17.46%	16.68%	14.18%
Payback Period (Year)	7	7	3
Discounted Payback Period (Year)	11	12	3
Analysis of Financial Aspect	Feasible	Feasible	Feasible

> “Full optimization of state-owned assets can generate asset yield.”

Maximum productivity analysis is carried out to determine alternative uses that provide the highest land value, the highest net present value (NPV), or the highest internal rate of return (IRR) of the three alternatives. Based on data analysis at the financial feasibility stage, the futsal mix scenario produces the highest NPV and IRR values compared to other scenarios, namely an NPV of IDR912,017,570.84 and an IRR of 17.97%. The highest land value of the three alternatives based on the Land Development Analysis (LDA) method is IDR 1,493,291.12/m^2.

Based on the analysis of NPV, IRR, and land value after development in the three alternative scenarios, it is concluded that the use of land as a sports facility with a mixed scenario of a futsal field and badminton court (the futsal mix scenario) will produce a higher NPV and IRR than the alternative development scenarios.

HABU analysis produces the best scenario for the development of underutilized assets. State assets serve both an economic and a public good function, so it is important to analyse both the economic and social benefits and impacts:

The economic benefits for the government and the community from the development and utilization of the sports field include employment, the circulation of money in the community, and income received by the central and regional governments. The overall value of the economic benefits from the development and utilization of the object of analysis for 7 years (2 years of development and 5 years of rental period along with the difference in terminal value) is IDR 8,719,140,872.13.

The social benefits and impacts include increasing the offer of sports facilities in Biak Numfor Regency and saving time and transportation, improving the quality of life and the level of public health, increasing sports achievement for athletes and young people, increasing community free time, increasing interest in sports and increasing community life satisfaction levels.

This case study demonstrates that comprehensive HABU analysis is very useful for optimizing underutilized state assets. The function of state assets as public goods is measured in terms of the economy and the benefits and social impacts on society, especially in remote areas such as Biak Numfor Regency. They may not be large or even feasible from a business standpoint, but nonetheless worthwhile when considering economics, social benefit, and impact analysis from a government/ societal standpoint.

Full optimization of state-owned assets can generate asset yield. The average yield of state-owned assets is an important metric because the yield of an asset refers to the return that the government receives from owning and managing the asset. This can include things like rental income, dividends from stock investments, or interest from bonds. The yield can be measured in a variety of ways, such as the annual percentage return on the investment or the total return over a given period of time. It is important because it can help fund government operations and measure the efficiency and effectiveness of government investment decisions.

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#05 What real estate valuers need to know about property tax

Paul Sanderson

The relevance of property tax to valuers

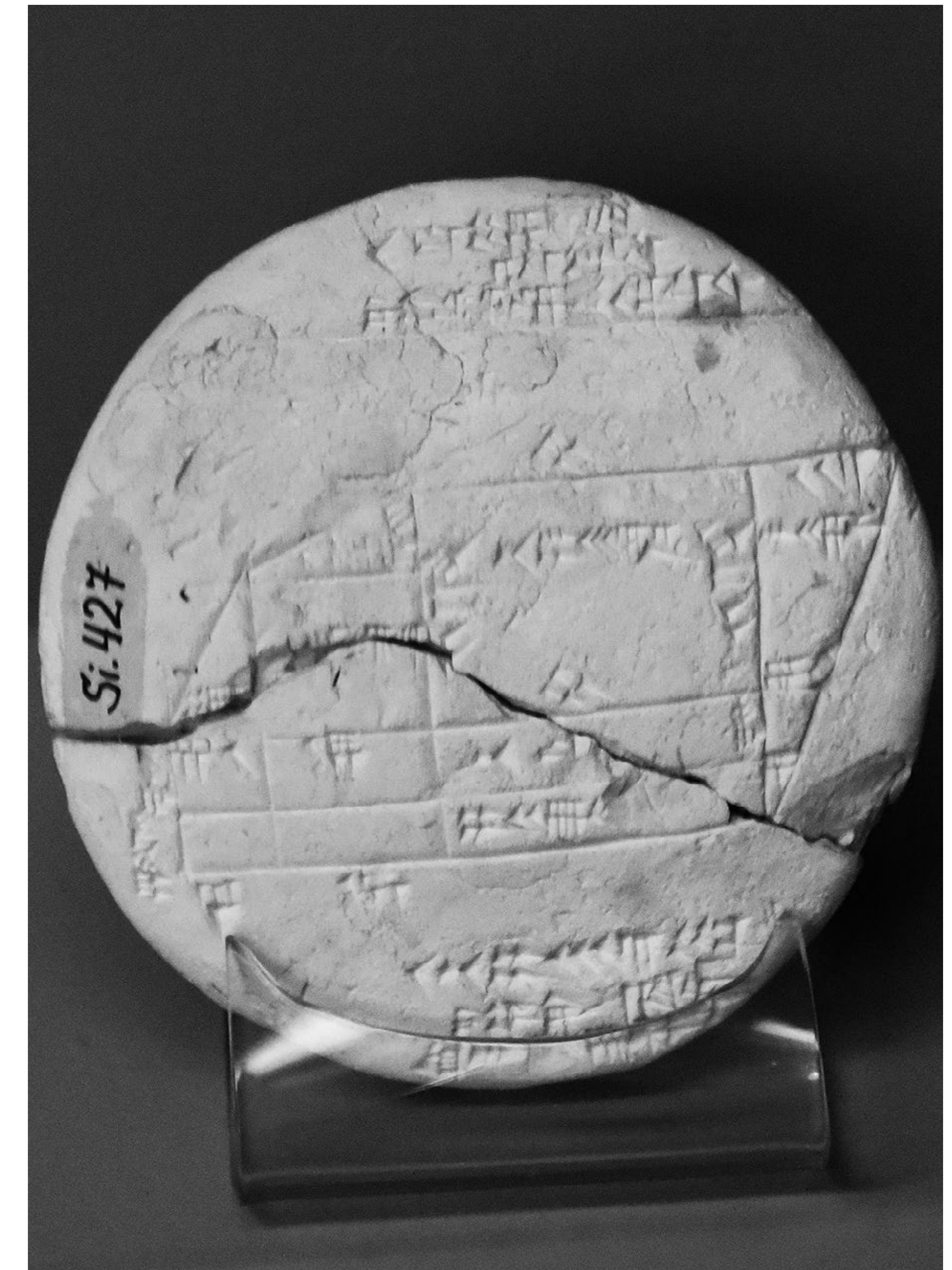
It is not necessary for real estate valuers to be experts in property taxation or valuations for property tax purposes. However, in my opinion, they do need to have an outline knowledge of the annual property tax system that operates in the country/jurisdiction within which the property is located in order to be aware of any changes in liability for property tax and determine what impact it may have on the valuation they are undertaking.

