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EDUCATION AND QUALIFICATION – THE HEART OF THE MATTER

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Photo by Raluca Slicaru

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EDITORIAL

The end of the most valuation-rich legislature in the history of the Union

EU law is initially proposed by the European Commission and then amended by the Council of Ministers and the European Parliament. Electorates are continually replacing one or other of Council's 27 members, but the Members of Parliament are renewed in one go every five years hence the concept of 'legislature'.

The 2019-2024 legislature was a game-changer for property and valuation:

The 'Banking Package' included a revision of the Capital Requirements Regulation (CRR) which introduced a new concept of 'property value' founded on 'prudently conservative valuation criteria' that valuers will have to accommodate alongside market value. Soon to be on the EU statute books, it will come into effect on 01.01.2025 the same day as EVS 2025. The Blue Book will contain a Guidance Note with an interpretation of the new CRR concepts that the European Valuation Standards Board issued – and that this Journal liberally commented and publicised – shortly after it became clear that the relevant provision had achieved political consensus and wouldn't change.

The other CRR game changer was Parliament and Council's ECB-inspired rejection of the Commission's attempt to extend banks' freedom to use stand-alone, valuer-free AVMs to revaluation and even to valuation at origination. This extraordinary event will have consequences. Reiteration by the highest European authorities of the central role of the qualified independent valuer in ensuring the safety and stability of financial and real estate markets will command a revision of the European Banking Authority Guidelines on loan origination and monitoring that confined mortgage valuers to a 'desktop' role so poorly defined that banks could interpret it as little more than an exercise in rubberstamping AVM 'value proposals'.

The European Green Deal – the largest legislative effort since the programme to complete the single market forty years ago – was a comprehensive package to reduce EU carbon emissions by 55% by 2030 compared to 1990 levels and to achieve climate-neutrality by 2050. To do this, it had to cover the four great carbon emitters: agriculture, industry, transport and buildings (the last being the single largest source at 36%). At the very end, some of the agricultural laws were watered down to some extent, but almost everything else came through intact. For buildings, everything is on the statute books: Extension of the EU Emissions Trading System to buildings, Renewables Directive, Energy Efficiency Directive with its accelerated decarbonisation of the public building stock at every level of government and public ownership, and the Energy Performance of Buildings Directive laying down that all new buildings will be zero-emission by 2030, organising the energy efficiency renovation of the worst performing public and private building stock by 2030, 2033 or 2035 according to building type as well as massive rooftop solar installation to even closer deadlines.

EVS 2025 has risen to this challenge as well. Building on the extraordinary foresight of EVS 2020 which already instructed valuers to take account of legal deadlines and inflection points for energy efficiency renovation in their estimations of market value, the new Blue Book will detail the specific residual approach to doing so.

Some may doubt whether any of this will really happen. Some political interests are calling for a pause to the production of EU climate law. Others have campaigned on a promise to 'roll back the Green Deal'. A pause in the tabling of new climate law there certainly will be. That job is largely done and the task now is implementation. 'Rolling back' existing EU law is another matter. It can't be done at national level because of the primacy of EU law. It can certainly be done at EU level, but would come up against the flip side of the EU legislative process. It is difficult to make EU law in the first place because it requires a double qualified majority in the Council of Ministers:

1. **55% of member states must vote in favour (15 out of 27)**
2. **The proposal needs to be supported by member states representing at least 65% of the EU population**

That works both ways. Experience shows that the threshold is even harder to achieve in reverse.

Michael MacBrien, Editor

REAL ESTATE VALUATION

#01 Education is key to deciphering value

Julia Barrasa Shaw
Photo by Raluca Slicaru

What education and training are required of a valuer? Across Europe, national regulation varies from little or nothing to specialised qualification requirements, but the Minimum Educational Requirements (MER) of TEGOVA's European Valuation Standards (EVS) create a (high) level playing field. Valuers must stay in step with a constantly changing society and business environment, and education and training are fundamental to that, hence the European Valuation Standards Board (EVSB)'s extensive review of the minimum requirements for the profession involving a thorough analysis of each item of the curriculum and the creation of some new ones in line with the present and potential future working conditions of the profession. In this process, we have sought to unify and simplify the knowledge set required by a qualified professional into now only two main categories: general and specialised knowledge.

"Valuers must be financially literate in order to understand the workings of an investment at income and expense level, as well as the business concepts involved in a transaction."

General knowledge

In relation to **principles of economic theory,** it is crucial to understand both macro and microeconomic aspects and their influence on the real estate sector and equally important to grasp the dynamics of supply and demand, as well as the effect of local economic policies on the market, because such factors inevitably shape the short- and medium-term value of properties.

In terms of **business and financial** knowledge, valuers must have general accounting skills and be financially literate in order to understand the workings of an investment at income and expense level, as well as the business concepts involved in a transaction.

Valuers must have a solid general knowledge of **building and construction**, including concepts such as design, development, property condition, refurbishment needs and costs, development times, etc. These construction process factors have an impact on a property's value, never more so than now under the new EU regulatory regime for energy efficiency, as we shall see.

Technological advances are significantly transforming the profession, so a general knowledge of **statistics** can give us an understanding of the basics of computer applications and enable us to detect and analyse the possible benefits and errors and the impact they have on professional development.

In-depth knowledge

All the information and analysis applied in the valuation must be duly justified. This requires thorough knowledge of **valuation reports**, their minimum content, the research and calculations carried out and all the information considered relevant for the work to be conducted. All reports must comply with **European Valuation Standards**, as well as **Valuations under Statute**, where appropriate, with which valuers must demonstrate complete proficiency.

"Valuers will need the knowledge and skills necessary to obtain the cost of renovation to the required EPC class which in turn requires proficiency in construction cost calculation."

When examining the regulations that influence a property, it is crucial to consider both the **regulations related to the property itself and** those related **to the land** on which it is located. In the first case, each country has legal frameworks that define the rights and responsibilities of the property's owner or user. Meanwhile, an understanding of land regulations ensures we can assess risks and opportunities that could have a direct impact on the property in the short, medium and long term. Examples are zoning changes, environmental impacts or potential liabilities for past planning infringements.

In the current real estate market, where business models are evolving rapidly, the analysis of any investment, including property, requires a thorough understanding of **applied economics**, including factors such as risk mitigation, evaluation and comparison of investments and revenue projection, which can inform every decision taken on valuation.

Sustainability is a crucial factor in real estate, impacting both existing properties and new-build. Compliance with new European environmental regulations and business commitment to sustainability are transforming the dynamics of occupancy and profitability in the real estate market.

Above all, given the impending EU-mandated legal obligation to improve the energy efficiency of buildings, valuers need a thorough knowledge of the national and local rules implementing the EU law the renovation deadlines laid down, the necessary renovation costs, as well as the impact this has on the market value and the methodology for measuring this. Member States will only be able to achieve the EU's mandatory and strictly time-lined goals by imposing renovations to higher energy performance certificate (EPC) levels by certain dates, doubtless by setting renovation triggers such as the sale or rental of a property or a new lease. EVS 2020's Standard 6 on Valuation and Energy Efficiency already places an obligation on the valuer to adapt to this, but in EVS 2025 the EVSB has set out a complete methodology, just approved by the TEGOVA Board and by the General Assembly in Bucharest. Under the future EVS, the valuer integrating identified energy efficiency renovation constraints into the estimation of value must take a residual approach and, in the more complex cases, apply a full residual method. Valuers will therefore need the knowledge and skills necessary to obtain the cost of renovation to the required EPC class which in turn requires proficiency in construction cost calculation.

Energy is not the only new EU law impelling the valuation profession to excellence. Alongside market value, the revised Capital Requirements Regulation creates a new concept of **property value founded on prudently conservative valuation criteria**, one aspect of which 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"*. It will take some time before the valuation profession gets a proper handle on this, but doing so will certainly require comprehensive, interdisciplinary mastery of many of the concepts and curriculum items discussed above.