Furthermore, if a real estate valuer is not aware of these changes, it is possible that any valuation of commercial or industrial properties may not accurately reflect factors that the market might be expected to take into effect. This, in turn, may leave the real estate valuer open to criticism from a client or, worse still, legal action for negligence.

Finally, developing expertise in property tax systems may provide an opportunity for valuers to offer clients additional services such as advising on property tax valuations, checking and/or managing property tax bills, and, where necessary, undertaking appeals on behalf of clients.

The general context

Property taxation includes a variety of taxes that may apply depending on the circumstances arising out of a particular transaction or event. For example, there may be tax payable on the transfer of a property based on its capital value or consideration payable on the sale or lease of a property. Tax may become payable in the event of the death of the property owner based on the value of assets owned. Although the imposition of wealth taxes has diminished in recent years, there are still a number of countries in Europe that apply an annual tax on the value of all assets owned, including properties.



A cadastre text written in Akkadian on a terracotta tablet. From the 18th century BC in Sippar, Iraq and held by the Ancient Orient Museum, Istanbul

“…the overall burden of property tax payable in any particular country or jurisdiction will determine how important it may be in the context of property valuation for any purpose.”

However, this article is primarily concerned with recurrent property taxes that are payable in most European countries. The vast majority of these taxes are ad valorem taxes, i.e. based on the value of the taxable property, although some are area-based, e.g. annual property taxes in Poland which depend upon the size and location of the property.

Property taxation is, of course, subject to political decisions concerning the underlying policies governing the system. These policy decisions may be taken at national, regional or local government level depending on the framework which applies in the country concerned.

Policy decisions will normally determine what types of properties are liable to taxation (and, conversely, what types of property may be wholly or partly exempt), the unit of assessment, the basis of assessment, how often values are updated, the tax rate or rates, who collects the tax, who is responsible for payment of the tax, and what appeal mechanism is in place.

In addition to the tax policy decisions outlined above, there are also a number of “assessment policy” decisions which may need to be taken into account. For example, some governments responded to the COVID-19 pandemic by postponing property tax revaluations. It should also be noted that although tax policy may determine the basis of property tax, e.g. capital value, rental value, land value, etc., those responsible for carrying out the property tax values are likely to determine what method of valuation should be applied to a particular property.

It is reasonable to assume that the overall burden of property tax payable in any particular country or jurisdiction will determine how important it may be in the context of property valuation for any purpose. The table shows the latest OECD data (2021) relating to property tax in European countries.

Country	Property Tax as a % of GDP	Property Tax as a % of Total Tax
Austria	0.633	1.456
Belgium	3.561	8.476
Czech Republic	0.195	0.577
Denmark	1.881	4.013
Estonia	0.188	0.560
Finland	1.507	3.505
France	3.823	8.469
Germany	1.243	3.147
Greece	2.993	7.677
Hungary	0.868	2.552
Iceland	2.084	5.944
Ireland	1.133	5.380
Italy	2.543	5.874
Latvia	0.894	2.866
Lithuania	0.300	0.915
Luxembourg	4.020	10.422
Netherlands	1.689	4.253
Norway	1.217	2.882
Poland	1.282	3.486
Portugal	1.586	4.435
Slovak Republic	0.480	1.340
Slovenia	0.616	1.646
Spain	2.732	7.124
Sweden	0.958	2.251
Switzerland	2.234	7.989
Turkey	0.968	4.240
United Kingdom	3.815	11.396

Note.
OECD Definition of tax on property:
Tax on property is defined as recurrent and non-recurrent taxes on the use, ownership or transfer of property. These include taxes on immovable property or net wealth, taxes on the change of ownership of property through inheritance or gift and taxes on financial and capital transactions. This indicator relates to government as a whole (all government levels) and is measured in percentage both of GDP and of total taxation.

The above table makes it clear that property taxation is likely to have a bigger impact on the value of properties in the UK, Luxembourg, Belgium and France than might be the case in Estonia, the Czech Republic, or Lithuania. However, that is not to suggest that the impact or incidence of property tax can be disregarded in countries with a lower burden of property tax.

It should be noted that the property tax valuation may provide a better indication of recent market value in countries having annual property tax revaluations, such as the Netherlands.

Latest trends in selected European countries

In Belgium, where property taxes are already high as can be seen from the foregoing table, it is reported that the indexation coefficient for annual cadastral income tax – which is linked to the consumer price index and therefore to inflation – will increase the real estate tax by 9.6% in 2023. Out of all the indexations set to take effect next year, the one concerning the cadastral income – the property tax – is likely to impact Belgian property owners the most. In addition to this record indexation, some municipalities have also announced that they will increase the property tax in their budgets next year. While part of the property tax is paid to the Regions, another part is levied by the Provinces, while last but not least, the municipalities get most of the revenue.

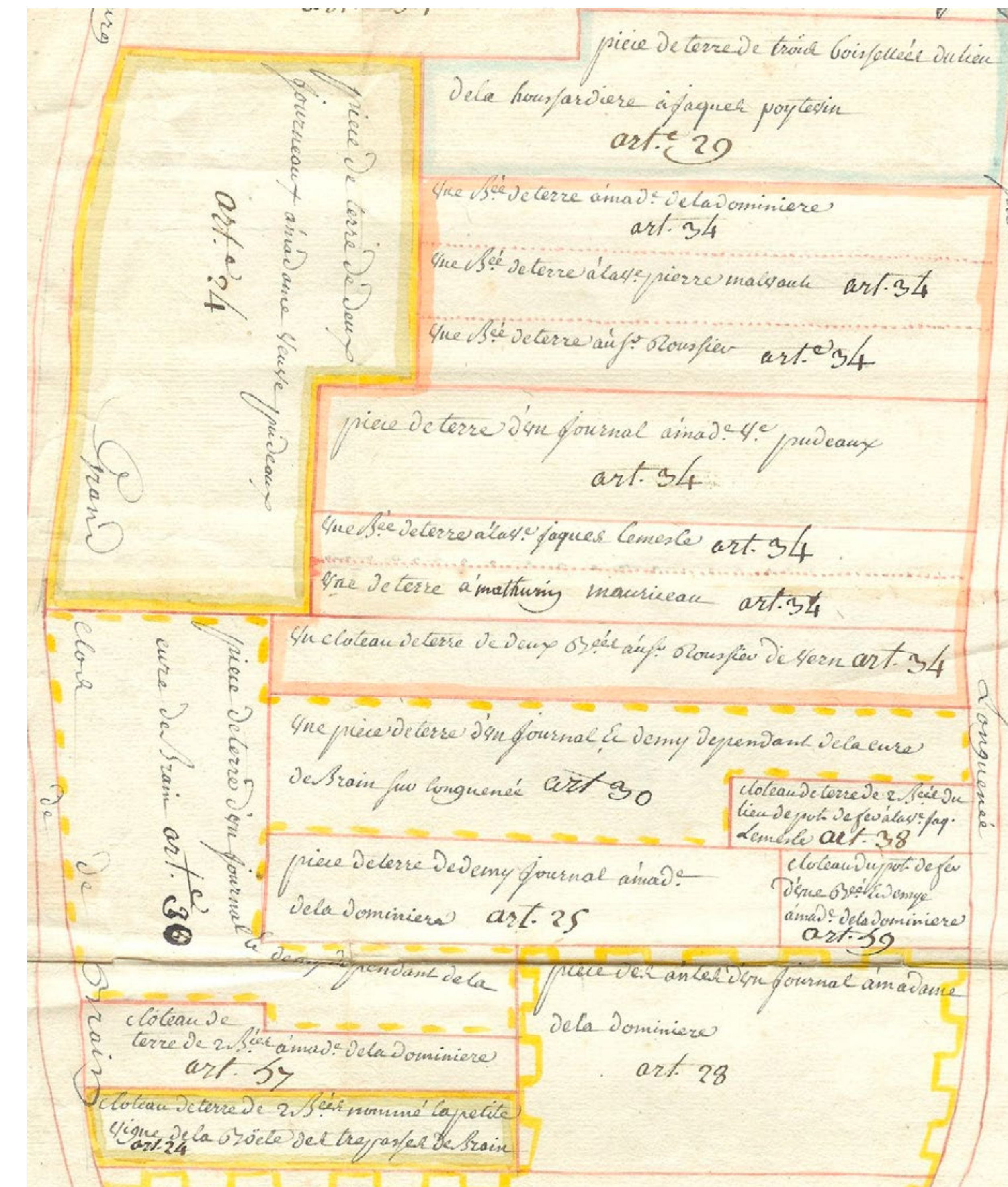
In Denmark, the property tax system has proved to be controversial in recent years. For various reasons, including discrepancies in the underlying valuations, the government decided to introduce a new property tax system from 2024. The new tax rules mean property value and land value tax rates will fall in most municipalities, according to the Danish tax ministry. Homeowners facing higher property taxes due to substantially higher new appraisals can be eligible for a tax subsidy – even though tax rates will be reduced. The new tax rules will not result in taxes for existing homeowners in 2024 that are higher than they would have been if the current rules (still in effect in 2022 and 2023) were to remain in place. However, the tax subsidy does not apply to new homeowners from 1 January 2024. This is because first-time buyers will be expected to "plan their finances in accordance with the new tax rules," the ministry states. From 2024 onwards, the two property taxes will be pegged to appraisals of the property and land value such that if these fall in valuation, so will the property tax.

In France, from 2023, the *taxe d'habitation*, the second of France's two property taxes, will no longer be payable on any primary residences. The tax has been phased out in recent years, with only the highest earners still paying in 2022. However, second-home owners are still liable to pay *taxe d'habitation* on their secondary residence(s), and the 2023 Budget announced the possibility of increasing these taxes on vacant and secondary properties.

The Mayor of Paris recently announced an increase of almost 50% in the local property tax rate from 13.5% to 20.5% in 2023. The tax, paid by the owners of real estate and allocated to the municipalities, has already increased significantly in 2022, so this additional increase has caused considerable controversy. It is this kind of dramatic change in property tax liability which, in my opinion, real estate valuers need to be aware of and, if appropriate, take into account when undertaking property valuations.

Tax officials in France have expanded the impots.gouv.fr website, used for tax declarations, to include details of all private properties owned. Information will be used to set the *taxe foncière* paid by all property owners and any other property taxes owed. The website also records features such as the number of rooms, surface area and cadastre lot numbers of these properties. The site will have a facility to declare and pay property-related taxes, such as the *taxe d'aménagement* and to declare the occupancy status and rents from properties, as well as settle any tax bills which arise from them.

Only properties subject to property tax are included on the website and any incorrect details can be corrected by using the secure messaging system. It might take several weeks for properties to be moved from, or added to, the site after a sale - the information is gleaned from the tax records of the sale provided by *notaires*. Where properties are not owned by individuals but by companies, they must be managed from a professional log-in at the impots.gouv.fr site. I should add that people with more than 200 properties have a dedicated webpage.



Seigneurial land plan, Anjou, 1750

In Germany, property tax valuations became the subject of a legal challenge as they were so far out of date. Property taxes in the former West Germany were based on values from 1964; in the former East Germany, they were based on valuations from 1935! Recently, the German Constitutional Court ruled that such inconsistencies across the country were unconstitutional. In response, the German government is introducing "reforms" to the property tax system and new valuations are due to come into effect on 1 January 2025 based on levels of value prevailing as at 1 January 2022, i.e. a 3-year AVD. However, there is considerable controversy surrounding this process as it is dependent on property owners completing a return form (declaration). As a response to concerns, the deadline for submitting the new property tax declaration forms has been pushed back from 31 October 2022 to 31 January 2023.

> *"In Germany, property tax valuations became the subject of a legal challenge as they were so far out of date."*

In Greece, several municipalities across the country are expected to demand corrections to the property zone rates implemented in January 2022, which led to large hikes in the Single Property Tax (ENFIA) in those areas. The first objections are expected to be filed in the electronic system of the Finance Ministry from island regions, such as Astypalaia, Kos and Kefalonia, where zone prices almost doubled, but also from municipalities such as Kassandra in Halkidiki, Hersonissos on Crete, and Nafplio. It is extremely likely that corrections will also be requested from municipalities of Attica where the zone prices also increased significantly but the readjustment did not lead to an increase in the ENFIA. Significant increases were recorded in Dafni, Kamatero, Moschato and Nea Peramos. In these areas the zone prices were very low, and it is thought unlikely the competent committee of the ministry will accept these objections.