In conclusion, excellence in the field of real estate valuation requires mastery of these fundamentals and a continuous commitment to innovation-oriented professional development. By thoroughly understanding and integrating the principles determining the value of a property, real estate professionals enhance accuracy to the benefit of all parties. A qualified valuer will be able to demonstrate knowledge and competence in all of these concepts and can obtain TEGOVA's enhanced competency by becoming accredited as an REV (Recognised European Valuer) or TRV (TEGOVA Residential Valuer).

It has been 12 years since the last MER review. I very much doubt it will take that long until the next one. Education and CPD should be a constant concern for TEGOVA's governing bodies and a subject for continuous discussion, questioning and innovation. For valuers, perhaps even more than for other professions, the only way out is up.

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#02

Stand up and be recognised: how REV is the path towards more and better assignments for European Valuers

Luke Brucato
Photo by Raluca Slicaru

Europe certainly loves its acronyms and the banking and property sectors especially: ECB, LTV, DCF, MER, EVS, TMA and the like find new friends in ESG, EPC, DNSH, and our darling REV – Recognised European Valuer. The constant proliferation of new acronyms in the world of standard setting and banking regulation is a sign of the complexity of the ever-growing framework and each acronym represents a need to simplify and provide the interested parties with the shortest path to understanding the concept at hand. In essence, this is what the three letters REV represent to all those who read them following a valuer's name: they are **the most immediate way to communicate three key aspects** of the professional displaying them:

1. Knowledge of the European Valuation Standards and how to apply them
2. Training in the relative field of the assignment
3. Ethical approach according to a common European framework

We are currently living (and working) in the **attention economy** in which the amount of information and entertainment available to consume far exceeds anyone's lifetime and all attention is measured and monetised. Our clients are first and foremost consumers of our valuation services and they rely on "shortcuts" to **quickly distinguish valuers who meet reliable and measurable criteria** from the rest of the pack. Take the Italian market example: most technical services (including property valuation) are carried out by professionals who are officially registered as architects, engineers, surveyors (geometri) and at least four other professional bodies. Together these professional bodies represent over 500.000 individuals competing for valuation work, among other activities. How can a bank, fund, foreign investor, or an asset manager identify those valuers who apply European Valuations Standards, have made a commitment to ongoing training and adhere to a code of conduct among over a half a million potential valuers? The power of the REV brand is that it allows its designation holders to stand up and be recognised by the market.

"In the Italian banking system, we have now seen several large national banks award valuation companies additional points in tenders according to the percentage of REV valuers they use on the ground."

In the past decade in Italy, we have seen an increasing reference to valuer qualifications, from commercial banks to public tenders, from courts to investor criteria. Their need to simplify the decision making process and ensure quality throughout the entire real estate decision chain have put the focus on valuer competence. Of course, there are several competing valuer qualifications available in most European countries, but REV stands alone in its direct connection to the European banking system thanks to TEGOVA's relentless representation of the profession's best interests at the EU level. So much so that in the Italian banking system, we have now seen several large national banks award valuation companies additional points in tenders according to the percentage of REV valuers they use on the ground. The Italian Banking Association (ABI) has for years identified REV as sufficient title to carry out valuation assignments according to its Guidelines on Property Valuation, a voluntary piece of self-regulation first published in 2010 and formally adopted by almost all banks. It's also worth mentioning that REV was by no means the first designation on the EU market for property valuers, but it has adapted well to national schemes such as the ISO 17024 accredited certification, with notable examples of strong adoption in Greece and Italy, where REV is seen as the European dimension to a national certification.

So, mission accomplished, right? Well, not really, more like mission started! In the last decade, as a member of the REV Recognition Committee and an auditor of TEGOVA member associations who would like to become REV awarding associations, I've had the privilege of witnessing first hand the challenges and satisfactions of implementing a local REV programme. The following is a summary of what I have learned and what the future of REV could look like:

1. REV, EVS and TEGOVA itself are now inextricably tied together in a self-reinforcing spiral of growth. TEGOVA's primary mission has always been the drafting and publication of European Valuation Standards (EVS) but a standard is only as powerful as the rules that bind it and the professionals that adopt it. REV is today in essence the strongest tool we have to usher in EVS to areas of the market that might still be unaware of its potential to elevate and maintain quality of valuation work. Having thousands of REV valuers operating every day on the European market means having thousands of EVS ambassadors. TEGOVA Member Associations (TMA) wishing to become REV Awarding Member Associations (AMA) should view the REV programme as the best and most immediate way to raise industry standards in their local market from the ground up.

2. As TEGOVA expands its standard setting activities to areas of valuation beyond property (such as businesses and plant, machinery & equipment) the **REV brand will continue to ensure a direct connection between the competence of an individual valuer and the evolving best practices of the profession**, creating relevance for both the professional and the local association. Current AMAs can leverage the existing REV framework and introduce REV-PME, REV-BV and any future professional recognition without reinventing the wheel of their management system.

"REV is a future-proof way to elevate the competence of the entire European network of REV valuers thanks to its direct connection to EVS which evolves in lock-step with EU banking regulation."

3. As the valuation profession evolves, the REV designation remains the quickest way to reassure clients that the latest requirements, training and standards are added to the REV's toolkit. The increasing demands to consider energy performance, measure physical risk, calculate property value in accordance with the upcoming Capital Requirements Regulation in 2025 and adhere to the principles of the EBA Guidelines on Loan Origination and Monitoring, mean that clients need to distinguish those valuers who can provide this level of service. REV meets that need and is a future-proof way to elevate the competence of the entire European network of REV valuers thanks to its direct connection to EVS which evolves in lock-step with EU banking regulation.

"The topic of price still does come up in our audits, but I believe it's incorrectly framed: rather than interpret the cost of the REV designation as an extra cost on top of existing qualification expenses (state licensing, training, ISO certification, association membership, etc.) it should be seen as a very convenient marketing expense."

4. Compared to other valuer designations, REV is surprisingly affordable for the individual AMA but TEGOVA, in perfect EU spirit, has given each AMA the freedom to set the final price of the designation for the valuer in order to reflect dynamics of the local market, average valuer income, national competition, etc. Nonetheless, the topic of price still does come up in our audits, but I believe it's incorrectly framed: rather than interpret the cost of the REV designation as an extra cost on top of existing **qualification** expenses (state licensing, training, ISO certification, association membership, etc.) it should be seen as a very convenient **marketing** expense. A LinkedIn premium account will cost a valuer anywhere from € 350 to € 1500 per year, an entry-level professional website in 2024 can still cost up to € 500 per year plus maintenance, while shaking hands at an international conference can run in the thousands. When viewed as an investment in marketing, **REV puts the valuer in the official register at an EU level on the TEGOVA website** and in the register at the national association level at a very affordable price.

5. At the time of writing, the REV designation is available in 20 EU countries through over 35 TEGOVA Awarding Associations, however **in some countries the ratio between active valuers and REV valuers is still too low**, which hampers both the creation of a widespread community of REV valuers and the adoption of EVS throughout national markets. One reason could be the false impression that having few REV valuers at a national level would bring the high quality (i.e. high fees) valuation assignments to a small group of select individuals, but this doesn't happen for two reasons. First, this strategy is only successful once the REV brand is well established and widely recognised, and that only takes place once a significant number of valuers in proportion to the whole have the REV designation and are actively marketing it in their local market. And second, specific in particular to the banking market, most national banks need to ensure to the ECB proper rotation of their valuer panel and having a small number of REV valuers works against that principle. **Current and future AMAs should push to maximise the number of their REV valuers** in order to create a force to be reckoned with at the national and EU level, while of course ensuring that quality of process and outcome is guaranteed.

Demand used to drive supply, but in advanced markets with little scarcity, supply creates demand, and **the EU needs a strong supply of REV valuers to educate demand** to the possibility of working with valuers who have invested in training, adhere to European Valuation Standards and follow a code of ethics. The EU needs an "army" of tens of thousands of professionals with REV designations, each one an ambassador for EVS and their local association, each one a member of a larger community of valuers who can congregate, network, refer business across geographies, and influence the local market stakeholders to drive more and better business to TEGOVA Recognised European Valuers.