In a draft law under public consultation, municipalities in Greece are given the opportunity to submit objections. The bill emphasizes that "it is a fact that when determining the starting prices of the areas included in the objective determination system, it was found that there were areas in the country for which the opinion of the municipal councils was not expressed, in accordance with the written provisions." Objections are filed electronically and must be accompanied by any factual evidence. After examining the objections, the commission will recommend to the finance minister the zones where there is a strong possibility that the determination of the starting prices will need to be repeated. The draft law also includes provisions leading to a new freeze on real estate value-added tax and on the capital gains tax, while the tax deduction for real estate renovations is extended for two more years.

In Ireland, the most recent of many interesting developments involves the introduction of a Residential Zoned Land Tax (RZLT). As part of government measures to combat Ireland's housing crisis, beginning in February 2024, a new RZLT will apply to land and sites that are zoned for housing development and have access to essential infrastructure - including water supply, roads and lighting - but are currently left unused. Local authorities have been preparing maps of all residential zoned land within their boundaries, which are due to be published by 1 May 2023. They will be available to view on local authorities' websites or at their public offices. Landowners can submit suggested changes to the updated maps and will be able to appeal decisions they disagree with before a final map of land subject to RZLT is published next December. If land is included on the final RZLT map, the owner of it on 1 February 2024 will be liable to payment of the tax at 3% of the market value per annum. The valuation will be self-assessed by the landowner who must submit a tax return by 23 May 2024.

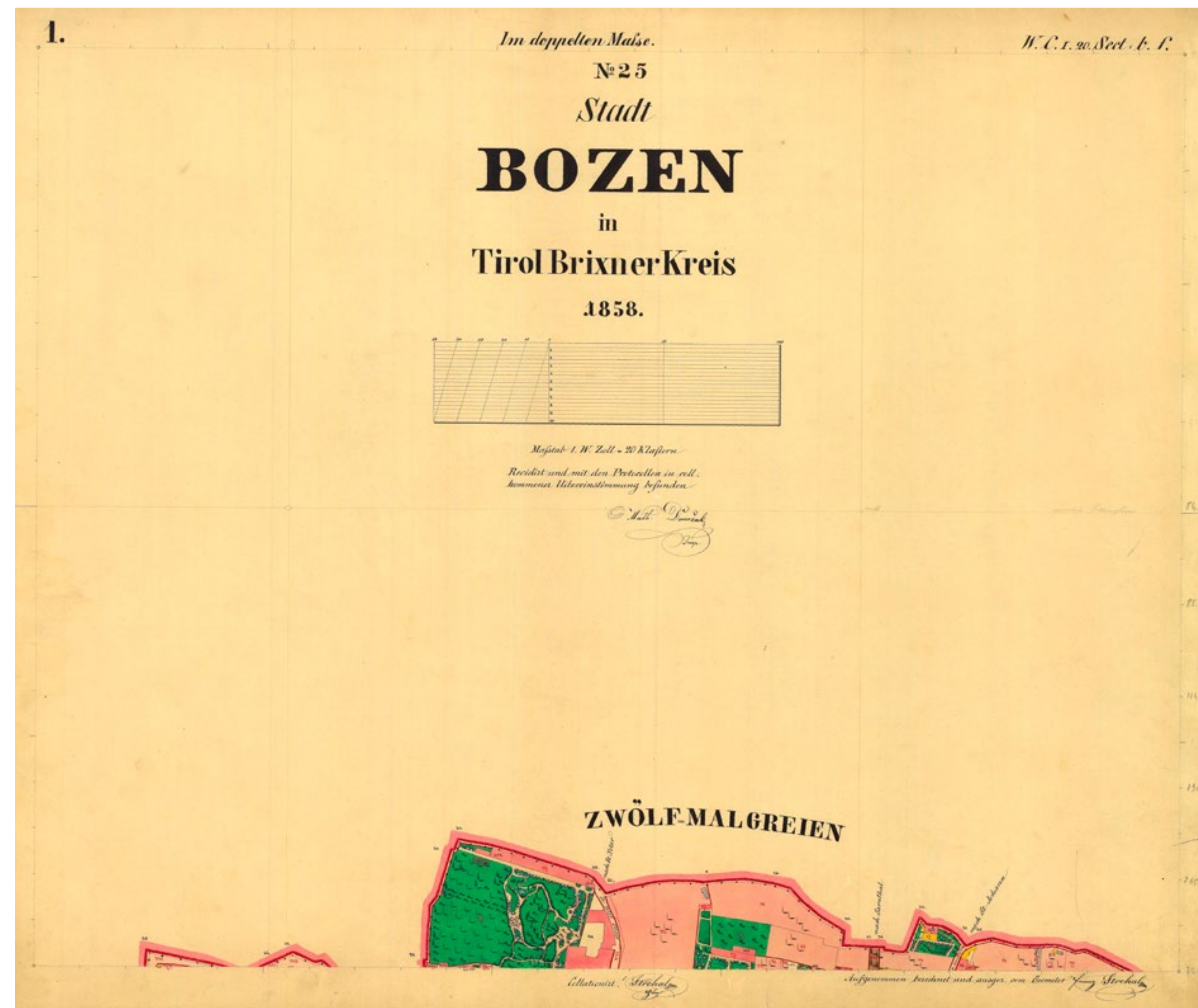
Real estate valuers in Ireland will need to be aware of what land is or is not included on the RZLT maps in due course and consider what impacts the tax may have on the market value of such land.

There is a "rolling revaluation" of all non-residential properties in Ireland being undertaken by the Irish Valuation Office (IVO). The IVO has experimented with a form of self-assessment in some parts of the country and reports that this process has been generally successful. Real estate valuers should familiarise themselves with which counties are being revalued and when so they can ensure the latest position is reflected in any valuation reports they prepare.

Finally, the annual property tax paid in respect of residential properties (Local Property Tax or LPT) is based on self-assessed banded capital values. The rate of tax is relatively low, but the use of self-assessment for LPT is generally regarded by the government as a successful way to create a tax base which is understood and accepted by taxpayers.

"the Irish Valuation Office has experimented with a form of self-assessment in some parts of the country and reports that this process has been generally successful."

In Luxembourg, a Property Bill was tabled in Parliament in October 2022 seeking to reform the land tax (impôt foncier - "New IFON") and introduce two new national taxes: a land mobilisation tax (impôt à la mobilisation de terrains - "IMOB") and a tax on the non-occupation of housing (impôt sur la non-occupation de logements - "INOL"). The New IFON will continue to apply to all owners of land in Luxembourg (with a lump sum tax deduction of €2,000 for the primary residence - subject to conditions). The main point of the reform is the update of the land values which have not changed since 1941. The IMOB aims to create an incentive for the actual construction of buildings on land earmarked for urbanisation. It will require the establishment of a national register of undeveloped land. The IMOB will be calculated on the same basis as the New IFON but will be multiplied by a progressive tax rate increasing with the number of years the land remains undeveloped. The INOL aims to tax a building constructed for residential purposes that remains unoccupied (i.e. when no natural person is registered in it for a period of six months). To establish that a dwelling is not occupied, a national register of buildings and dwellings will be created.



Cadastral map of Bolzano, 1858

In the Netherlands, the ownership or use of real estate is subject to the following property taxes: real estate tax, water board charges, sewerage charges and waste disposal charges. Certain property taxes are levied on the owner of the real estate, others on the user. An owner-occupier will be charged both. The municipal authority appraises the property to determine the tax base for property tax purposes and reassesses the value of all properties each year. This value is the base of all taxation relating to the property (referred to as the 'WOZ value'). The Netherlands is particularly interesting as it has a body – the Netherlands Council for Real Estate Assessment (Waarderingskamer; Ndlr: TEGOVA member) – which provides central guidance to municipalities with regard to property tax valuations. It also carries out audits of the valuations to ensure consistency across the country.

In Poland, the Constitutional Tribunal issued a decision concerning the rate of real estate tax for property that is not used in a business activity, but is owned by an entrepreneur or entity conducting a business activity. The tribunal concluded that the provision that treats such real property as connected with business activity just because of the fact that its owner conducts business operations is unconstitutional. The tribunal found that the current statutory language suggests that, for purposes of real estate taxation, there is no distinction between taxpayers owning and using real estate in their business activity and taxpayers simply owning real estate but not using it for the purpose of running a business. This means that both sets of taxpayers must pay the real estate tax at a higher rate - a rate that is intended for real property used in business activity. The difference in treatment would affect business owners who are natural persons and who play a dual role as individuals (having control over their separate property) and a business operator.

Cadastre survey marker, Alto Adige, 2018

According to the tribunal, the provision imposes a disproportionate fiscal burden on one set of these taxpayers because it makes no distinction between the tax situation of taxpayers who own real estate, but do not use or cannot use it to conduct business activity, and taxpayers who use the real estate for the purpose of running a business—a constitutionally unjustified violation of the right to property. Thus, application of the rule cannot be justified by a claim that the treatment is warranted to protect the public interest, and this treatment does not satisfy the proportionality test. Consequently, the tribunal found that applying a higher real estate tax rate only because the entrepreneur or other entity as owner of the real estate is engaged in business activity was disproportionate interference with such property right.

In the United Kingdom, a revaluation of all non-domestic properties is currently being undertaken for property tax purposes. This means that all commercial properties are in the process of being revalued for the annual property tax which is often referred to as "business rates". The new draft rating lists containing the updated "rateable values" were published in November 2022 and the new values come into effect on 1 April 2023.

This means that the amount payable in respect of business rates may change, in some cases quite significantly, in the near future. Any real estate valuer carrying out a valuation of, for example, a large retail unit or office building in the UK, needs to be aware of this and take into account the impact of any material change – upwards or downwards – in this annual outgoing.

However, the UK government, and the devolved regional governments in Scotland, Wales and Northern Ireland, have all introduced a number of "reliefs" from payment of the full amount of business rates otherwise payable during both the COVID-19 pandemic and the current cost-of-living crisis. Some of these reliefs are being phased out over the next 12 months, so the current amount of business rates payable may change for this reason quite soon. It should also be noted that there will be a system of "upwards transition" which means that the full amount of any increase in business rates resulting from the revaluation will be phased in over a period of years. In the past, there was a system of "downwards transition" which meant that any reduction in the rates bill was also phased in over several years. Downwards transition does not apply to the 2023 revaluation.

Paul Sanderson JP LLB (Hons) FRICS FIRRV is President of the International Property Tax Institute

About the International Property Tax Institute

The International Property Tax Institute (IPTI) is widely recognised as the world's leading organisation on property tax policy and practice.

IPTI's mission is to provide impartial, objective expert advice in the area of property tax systems and promote the concept that these systems should be fair and equitable and meet the needs of all stakeholders, i.e. governments, taxpayers, practitioners and academics. In addition, IPTI seeks to ensure that property tax systems contribute to the provision of high-quality services for the benefit of communities.

IPTI is a not-for-profit organization comprised of experts who support stakeholders in developing and maintaining effective and efficient property tax systems by providing them with:

- Research and analytical information
- Impartial, objective policy advice
- Strategic advisory and consulting services to create, test and implement policy, and to improve performance through innovative good practice
- Education and training services to enhance professional development and build technical competence
- Property information services to enable more effective decisions

In addition, IPTI specialises in:

- Property valuation processes: including data collection, mapping and data management; mass appraisal valuation for residential and non-residential properties; quality control
- Property tax collection and enforcement
- Appeal systems
- Technology and process integration and implementation, including data management, data analysis and reporting systems
- Electronic and on-line learning
- Sharing best practice