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#03

The impact of flood risk on the assessment of property values for secured lending

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Introduction

The catastrophic floods in Slovenia in August 2023 gave rise to a number of new professional challenges in the areas of real estate valuation and risk management in secured lending and collateral. In flood risk management, these areas are closely linked and interdependent. In this paper, we present some key findings on the responsiveness of property markets to flood risk as identified by researchers in a number of international studies, as well as their applicability to property valuation and risk management in secured lending.

Figure 1: Cartographic representation of selected flood-prone areas in Slovenia

Figure 2: Data on flood risk in Slovenia

A **40-centimetre** flood can **wash away** most cars, even larger ones.	In 2007, in Pomurje (western Slovenia), **half of the average annual rainfall** fell in just **24 hours** – about 310 millimetres (or 310 litres per square metre)!	**€ 551 million** of damage was caused directly by the 1990 floods, even more than the damage caused by the catastrophic floods in 2014.	**In 2014, all regions of Slovenia** were affected by flooding, with three major flooding events.
A quarter of Slovenians live in areas prone to **catastrophic flooding**, which can occur **every 25 to 100 years**.	With a **2°C increase in global temperatures**, we can expect **100-year floods every 62 years**.	**41% of the damage** caused by natural disasters in Slovenia **is caused by floods**. It takes years to remedy.	**In the 60 years** from 1920 to 1979, there were **8 major floods, and in the 35 years** from 1980 to 2014 there were **13!**
10% of Slovenia is flood-prone, with various natural factors leading to periodic inundation.	**Half** of all Triglav Insurance policy holders also have **flood insurance**. Often, however, this insurance is **insufficient**.	In the 2012 floods, **20,048 members** of the civil defence forces, 70% of them **firefighters**, were involved in rescue and recovery efforts.	Hydrological forecasts are about **80% reliable**. On average, 36 hours elapse between warning issuance and flood occurance. Only one-fifth of warnings are misleading or incorrect.

"The mere existence of flood risk does not always translate into actual price changes, as markets react to such risk in various ways."

Research Findings Related to Flood Risk

The impact of flooding on property values has been widely studied by researchers, with varying results. As the most important factor in determining the impact of flooding on property values, these studies identified the need to proactively categorise areas as flood-prone or flood-safe. The researchers point out that the classification of an area as at-risk or safe does not in itself mean that a particular property is at risk of flooding or has been affected in the past, but only indicates the risk of flooding in that area in the future, as flooding is a localised and sporadic phenomenon. The definition of flood-prone areas is used in two ways in the studies:

- to determine the change in property prices in flood-prone areas compared to flood-safe areas and/or;
- to identify changes in property prices after a flood compared to property prices before the flood.

The second research methodology is the comparable transactions approach, which is also the basis for estimating the market value of properties. In methodological terms, the advantage of this approach is that it is free from omitted variable bias; however, the disadvantage is that it can be limited to narrowly-defined local property markets.

Flood impact studies are mainly based on hedonic pricing models. The hedonic model is a variant of the comparable sales approach, which takes into account the diversity of the geographical areas in which the properties are located. In these models, the market price of a property with a hedonic price function depends on its characteristics. In studying the impact of floods on property prices, we are concerned with the extent to which prices are dependent on a non-urban externality in the form of flood risk. Hedonic models are mainly used to study residential property. In his research, O'Sullivan (2012) found that the influence of the surrounding area is crucial in this type of assessment, as when choosing a property, we are also choosing a neighbourhood. He also noted that the mere existence of flood risk does not always translate into actual price changes, as markets react to such risk in various ways.

"The volume of demand for property in an at-risk area has a significant impact on property prices. The rule is: the greater the demand, the lesser the impact."

International studies show that various factors related to flood risk can cause changes in property values, though not in all cases. We find that the following factors are particularly important:

- **Scope of flood-damage events.** The more flood damage there has been in the past, the greater the negative impact on the value of the property.
- **Frequency of flood-damage events.** If flood-damage events occur regularly in the area where the property is located and have a direct impact on the property, this has a direct negative impact on the property's price.
- **Demand for property.** The volume of demand for property in an at-risk area has a significant impact on property prices. The rule is: the greater the demand, the lesser the impact. Examples include the Hrušice district in Jesenice and the coastal flood zone in Piran. This relationship is based on the fact that local residents are accustomed to flood risk and, despite being aware of the risk, choose to live in at-risk areas. Typically in areas where demand for property is high, property prices fall immediately after a flood, but eventually return to their previous levels once the damage is repaired and the memory of the event has faded. Local markets where demand for property is high show less responsiveness to flood events than markets where demand is lower.
- **Investor awareness and the unpriced flood costs.** In flood-prone areas, where residents regularly experience floods and are aware of the risk of flood damage, property values respond differently to flood risk than in areas that flood only occasionally, at longer intervals. In theory, investors' insensitivity to flood risk represents an unpriced flood cost.

"Following previous flood events and flood risk in Slovenia, risk zoning was conducted in accordance with the EU Floods Directive. Information on the identified flood risk zones is publicly available, including to investors, and serves as a basis (in addition to experience) for defining flood protection policy."

- **Impact of disclosure on flood risk.** Flooding is a localised and sporadic phenomenon. The existence of a flood risk does not always translate into actual price changes, as markets react to such risks in various ways. Due to property owners' misconceptions about the exposure of their properties, investors do not fully consider the costs of flooding when buying property in these areas. This is not unique to Slovenia. This behaviour among investors has been observed in most international surveys. Following previous flood events and flood risk in Slovenia, risk zoning was conducted in accordance with the EU Floods Directive. Information on the identified flood risk zones is publicly available, including to investors, and serves as a basis (in addition to experience) for defining flood protection policy.
- **Property insurance.** Research in the US has shown that almost 80% of property owners in areas that suffered the most flood damage did not have flood insurance on their properties. The same applies to Slovenia. Following the catastrophic floods in Slovenia in August 2023, it was found that the vast majority of affected properties were either not insured at all or were significantly underinsured.
- **Social status of the property owner.** International research on flood damage events shows that the social status of property owners has a significant impact on the amount of damage suffered, due to the unpriced flood costs. In the US, the unpriced flood cost was found to be 17% higher for households below the poverty line than for middle-income households, and 68% higher than for high-income households. This has a significant impact on the scope of defaults on secured loans following flood events. In Slovenia, after the floods that we experienced in 2023, we perceive that the property status of the injured parties is an important factor affecting their ability to repay loans. However, since the EU and the government have taken measures to help socially weak flood victims, we expect that the impact of this factor will be significantly less than in the US. We will be able to judge this only from the appropriate time distance once all measures of the state are finally implemented and the consequences of the floods on the portfolios of secured loans of banks fully disclosed. In a severe climate change scenario, mortgage defaults resulting from flood events in the US could increase by more than 40% in at-risk areas by 2050. If this is indeed the case, we can expect increased losses from defaults on secured lending in Slovenia in the future.

"Actual flooding can confirm the risk assessment, extend the risk areas, or show how the risk has changed."

- **Climate change.** The current resilience of the property market to flood risk is not necessarily representative of what will happen in the future, as climate change is causing more frequent and severe flooding, which is changing investors' perceptions of flood risk. The more flood events occur, the more aware investors will become, which is likely to gradually reduce the level of unpriced flood costs.
- **Asymmetry of flood damage.** In the US, it has been found that 20% of at-risk properties represent approximately 80% of the total costs in a flood-damage event. Given the difficulty in adequately identifying the flood risk of individual properties (as discussed below), we may conclude that financial institutions will need to manage flood risks on a portfolio basis, mainly through changes in lending policies, and only rarely on an individual basis.
- **Distinguishing between flood risk and flood events.** Actual flooding can confirm the risk assessment, extend the risk areas, or show how the risk has changed. Experience in Slovenia shows that this happens mainly in areas where flooding was already a known risk. Past flood-damage events are therefore not necessarily the only indicator – or a sufficiently reliable one – of future flood damage.

"If secured financing and insurance cover were no longer available to investors in some areas, this would change the financial circumstances, reducing demand and liquidity in the local property market."