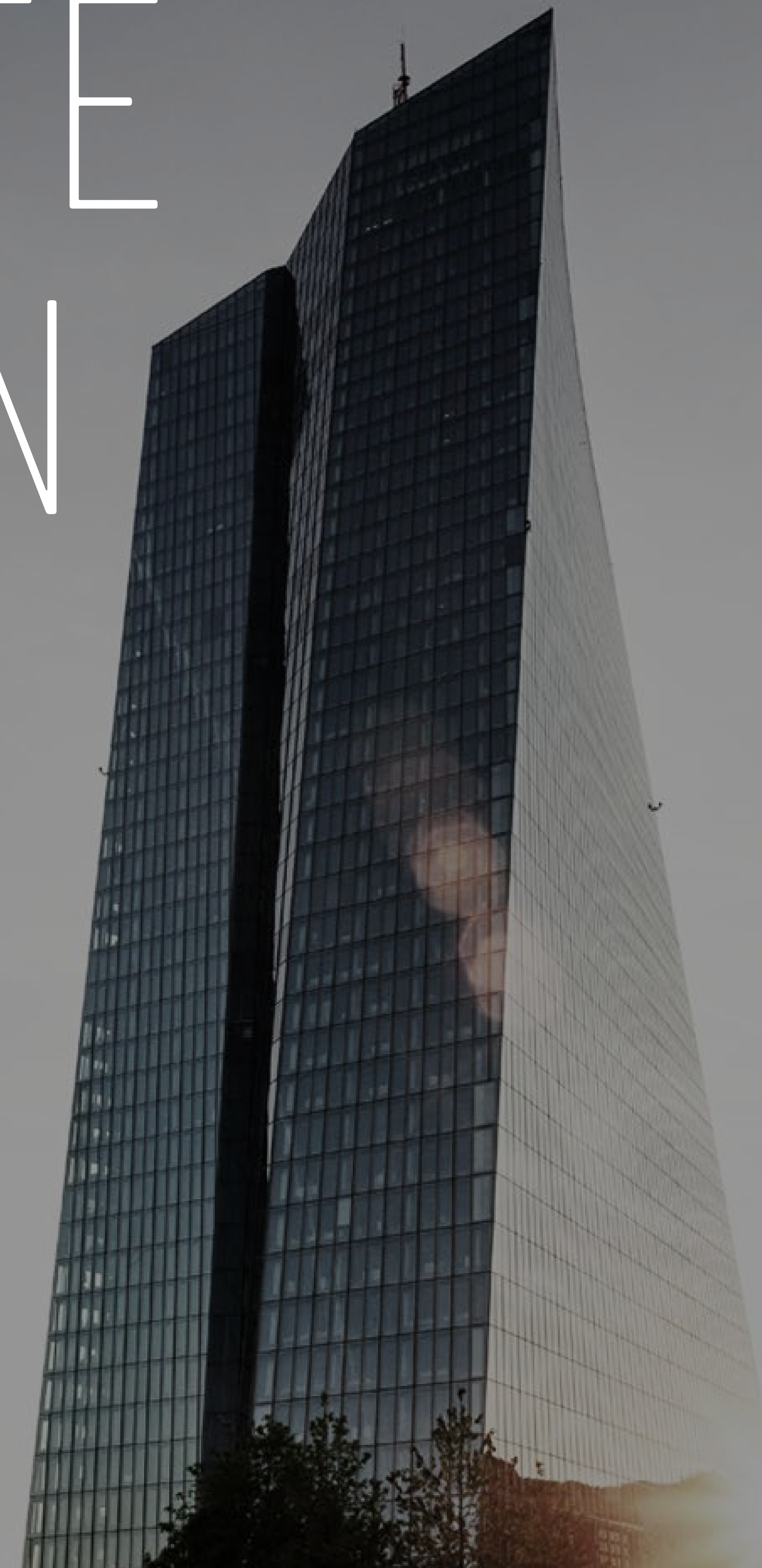
IPTI has a Board of Advisors which is comprised of internationally respected professionals all of whom have extensive experience in their respective fields. The breadth of membership of the Board reflects IPTI's commitment to international participation and sharing best practice on a global basis. The Board contributes to the strategic direction and overall planning for IPTI.

More information about IPTI can be found on its website www.ipti.org

IPTI is pleased to be working in collaboration with TEGOVA on areas of common interest.

EU REAL ESTATE AND VALUATION REGULATION

Michael MacBrien



The European Central Bank

#06 Recast of the Energy Performance of Buildings Directive: For the ECB, energy performance certificate classes have to represent the same thing across the Union

“From the ECB’s risk perspective, this very limited harmonisation of EPCs reduces their usefulness as proxies for the riskiness of a specific real estate asset”

Major significance for valuers determining energy efficiency impacts on market value

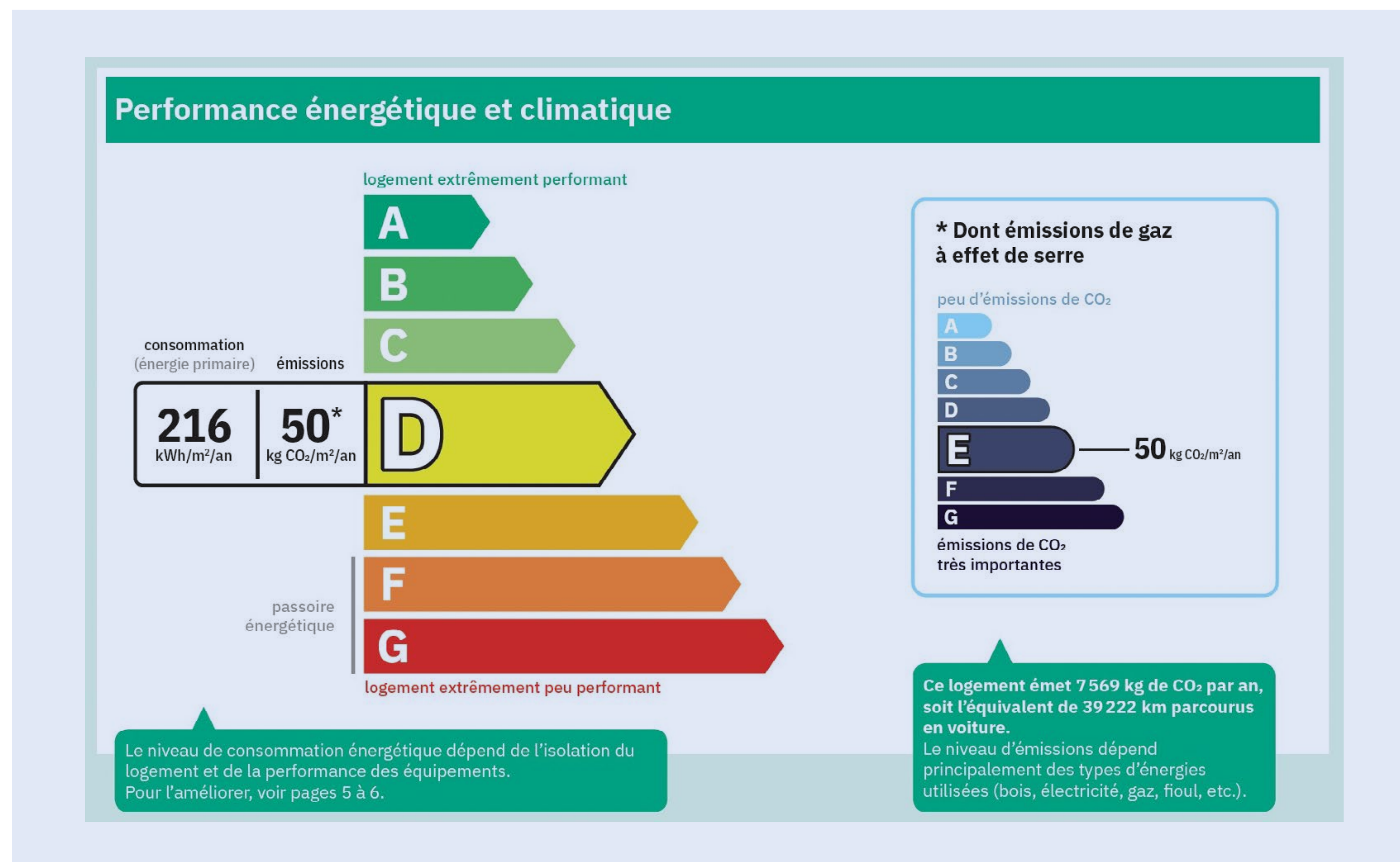
Coming very late in the legislative debate, the European Central Bank’s Opinion on the Proposal for a recast of the Energy Performance of Buildings Directive is limited to a few provisions that fall within the ECB’s core competence, one of which has major fallout for valuation practice: energy performance certificates (EPCs), for which the ECB wants greater harmonisation of definitions and methodologies so that across the Union, classes ‘G’ or ‘D’, etc. mean the same thing.