- **Flood protection measures.** Measures taken by the state and local authorities in response to flood risk and flood events and aiming to reduce flood risk and bolster flood protections have a significant impact on the development of the local property market. Exposure to flooding is not necessarily an entirely unmanageable risk. After a flood-damage event, the government, local authorities and property owners can start taking action to reduce future risks. Rarely can these measures eliminate flood risk altogether. Managing land and watercourses to reduce the volume and rate of runoff can mitigate future flooding. However, it is virtually impossible to predict the type of measures, their effects on overall flood risk and, above all, the dynamics of their implementation.
- **Changes to insurance and lending policies.** In the event of a flood-damage event, the unpriced flood costs result in increased defaults by debtors who have suffered significant damage or even loss of property, which can lead to losses for banks whose loans are secured by real estate and to high claims payments from insurers. Banks and insurers typically review their lending and insurance policies whenever such an event occurs. Changes in secured lending and flood insurance policies can have a significant impact on the development of local property markets. If secured financing and insurance cover were no longer available to investors in some areas, this would change the financial circumstances, reducing demand and liquidity in the local property market. Demand for property would be limited to investors who do not need loans and who will exercise their own individual judgement on potential flood risk damages. This would result in reduced unpriced and uncalculated flood costs, and would most likely lead to a decline in property prices in these markets.

Assessing Property Values in Relation to Flood Risk

Flood risk to property as a type of functional obsolescence

Flood risk to property may be classified as a type of functional obsolescence. This can be divided into curable and incurable obsolescence. This includes:

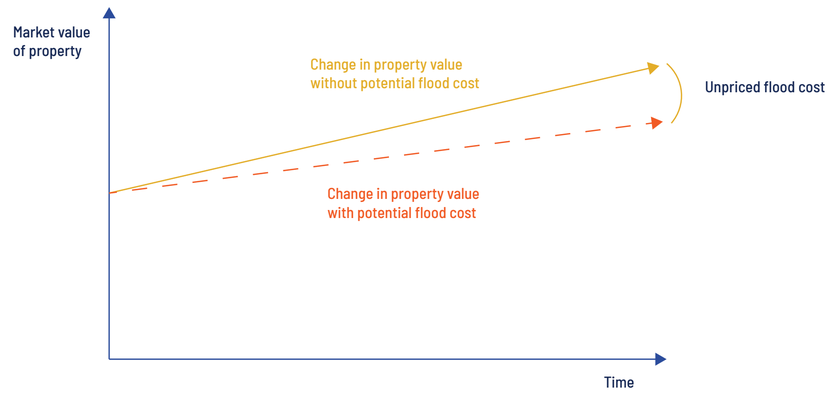
1. **Curable functional obsolescence**, which occurs when functional obsolescence can be cured via the appropriate investments. For flood risk, this refers to cases where such risk can be eliminated. There are two ways to do this:
    - individual investments by the property owner to cure the obsolescence and eliminate flood risks
    - systemic investments by the state or local community to cure the obsolescence and eliminate flood risks.
2. **Incurable functional obsolescence**, which occurs when curing the functional obsolescence is not justified or not possible (e.g. the property is located in an area of high flood risk where individual and systemic remediation of such risk is not possible and/or not justified).

Similar to assessing the flood risk of a property being valued, we may also assess the curability of both risks. This is a complex issue, to be dealt with by trained specialists. As property valuers, we are not generally trained to make such assessments. Flood mitigation plans, which are primarily the responsibility of the state and local communities, may be disclosed by valuers in their reports. However, this disclosure cannot be binding, as these plans often concern large-scale projects for which data and information are not publicly available. International research suggests that over time, flood risk recovery has a significant and positive impact on local property markets where such projects are implemented. This also provides guidance for banks' flood risk management policies, which are usually enshrined in internal policies for this type of lending. These policies need to be regularly adapted to changing circumstances.

"The curable or incurable obsolescence of a property due to flood risk should be distinguished from investors' perception of the potential costs of flooding on the property."

The curable or incurable obsolescence of a property due to flood risk should be distinguished from investors' perception of the potential costs of flooding on the property. If local property developers in at-risk markets do not recognise these costs and include them in their expectations, then these costs remain **unpriced flood costs**. If investors recognise these costs and include them in their investment expectations, then the unpriced flood costs become **priced flood costs**, and the market rebalances itself at lower levels than if the flood costs remained unpriced. In Figure 3 we present the evolution of local property markets in versions with both unpriced and priced flood costs in graphic form.

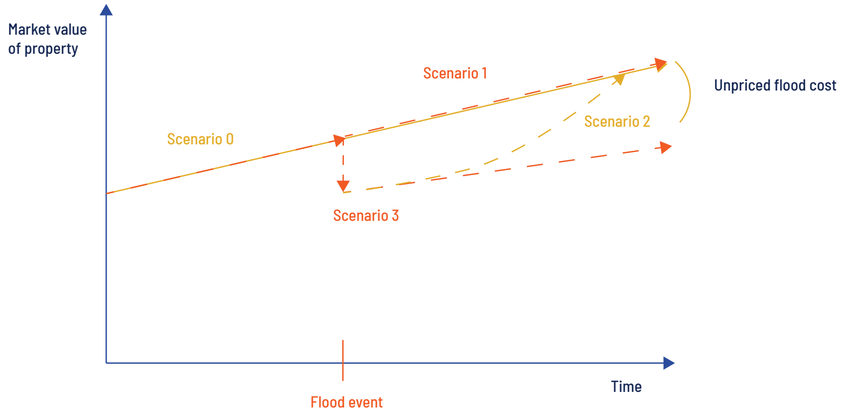
Figure 3: Developing the local flood-prone property market in versions with and without estimated flood costs



Source of both graphs: Own images.

Figure 4 shows the possible evolution of a local at-risk property market after a flood event. Three scenarios are possible:

Figure 4: Developing the local flood-prone property market in versions with and without estimated flood costs



SCENARIO 0: Development of a local at-risk property market without a flood event.

SCENARIO 1: After a flood event, the local property market does not react to the flood costs and the existence of a flood risk, even if there is incurable functional obsolescence (example: the coastal area of Piran).

SCENARIO 2: After a flood event, the local property market temporarily reacts to flood costs and the existence of a flood risk. The temporary nature of this response may result from the implementation of flood protection measures (curable functional obsolescence).

SCENARIO 3: After a flood event, the local property market permanently reacts to the flood costs and the existence of a flood risk. The permanent nature of this response may result from the inability to implement adequate flood protection measures (incurable functional obsolescence). The unpriced flood costs thus permanently become priced flood costs.

It is impossible to predict how and to what extent a local at-risk market will react to a flood event.

"A direct reduction in estimated property values to account for flood damage is not appropriate for several reasons."

Assessing Flood Damage and Property Values

Are valuers qualified to assess the value of flood damage?

There is also the question of whether valuers can estimate and disclose the amount and type of damage to the insured property in the valuation report and reduce the estimated value by the value of said damage.

As a rule, valuers are not professionally qualified to assess damage, unless they are also specialised experts in the construction industry. Damage assessments of flood-damaged properties are the responsibility of specialised construction experts, who are trained to prepare and evaluate rehabilitation projects for affected structures and to give opinions on whether rehabilitation is feasible given the structural damage.

A direct reduction in estimated property values to account for flood damage is not appropriate for several reasons:

- the damage may not be significant and may not have an impact on secured lending
- the damage may be reimbursed by the state
- the damage may be reimbursed by an insurer.

In receiving compensation for the damage, the borrower can partially or fully restore the damaged property without the restoration costs affecting their disposable income.

How can we include flood risk in property valuations?

We have already answered the initial question as to **whether flood risks can be valued individually**. We have concluded that this is not possible in the valuation process. It remains an open question whether flood risk can be directly included in the valuation.

Valuers generally base their valuations on market data, i.e. transaction prices/rents of comparable properties in the same or similar locations that exist at the date of the valuation and are available within a certain time frame. Investors may take the decision to purchase a property based on a number of factors: the general state of the property market in the country, supply and demand in the local property market and their own assessment of the risks to which the property is exposed. In properly functioning property markets, market prices should already reflect the increased flood risks, with investors aware of the risks and lower prices than in areas without such risks. However, most local property markets do not meet the criteria of a complete market. International research on at-risk areas shows that there are unpriced flood costs, i.e. the direct costs of restoring the affected properties to their original state, and the indirect costs (higher insurance premiums for at-risk properties, etc.) to which the investor is exposed or which increase the operating costs of the properties.