The ECB’s key complaint about this aspect of the Commission’s Proposal is that:

- defining EPC class ‘G’ as “the 15% worst-performing building stock” leads to a G class building stock that is radically different from country to country according to the degree of energy efficiency currently achieved in each country;
- and that member states retain considerable freedom over what exact degree of energy efficiency classes ‘F’ to ‘B’ stand for (‘A’ is zero-emission).

From the ECB’s risk perspective, this very limited harmonisation of EPCs reduces their usefulness as proxies for the riskiness of a specific real estate asset and reduces the Eurosystem*’s capacity to monitor and assess the impact of the climate-related financial risks on the assets it holds on its balance sheet, and to ensure adequate risk protection of its balance sheet.

*the ECB and the Eurozone national central banks as one interlocking entity



French EPC

Readers of European Valuer have seen how, coming into the debate just as late on the Capital Requirements Regulation, the ECB has caused Council and Parliament to wipe out key Commission-proposed provisions that would have given banks freedom to use stand-alone AVMs at origination. However, that is a systemic valuation issue whereas in this case, although they make it sound like a major banking supervisory concern, it's not as if divergences in energy performance certification are going to cause a run on banks. So one could be sceptical about the ECB's chances of engineering serious change at this late stage were it not for a convergence of interests with some big players in Council, Parliament and the Commission.

The December 2022 issue of European Valuer reported that in Council, Belgium, France, Germany, Ireland, Luxembourg and the Netherlands have rebelled against too-divergent EPCs, the Commission is threatening to take the whole Directive off the table if it is watered down too much, and Parliament is also likely to oppose dilution. The Council rebels want EPCs to be replaced as renovation triggers by "equal and verifiable parameters" so as to ensure a more equal effort by member states.

The ECB doesn't go that far and instead suggests improving the EPC:

> A more accurate, but simple methodology to harmonise EPCs could be to find a common indicator at Union level as main driver, such as primary energy use in kWh/(m2.y) or CO_2 emissions or preferably the combination of both, then calculate it for all buildings and divide the results into seven classes. To complement the information from EPCs on the energy efficiency, based on primary energy use in kWh/(m2 .y), an upper limit on acceptable greenhouse gas emissions (kgCO2eq/(m2.y) for each EPC class could be considered to ensure a speedier decarbonisation of real estate. *(p. 4, footnote 4)*

If this were just the ECB in isolation complaining about impediments to assessing energy efficiency impacts on banks' real estate exposures, it might not go far. But in the current political context, it may help Commission, Council and Parliament reach a compromise.

For valuers – and in the first instance for the European Valuation Standards Board drafting guidance on carrying out EVS Standard 6 on Valuation and Energy Efficiency – harmonised EPCs would probably be easier to identify and interpret than separate "equal and verifiable parameters".

"For valuers... harmonised EPCs would probably be easier to identify and interpret than separate "equal and verifiable parameters"

The ECB also points out difficulties that will arise from years of coexistence of EPCs issued before or after revision of the Directive:

5.1 As newly issued EPCs will be valid for up to 10 years, adoption of the proposed directive will imply the coexistence, after 2025, of two generations of EPCs for a considerable period of time. The transposition of the proposed directive should therefore clarify how those old and new generations of EPCs correspond to each other, whether they should be treated identically for regulatory purposes and how owners will receive the updated EPCs based on Union standards, ***as it would impact the value of buildings***[1]. For instance, *'zero-emission buildings' (ZEBs) are linked to energy performance class A under the proposed directive, but it is not clear whether buildings that have obtained an energy performance class A under the existing directive will count as ZEBs*. It is particularly relevant to consider this point in conjunction with other Union law, such as the Taxonomy Regulation and the SFDR[2], that cross-references EPCs and the definitions of ZEB and 'nearly zero-energy buildings'.

5.2 In addition, Member States should identify the most appropriate solutions to incentivise building owners to update their EPCs in a timely manner, as a means of raising awareness of recommended cost-efficient renovations to improve energy performance. *(pp. 6-7)*

[1] Our underlining, italics and bold, Ndlr
[2] Sustainable Finance Disclosure Regulation

BUSINESS VALUATION

Ivars Strautiņš, Chairman of the European Business Valuation Standards Board

#07

Taking European Business Valuation Standards to the next level

Ivars Strautiņš

EV interviews *Ivars Strautiņš*, new Chairman of the European Business Valuation Standards Board

European Valuer – EVS-BV 2020 were the first ever European Business Valuation Standards, authored by leading practitioners including yourself. First-ever is always tough. What was it like?

Ivars Strautiņš – I really must start by saluting the extraordinary leadership, energy and insight of the founding Chair, Danijela Ilić. Danijela is an absolutely top-class national and international business valuer whose energy, insight and attention to detail brought us to port.

TEGOVA's mandate to us to create modern business valuation standards based on European valuation practices and grounded in EU law posed a real challenge. The raison d'être of all Blue Books is the same and is more relevant than ever – strategic European autonomy. Yet some important customers of business valuation services are international companies and financial institutions, so we had to ensure the compatibility of EVS-BV with other already established valuation standards by following the generally accepted framework and concepts of business valuation whilst at the same time integrating European valuation practice and the plethoric body of business-relevant EU legislation.

EV – Is it time yet to review EVS-BV 2020?

IS – The first edition included best practices prior to 2020 and was based on the assumption that the economy would develop in a business-as-usual pattern. The changes in consumer behaviour caused by the COVID pandemic, the war in Ukraine and its impact on the flow of goods and services[1], the efforts of Russia and China to change the world order, as well as massive new EU legislative initiatives are modern realities that will affect the sustainability of businesses in ways that no one could have predicted at the time. Although these factors may not significantly affect the key standards, there is an urgent need to provide appropriate guidance on how to interpret them in the light of what my EVS real estate colleague Jeremy Moody has called "the Era of Risk"[2] in order to produce a reliable business valuation. Given that their greatest impact is directly on European companies, I doubt that other international standard setters will pay such phenomena the necessary attention.