"Applying flat-rate discounts to the estimated values of properties that may be affected by flood risk or flood damage is not professionally justified."

We have found that, particularly in at-risk local property markets that have not experienced flood events for a long time and in markets characterised by high demand (e.g. prestigious locations near the coast), investors do not include these potential costs in their expectations. As a consequence, market prices in these markets stabilise at higher levels than would be the case if these costs were taken into account.

In our experience, local property markets react to flood events as follows: after a flood, property transactions in the affected area decrease sharply or almost cease. Transaction prices in these areas (if any) tend to be lower than expected given the state of the property market. It is impossible to predict what, if any, adjustments will be made after a flood event, as each local market reacts differently to a flood event.

The recovery of markets affected by flooding may vary. Over time, markets recover and generally approach the levels seen in unaffected property markets. Investors' historical memory is relatively short. There are few markets where, due to regularly recurring flood damage events, investors recognise the unpriced costs of flooding and incorporate them into their purchase expectations (a rare example is Nagoya, Japan), which in the long term would keep property prices at levels lower than expected given the general state of the property market.

The failure to account for the unpriced costs of flooding is also characteristic of certain flood-prone local property markets in Slovenia. Examples of this include areas in Slovenia that have been affected by floods, e.g. the municipalities of Železniki, Celje, Laško, etc.

Affected property markets have recovered faster in areas where property owners, the local community and, above all, the state take immediate action to combat flooding.

The heterogeneity of these markets' response to flood damage events makes it virtually impossible to predict fluctuations of the local property market due to a flood event. Applying flat-rate discounts to the estimated values of properties that may be affected by flood risk or flood damage **is not professionally justified** and these cannot be applied by certified valuers, as there are no credible and reliable studies or databases for this approach. Functional obsolescence will be reflected in valuations with a time delay only when the market for this type of property is revived and appropriate reference transaction prices or data are available. It is only after flood events that it will

become apparent whether investors' awareness in these markets has changed in the long term and whether they have started to include the unpriced flood costs in their investment expectations.

The recovery dynamics of flood-affected markets depend on external factors such as:

- supply and demand
- the general state of the property market
- assessing whether flood-related functional obsolescence is curable or incurable and
- possible changes in investors' perception of the unpriced flood costs.

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#04

Valuations and energy labels in the housing market: do they get in each other's way? The Dutch experience

Jan-Willem Pijper

The Dutch valuation report model is to be amended in 2024. Valuation reports will in future include more information about sustainability and the energy label, which makes perfect sense from today's perspective, but is, in reality, only a recent development. Let us take a look at the history of the energy label in the Netherlands and the future of property valuation.

Until December 2020, every owner-occupied house in the Netherlands was able to obtain a standardised energy label, which homeowners could easily modify by uploading photos and adding information. For between two and ten euros, the owner was immediately granted an energy label valid for ten years.

This system was abolished with effect from January 2021, as the EU Energy Performance of Buildings Directive needed to be better implemented in Dutch legislation. From that date onwards, a full energy label could only be issued by a certified energy adviser following a visit to the property. Despite all kinds of problems during its introduction, the new energy label is now well established and costs average around EUR 300.

A valid energy label is obligatory for any property sale. In accordance with the EPBD requirements, it is needed not only at the time of the sale, but also from the very beginning of the sales process and must be included in the advertising of the property. In short, the energy label has become well established in the Netherlands' residential property market.

While some VBO valuers also issue energy labels, the number who do so remains limited. The training to become an Energy Performance Advisor is tough and the earnings model is not yet compelling enough for most valuers. This hasn't been helped by the many changes in the Netherlands over the years with regard to energy labelling obligations and the methods of determination, nor by the fact that the minister responsible has always stressed the importance of keeping the price at around EUR 250, whereas the actual cost of an energy performance assessment is quite a bit higher than that. This means that valuers find the idea interesting, although the additional step of including an up-to-date energy label with the valuation is not an obvious one.

"The energy label is also taken into account from a financing perspective."

The energy label has a considerable impact on valuation and market values. There is currently incontrovertible evidence that (comparable) houses with a better energy label fetch more on the market. Valuers must back up their valuations with references and provide an energy label for each reference. Currently, there are, however, both old (before 2021) and new (after 2021) energy labels on the market. This makes it quite a task for the valuer to find suitable references.

The energy label is also taken into account from a financing perspective. According to the 2024 Dutch Lending Standards, there is more scope for financing a house that has a better label. There is also more scope in financing for renovations, to upgrade to C-class or higher. Further incentives exist in the form of mortgage interest rebates.

The central government and local authorities offer subsidy schemes to encourage the implementation of sustainability measures, e.g. for insulation, (hybrid) heat pumps and even energy advice, all to make the housing market more sustainable. It is thus only logical that sustainability and the energy label should play a bigger role in the valuation report.

The work of the Dutch property valuer is therefore evolving rapidly. Since summer of 2021, valuers have had to include all kinds of observations about the structural condition of the house in the valuation report. Where a property has been poorly or sparingly maintained, standardised costs will also be included, giving the consumer an insight into the expected cost of improvements. Valuers engage in continuous education to ensure that they carry out this task correctly. In accordance with EVS, Dutch valuers may be asked to include a market valuation that specifically assumes that a particular renovation has been carried out. In such cases, lenders will take these costs into account when granting a mortgage.

The causality of higher prices for houses with better energy labels:

An ING Housing Report indicates that a green energy label significantly increases a property's value, with some willing to pay over 10% extra. Most people prefer at least a C label and are investing in sustainability, partly to save on energy costs, expecting it to raise their home's value. The desired payback period for such investments is ideally three to six years.

Next to that, a research report, conducted by the Kadaster investigated recent price trends in the housing market, segmented by energy labels, type of housing, floor area, and location. Key findings include an increase in sales of sustainable homes, with properties having poor energy labels (F and G) experiencing the most significant price drops, particularly in the largest cities (Amsterdam, Rotterdam, The Hague, and Utrecht). Large apartments with poor energy labels saw notable price declines, highlighting a clear trend where homes with better energy labels tend to retain higher value. This comprehensive study, ranging from 2020 to the second quarter of 2023, underscores the growing influence of energy labels on property values across different housing market segments and locations.

"Valuers use the data from the energy label, but may also note, for example, that changes have been made to the property since the energy label was recorded."

Since 1 March 2024, we in the Netherlands have been taking the next step with regard to the valuation report. In addition to the property's structural condition, valuers also include the energy status in the survey report. For example, the structural condition looks at whether the glass in the window frames is crack-free (and working properly). The energy status looks at the insulation value of that same glass and the valuer should indicate what it would cost to achieve the best level of insulation. This also requires valuers to undertake additional training.

Valuers use the data from the energy label, but may also note, for example, that changes have been made to the property since the energy label was recorded. They will also consider whether it is possible to take into account standardised costs of sustainability measures, as is the case for architectural costs. The logical follow-up question, of course, is whether valuers can then also establish a market value based on a particular starting point, namely the property's value after sustainability measures have been undertaken.

This task will become easier as more reference material becomes available, making it easier for financiers to include the funding of these sustainability measures.

It is in this complex and changing field that valuers perform their work. The VBO receives many questions about developments in the industry. Members see opportunities, but also have many concerns. Looking at this field, we see the following main points:

1. *Valuers are the experts responsible for valuations.*

The challenge is for valuers to continue to focus on property values, the area in which they are experts. They look at the impact of the structural condition and the effect of sustainability measures on the value of a property. Valuers are, in essence, neither surveyors nor energy consultants. They employ their knowledge and experience to issue an informed statement about the market value of a property, taking into account all its features and risks. Valuers' reports are therefore a crucial factor in the mortgage lender's decision to grant a mortgage and in its risk assessment.