The second thing is that EVS-BV 2020 contains many texts directly borrowed from EVS without any criticism – highly understandable given the constraints we worked under at the time – and we must now serenely review their relevance for EVS-BV. I was also a member of the European Plant, Machinery & Equipment Valuation Standards Board and, while working on the alignment of EVS-PME with EVS we already partially revised the EVS texts that we were transposing and concluded that some of them seem redundant even for EVS.

EV – What is your view on the necessary degree of harmonisation between the three Blue Books?

In my opinion, there needs to be a high level of consistency between the basic concepts and definitions. We haven't done so badly so far, but there is room for improvement. The real estate and business valuation standards boards will need to coordinate their work and can learn a lot from EVS-PME 2022, whose authors had a sustained interest in Blue Book consistency.

EV – In EVS-BV, are there any Standards missing?

IS – Although it's hard to overstate the importance of Financial Reporting to business valuation, somehow the current EVS-BV lacks a standard or at least guidance on this topic.

EV – Should there be a section on Methodology? What are the methodological challenges?

IS – We must keep in mind the core difference between a standard and a methodology. EVS-BV as a set of standards should reflect best practices that have been tested and implemented in the industry and represent a measure of performance and quality. Since qualified business valuers must be persons with appropriate education and practice, it makes no sense to describe in the standards the basics of business valuation methodology that they already know. By delving deep into methodology we risk turning EVS-BV into a kind of textbook on business valuation. To my mind the current setup – the mandatory standards section and guidance notes, which are partly devoted to methodological issues specific to the implementation of the standards – should be maintained without a separate methodology section.

Returning to the question of Blue Book harmonisation, I know that EVS has a dedicated section on Methodology, but in my view this reflects a difference of nature between real estate on the one hand and business and PME on the other. In the latter, the Standard on valuation approaches and methods is sufficient.

"Start-up businesses are a very special valuation challenge."

EV – Are there business valuation specialisations meriting special treatment in the new EVS-BV?

IS – Valuation of start-up businesses, as start-ups are key to Europe's future economy and society. They're a very special valuation challenge, because start-ups typically have negative cash flows, limited or no historical financial data, and sometimes lack valuable tangible assets. Those factors reduce the usefulness of traditional valuation approaches because start-ups cannot provide the financial performance indicators on which the value estimates of those approaches are based. That's why specific methods for evaluating start-ups, based more on qualitative than quantitative criteria, are used and they should be described and explained in EVS-BV.

[1] See "The business valuation challenges of war and sanctions", Ivars Strautiņš, European Valuer September 2022

[2] See "The dawn of an uncertain era – The Era of Risk?", Jeremy Moody, Guest Editorial, European Valuer December 2022

“I do not see any serious obstacles to commercial real estate valuers expanding their activities to business valuation after completing some specific training. Indeed, I see synergies.”

EV – What are you going to do about all the European Green Deal legislation impacting business valuation?

IS – When EVS-BV 2020 was drafted, the European Green Deal was on the radar, but the legislation hadn't even been tabled. Now the legislation has become a reality that is both all-encompassing and sector-specific. In my opinion, these aspects should be reflected not only in the EU Legislation section, but in specific Guidance and/or information Papers. After all, the Green Deal is transformative, and the entire package will be on the statute books in perfect time for the next edition of EVS-BV.

EV – Is business valuation a realistic new activity for real estate valuers?

IS - Certain commercial properties, especially properties in the leisure industry, such as leisure centres, professional sports stadia, theatres, hotels, restaurants and clubs, and also forests and certain agricultural properties, have valuations based on the accounts of the enterprise operating on the property. Their valuation procedures and methodology have much in common with business valuation. The core difference is that while EVS requires exclusion of all elements of over-trading peculiar to a particular occupier or brand, business valuation is based on these specific characteristics or elements of goodwill that distinguish one business from another.

Therefore, I do not see any serious obstacles to commercial real estate valuers expanding their activities to business valuation after completing some specific training. Indeed, I see synergies.

EV – Are there fields for cooperation between real estate valuers and business valuers as we have seen with real estate valuers and PME valuers concerning building technical systems?

IS – Close collaboration between business, real estate and PME appraisers is critical when business valuation is undertaken using asset-based approaches. In this case, the real estate and PME valuations are among the main inputs that the business valuers use to form their opinion on the value of the business. It is therefore crucial that all parties involved understand their roles in the engagement and can fully rely on each other to produce a reliable business valuation. This can only be ensured by duly following EVS, EVS-BV and EVS-PME standards.

Conversely, due to their experience in business analysis, business valuers' assistance can be valuable in cases where real estate and PME valuers perform valuation with the income approach, based on the income-generating potential of an asset. As an example, I can mention renewable energy-related PME valuations, in which value is mostly determined by the provisions of energy purchase contracts.

EV – Some people tend to associate business valuation with accountants and business consultants. What makes valuers relevant?

IS – Although from the outside it may seem that business valuers, accountants and business consultants perform similar tasks, in reality they are fundamentally different.

The task of accountants is to prepare reliable financial statements that reflect the historical transactions in which the company has engaged. Their statements must comply with the requirements of national and international financial reporting standards, and their professional activities are regulated by law.

The task of business consultants is to work side by side with the client on strategic and operational planning of the business to help achieve the client's specific goals. Although business consulting is not a regulated profession in most countries, formally they have to follow the ISO 20700:2017 standard Guidelines for the Regulation of Management Consulting Services in their practice.

The task of business valuers is more complicated: they have to provide unbiased and independent opinion on the value of a business or ownership interest therein based both on the present situation and future potential and opportunities of the business being valued. Business valuations must comply with EVS-BV or other relevant business valuation standards. Although business valuation procedures include analysis of financial statements prepared by accountants and business plans developed with the help of business consultants, they form only part of the necessary input data.

EV – You want to strengthen the membership of the EVSB. What profiles are you looking for?

IS – There is room for many profiles, but in particular, the new fields of business valuation we are envisaging for the next EVS-BV require deep specialist knowledge. We need business valuers with experience in valuation of start-up businesses, sustainability reporting and financial accounting, amongst others. We are open to persons presented by TEGOVA member associations but also to complete 'outsiders'.

Ivars Strautiņš is Chairman of the European Business Valuation Standards Board

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

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