2. It is possible to issue a valuation that takes into account sustainability measures, although it does present challenges.

Valuers can determine a value after the renovation has been completed. Put simply, an extension or dormer windows creates a number of square metres to which a value can be attached, but determining a value to take account of sustainability measures is rather more complex. After all, what metrics do you employ? Are you comparing houses with energy labels that were issued during the same period? And is it just about an A rating or does it involve more than that? Do you take into account possible changes in regulations, such as the Netherlands' well-known solar energy remuneration scheme? Do you calculate the net present value of the expected energy savings? And do we take into account the current occupant(s) energy consumption?

Many valuers do, however, already see ample opportunities to include the value of installing a heat pump or solar panels in their valuations. It does, however, require knowledge and a set of agreements to ensure that this work is applied consistently by different valuers.

3. Valuers are increasingly adding energy efficiency and sustainability value, but is it appreciated?

Is this added value perceived? Are consumers willing to pay for it and do lenders use it in their risk assessments? After all, defaults on Dutch mortgages are relatively rare and the housing market remains very tight, which means that the risk on these mortgages seems low whatever the sustainability factors are. Or does something have to go wrong before we change our minds? Meanwhile, the various changes to the model report mean that valuers will have to undertake even more training. Do these costs still outweigh the benefits?

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PROPERTY AND VALUATION IN RE-ELECTRIFYING EUROPE

#05 Re-electrifying europe: *approaches to compensation*

Jeremy Moody

Colin Smith

Caution - This paper has been prepared as a desk exercise offering a general overview of the varying approaches to compensation in respect of property, farming and business for the effects of new electricity infrastructure around Europe. It is not a comprehensive study. The specific examples cited are understood to be accurate at the time when the underlying information reviewed was written. However, specific points may since have changed or not fully describe the position within each national context. They offer illustrations supporting the wider analysis but each is likely to have further detail. This is an overview, not a manual for professionals or others.

The Re-electrification of the West

Introduction - We are embarked on an energy transformation. To reach net zero for 2050, we are both to de-carbonise power generation and at the same time to increase massively the amount of electricity we need, powering transport, manufacturing and managing data. That larger volume of de-carbonised renewable electricity has then to be transmitted and distributed for it to be useful.

Each country is going to see major and successive programmes to strengthen and increase the capacity and scale of electricity networks. While the networks obviously need cables, they also need other infrastructure including substations which might require 40 ha, even 200 ha, and sites for battery and other power storage methods. While these potential uses can create value for particular locations, this article reviews approaches around Europe to compensation where rights over land are taken by or under the shadow of statutory powers and how it might be assessed. It follows our article on the scale of this work and the consequent property issues in European Valuer Journal No 32 (February 2024).

Upgrading the capacity to move electricity across land and businesses, often farming and forestry, will raise issues under the land law and statutes of each country, balancing the protection of owners' rights and interests with the public need, typically by payment of compensation for costs and losses incurred. Equivalent issues arise for conveying other sources of power and heat, such as hydrogen, geothermal and local heat distribution systems as well as for the pipelines for carbon capture and storage.

Alongside the background of, often longstanding, statute and practice, these issues have become salient:

- with the enormous volume of this work with its effects on property and business over the next two decades or so
- as this infrastructure is often seen as intrusive and burdensome by people near to a proposed line, especially where it offers no local benefit in taking power from one distant place to be used in another distant place
- since these new or upgraded lines and pylons become an easy focus for objection and confrontation, delaying or frustrating schemes and increasing their cost.

All these factors lead to questions of compensation and other possible financial recognition to be handled in each country. The pressure for this work can also drive changes in policy, some pragmatic management of specific cases but also more insistent pressure for access to land.

General

An area that is still developing - There is a long history of provisions for compensation where land or a right over land is taken with statutory authority (variously called compulsory purchase, eminent domain, expropriation, forceful expropriation and by other labels). Much modern practice has its origins in the approaches taken in the 18th and 19th centuries for the development of canals and railways with the land and associated rights they required. That has then been systematised and further adapted, and then drawn on as post-communist states have recognised private property. With that origin, the law for compulsory purchase and compensation can seem more focused on outright acquisition of land rather than on the usual task here of acquiring rights over land.

As the World Bank has noted, there are still no generally accepted international criteria for standard practice:

> "although the compulsory acquisition power is deeply rooted in virtually all legal systems, the establishment of efficient and fair legal and institutional frameworks for exercising this power remains unfinished business in many countries around the world... The task of better defining the principles and processes that govern compulsory acquisition powers is one that is very much alive and at the heart of current land policy debates," (Lindsay JM (2012), *Compulsory Acquisition of Land and Compensation in Infrastructure Projects*, World Bank PPP Insights)

Differing national legislation for acquisition - National legislation varies with history, legal traditions and cultures, especially the different balances seen between public interest and private rights. There may also be differences between areas of federal states, sometimes for reasons of different institutional and regulatory structures and sometimes for differences in projects.

Post-Communist countries, such as Bulgaria, Hungary and Romania, have entrenched private property in their new constitutions, only permitting compulsory purchase where necessary to meet public needs and then with fair compensation, requiring the design of processes and then approaches to compensation. Ukraine's constitution states that "The right of property to land is guaranteed" and then "The expropriation of objects of the right of private property may be applied only as an exception for reasons of social necessity, on the grounds of and by the procedure established by law, and on the condition of advance and complete compensation of their value." The Lithuanian constitution provides for "just" compensation. Most of the models adopted in post-communist states since 1990 tend to assume that agreement will be reached with compulsory purchase as the last resort; the acquirer proposes the compensation with any necessary adjudication by the court. It has been suggested that this might see more recognition of the value a property has to its owner while traditional models are based on its market value.

While the legislation for compulsory purchase and compensation conventionally focuses on the outright acquisition of land – as here for a power sub-station – the regime for acquiring rights over land and then paying for them is not always as well developed and can vary according to the type of utility concerned.

Most countries have provisions for electricity operators to acquire rights to install cables over land. Bulgaria describes a right for construction. Estonia, having had to separate its network from Russia, requires landowners to "tolerate" the construction of electricity infrastructure (or be subject to full compulsory purchase) with toleration payments made as compensation. After a Supreme Court challenge, these became a reimbursement of land taxes for the area affected by a line. In the Netherlands a failure to achieve agreement can lead to imposing a "tolerance obligation" for works in the public interest. In Portugal, approval of such an infrastructure project is taken as enabling the operator to have access to the properties concerned, limiting their use.

Some countries specify the width of the corridor for lines of particular voltages (from 20 m in the Czech Republic for up to 400 kV lines to up to 60 m in Luxembourg for 65 to 220 kV lines) but others make no direct specification. Similarly, there are differing approaches to the land operationally taken for the construction of pylons.

Compensation - The relevant national law will often set out a statutory basis for valuation, overriding the expectation of EVS that valuation be at market value. However, the approaches are typically based on market value with its assumption that the parties are willing, so ignoring the point that the sellers here are unwilling and avoiding any particular value that a property has to them, rather than the wider market.

The compensation may, in general, be for:

- the compulsory acquisition of:
    - land as for sub-stations and other infrastructure
    - rights over land for cables, whether carried overground with pylons or, less commonly, placed underground
- loss, damage and cost caused by the works (such as crop loss), impeded access or the cables, pylons and other infrastructure then limiting operations (including adding to farming costs).

"These are property and business-based claims. It has been rare for such compensation to be paid for other issues such as visual intrusion, noise and concerns over high voltage cables and health."

These are property and business-based claims. It has been rare for such compensation to be paid for other issues such as visual intrusion, noise and concerns over high voltage cables and health (for which World Health Organisation and other studies show no scientific basis), however much these may be part of the public argument over new overhead cables.

There are, however, some emerging "community benefit" schemes, in effect offering a practical recognition of the impact on a local area of a cable taking power elsewhere – a "gain-sharing" mechanism, rather than compensation.

They may, in part, also respond to common concerns over visual impact, noise and other factors which are likely to have featured in the regulatory process approving the project and its route.

Community benefit payments - Some countries have (or are developing) community benefit schemes whereby payments are made towards facilities in communities seen to be affected by a new power line. Even where these exist, they are often informal and arising from discussion with local authorities in the process of regulatory approval. In practice, they are a means of handling local reactions to new and intrusive infrastructure, especially where it brings no local benefit, but there is scepticism as to this making a project any more acceptable. In the United Kingdom, the public reaction to the growing scale of work for new cables has led to a further proposal for discounts on electricity bills for householders close to a line but this has yet to be decided.

In practice, closer consideration shows the installation of major electricity lines to be accompanied by payments based on a shifting mix of classic compensation for loss and what is, more pragmatically, needed to ease access to land, varying between countries and over time.

Among further factors evident when considering payments for electricity cables:

- as these are typically long linear projects affecting many properties and businesses, the acquirer has a strong interest in maintaining a uniformity of approach to compensating all those affected to avoid particular settlements being used to increase overall payments
- the lower levels of payment for acquiring rights over land rather than buying the land itself
- where disputes use the same processes as for outright acquisition, the lower sums at stake can make that process seem disproportionate and so less accessible
- those affected continue to live and work alongside the cable.

The European Convention on Human Rights

One common provision was made with the 1952 amendment of the European Convention on Human Rights with its Article 1, Protocol 1 (A1P1) which entrenched a qualified right to property but did not directly consider compensation:

"**Protection of property**

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

"The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

Compensation for the deprivation of private property in the public interest has since been the subject of numerous ECHR cases. While usually paid at market value, the Court has stated that there may be circumstances where the public interest outweighs the need to protect the individual's rights and, in those cases, A1P1 "may call for less than reimbursement of the full market value." (*Lithgow v. United Kingdom* [1986] The court has summarised its position:

"the Court has already found that the taking of property without payment of an amount reasonably related to its value will normally constitute a disproportionate interference and a total lack of compensation can be considered justifiable under Article 1 of Protocol No. 1 only in exceptional circumstances" (*Jahn v Germany* [2005])

Compensation for Rights over Land for Electricity Cables

Cables are almost universally installed by acquiring a right over land rather than acquiring the land itself.

While there is generally a recourse to statutory powers, some countries go to lengths to achieve access by voluntary agreement. The working of Germany's Electricity Network Charges Ordinance is understood to mean that only one in twenty cases reaches compulsory purchase, the operator trying three times to reach agreement before that, at which point compensation may be less than had been offered. Italian law also encourages co-operation by providing that compensation on compulsory purchase will be less than on agreement, and so sees agreement in over 90 per cent of cases. In contrast, Latvia moves directly to compulsion.

Approaches to compensation similarly vary across Europe, with perhaps more variation in unacknowledged practice than in the regimes for land acquisition. There is a general recognition of compensation for immediate loss and damage from the works, such as crop loss. There is a near universal acceptance of the principle of payment for diminution in the value of property crossed by the line. The approach may then reflect the national balance between the rights in private property and those of electricity operators as embodying a public interest.

However, Lithuania does not pay for loss of value for a property but for agreement to the servitude, damage to crops and forestry and any resulting restrictions on the land's previous use.

The Netherlands is distinctive in that Government policy is understood to require payments where electro-magnetic fields are above certain limits, with the operator buying some affected houses.

Incentive payments – Offering incentive payments can be one way to try to avoid the costs of delayed infrastructure work, with land being only a small fraction of those costs. Outside the formal structures, some operators offer premiums for early agreement on compensation to ease issues but potentially limiting a full recognition of the effect of the project on the owner or occupier. Some countries prohibit this.

The Irish Republic offers a flexibility payment to farmers giving voluntary access for 110 kV and 220 kV lines. Recognising that construction is disruptive to a farm, this makes an additional payment in three stages: on access, during construction and on completion of the line.

In Finland, compensation is set by an official expropriation committee independent of the operator which can then pay 10 to 15 per cent more to owners who agree swiftly.

Loss and damage (including crop loss) – Whether the cable is to be installed underground or overground with poles and pylons, works will be done on land that are likely to cause loss and damage, particularly for farms and forests. Growing crops can be lost or damaged. New crops might not be sown. There may be lost area-based subsidies. Trees may be felled. Longer lasting damage can be caused where soil structure is damaged, most obviously by underground works, where poor restoration and disrupted drainage can compromise future crops. Finnish practice recognises the impact of heavy construction machinery on soil structure and yields – becoming yet more important as parts of arable farming adopt minimum tillage practices. Other problems can arise from poor management of the work as where livestock are let loose or the contractor used by the operator acts outside the area of the rights taken – trespassing where it had no right, perhaps a matter for civil action in the courts.

In the United Kingdom, there is a general statutory provision for claims for disturbance and loss that do not arise from the value of the land taken. In Romania, such claims are customary rather than statutory but still met.

Most operators make a one-off payment for this, after attempting to restore the condition of the land. Some, such as the UK and the Republic of Ireland, not only make that statutory payment but then also annual payments for interference with operations, according to the size of the pole or pylon. Switzerland can pay for restrictions on cropping for up to 25 years. France can pay for damaged crops for up to nine years but Germany only makes limited payments in the second and third years.

Such issues will need to be valued with evidence to support the compensation claim. It is useful for a farmer or other owner interacting with the project to keep a diary of time and incidents. There may be some compensation for time involved in the issues.

It seems nearly universal for operators to compensate for the loss of trees where a new cable crosses forestry land, equivalent to crop loss.

Effect on the value of land - Compensation for this is almost always expressed as being in terms of the reduction in the value of the land across which the cable is imposed. This appears to be the only basis for a claim in Estonia with an ad hoc payment for a third of the land value (with forestry land assessed at its value at maturity).

Most compulsory purchase regimes work from market value (though not all recognise development value) to which Italian law adds premiums for agricultural and development land. Swedish law adds a 25 per cent uplift to the reduction in the value of land. It may reflect the restrictions imposed by the power line and infrastructure on the current use of the property and also those on its future use. Compensation is generally not paid for visual impacts and similar factors.

"In some cases, the reduction in value can be relatively easy to show, as where recognised development prospects are limited by a new power line. More generally and especially where market evidence is slight, the value may be based on a conventional acceptance that values are diminished to some extent."

Compensation is typically only for land within a defined corridor along the line. The project might have an easement width for the long-term rights and a working width for the construction operations. This typically (but not universally) excludes claims from third parties whose property is not crossed by that corridor.

In some cases, the reduction in value can be relatively easy to show, as where recognised development prospects are limited by a new power line. More generally and especially where market evidence is slight, the value may be based on a conventional acceptance that values are diminished to some extent. Even where operators do not necessarily accept that there is a loss of value to farmland, they may apply standard payments using published schedules of rates (whether suggested by the acquirer or with some wider agreement with farming, landowning and similar representative bodies). The loss of value can be more pronounced where several lines cross a property.

Where a right of way for access for maintenance is included, Spanish law allows payment of 50 per cent of market value.

Where there are development prospects, one recurrent issue is where a higher value use of the property may be possible but would now be prevented by the new power lines. Most countries allow such a claim on proof that this expectation is not speculative but is based on a current or imminently prospective permission; however, Spanish law does not cover compensation for this value. It might also arise where pylons might be seen to detract from the visual amenity of a potential tourism or recreation facility.

Payments for pylons and lines – One way of approaching the impact on land value for compensation is to consider the land under a pylon and under a line, both generally with one-off payments.

Differing approaches to the land under a pylon, tending to recognise the loss of the use of land, include:

- a one-off payment for the value of the land under the pylon
- a payment of 2.5 times the base area of the pylon at market value
- a payment on standard rates for the land
- a payment for loss of income and inconvenience
- paying for an area of disturbance
- using an expert or court valuation.

Austria pays a premium if a property is to have more than one pylon. It also pays a premium where a pylon is closer to a farmhouse, the operator considering that land nearer the farmhouse to be more valuable rather than that the value of the house has reduced.

Differing approaches to the land under a line, with payments based on varying corridor widths, include:

- a one-off payment based on the land's market value, typically using a percentage of that value, with examples around Europe varying between 20 per cent and 67 per cent
- a payment on the basis of a schedule of standard rates.

These values usually include proven development value that would be frustrated by the line.

"Compensation for lost property value will typically be paid only on land used for the cable. However, some countries have legislation or government guidance that allows third party claims for depreciation of the value of properties that are outside the line but close to it."

Temporary occupation of land for construction – Temporary construction compounds and access tracks may be matters for practical negotiation but can also be within the rights compulsorily acquired, as in Spain where 10 per cent of market value is paid for land used temporarily.

Third party claims – Compensation for lost property value will typically be paid only on land used for the cable. However, some countries have legislation or government guidance that allows third party claims for depreciation of the value of properties that are outside the line but close to it. It is understood that payment can be made in Sweden for loss of visual amenity for properties within 200 m; Finland's expropriation committees can do so within 100 m. Compensation is payable in Denmark if a new 400 kV line is within 50 m of a farmhouse or a 150 kV line is within 35 m; the visual impact of part of the line can be compensated for in a corridor of up to 280 m. Italy requires proof that residents would suffer serious disadvantage. Croatia sets no limit but relies on expert assessment. France allows payment for loss of visual amenity, assessed on a case by case basis. Varying approaches include offering to purchase such a house (as offered by Belgium's Flemish government for properties near the Ventilus high voltage line which would not be within the compulsory purchase regime) and use of a standard formula.

Many countries make no provision for compensation to other owners whose property is not crossed by a power line. However, in some cases an operator may find it practical to recognise an issue privately but such payments are rarely publicised.

While market studies point to nearness to the line and its visibility, most typically of pylons, as key factors for the value of dwellings, this will be a matter for evidence. A strong housing market might narrow differences that would be more apparent in a weak housing market. Possible loss may be more evident for higher value rural properties, not only with their higher value but also so far as their buyers are able to be more discriminating in choosing a property to buy.

Further Rights

Maintenance works – Once a line and infrastructure are installed, the electricity operator is likely to need to return for maintenance work. The rights for this are likely to be secured as part of initial acquisition. Such work may be more common but less disruptive for overhead lines with their great exposure to wear and tear, storm and accident and less common but more disruptive for underground lines. It would be conventional to compensate the occupier for loss and damage (as to crops) in this work.

Fibre optic cables – The acquirer may have more uses in mind for the cables than simply transmitting power. This might most often be for cable to carry a fibre optic line. This might be for an electricity operator's own purposes but it could also be for a public communications network. In the latter case, other legislation and compensation provisions might also apply.

The later addition of a fibre optic cable for third party purposes may also be outside the defined rights initially taken over the land, creating new issues at that point.

Upgrading – A similar point applies should the electricity operator wish to upgrade a power line. Not only might there be extra infrastructure works, but the initial right acquired might not cover the increased power to be carried. This would then require the acquisition of new rights over the land with a further compensation claim.

Determining Compensation

A variety of approaches exist around Europe, often overlaid by the use of schedules of standard payment rates. In general, where the landowner's agreement is sought, it is typically for the owner to make a claim which can then be considered and, as appropriate negotiated. Finland though uses official expropriation committees, independent of the operator. Portugal, moving directly from project approval to a right of access, uses qualified assessors to determine issues of loss of property income, changes in land use (as under pylons), temporary access, loss of production and damage.

Dispute Resolution

Disputes are generally referable to an appeal mechanism. While some disputes might be taken to the courts, most countries provide a means for them to be resolved by a specialist court, arbitration or other means. In Romania, the court appoints an expert commission, with one expert appointed by the court and one each by the parties.

Decisions by courts and tribunals may be public but awards from such arbitration processes generally appear to be private. Operators, anxious to uphold uniformity of approach, can want that privacy.

Taxation

With compulsory purchase creating a disposal of property (or income for crops), countries again differ as to whether compensation is taxable. Where, as in the United Kingdom, it is taxable (with payments of land as capital and for crops treated as income) there can be relief on reinvestment. Receipts are not taxable in other countries such as Hungary and Romania.

Overview

Unlike the approaches to the compulsory purchase of land, this survey illustrates the variety of national approaches around Europe to compensation arising from the acquisition of rights over land for power cables and their installation. Broadly but not universally, compensation is paid for loss in property value and costs for businesses, commonly farming and forestry. Law and practice vary with national history and local context, now coloured by the urgent need for major expansion of electricity infrastructure. That need is in tension with the often limited evidence of the effect on land values of taking such rights, leading to varied and shifting mixes of compensatory and pragmatic approaches to payment. This picture may well develop further.

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BUSINESS VALUATION

#06 Pub/bar/café valuation

Gareth Williams

The humble public house / bar/ café – an essential piece in the social fabric of many towns and cities. Never was this better demonstrated than when, in most markets, access to these establishments was curtailed, and in many cases prohibited, during 2020 and 2021 at the height of the COVID 19 pandemic. Humans are social beings and pubs/bars/cafés are an ever popular destination in which to socialise and were sorely missed. The licensed property market is however resourceful – adapting their business models as market demands and requirements dictate. As an example, in Ireland the pandemic resulted in significant investment in outdoor seating areas to facilitate "outdoor dining" in a market not best known for its al fresco delights. Yet outdoor areas are now a significant source of income for public houses here.

While there is no uniform licensing system for public houses / bars / cafés across Europe (and indeed the Irish legislation is presently under review) – there are common factors which need to be assessed and considered when undertaking valuations on these assets.

"The valuer should be cognisant of any market dynamics or upcoming legislative changes that may impact on trade (and therefore value)."

Trading

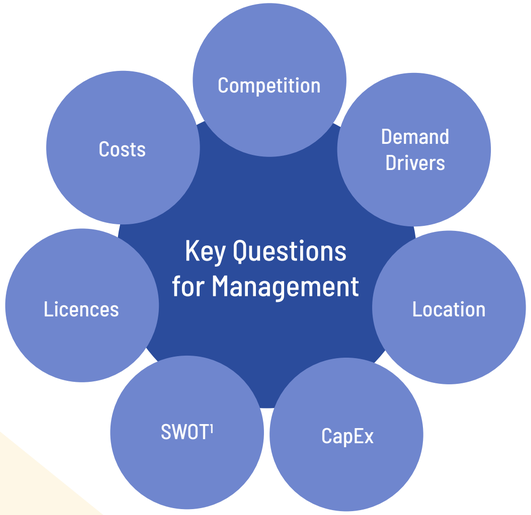
A review of historic trading performance of the business is essential, reflecting the fact that each property will have its own unique trading characteristics, not always comparable to its competitive set. That said, a robust "benchmarking" exercise should be carried out with the following items being identified within accounts:

- Average net (of VAT) revenue per week (with breakdown between drink sales, food sales, off-licence sales, door receipts and any other income)
- Cost of sales
- Gross profit margin
- Wage costs / salaries
- Utilities
- General overheads
- Repairs and Maintenance
- Fixtures, Fittings & Equipment (FF&E) Reserve
- CapEx

In addition to historic trading, it is prudent to ascertain Management's view of prospective trading performance going forward – through a review of any trading budgets, forecasts or projections.

Additionally, the valuer should be cognisant of any market dynamics or upcoming legislative changes that may impact on trade (and therefore value) e.g., changes in minimum wage, volatility in the cost base, tax changes and planning in the immediate area.

Ultimately, it is important to establish a thorough understanding of the business being valued which will require a detailed consultation with Management. The key areas of discussion can be summarised in the following:



There are some well known challenges in the hospitality industry at present such as labour shortages, general cost pressures and decreasing discretionary spending on which the sector relies.

Leading on from these challenges, in considering trading performance or anticipated trading performance, there are a number of factors to be considered, such as –

General

- Business mix
- Opportunities to increase revenue / profitability
- Any group efficiencies
- Impact of proposed legislation

Staffing

- Staffing levels
- More staff required?
- Staff costs
- Staff shortage impacting on trade (hours, areas open, offer etc.)?

Revenue

- Changing trends impact of reducing discretionary spending
- Impact of hybrid working
- More food / Less food
- Events
- Weekday vs weekend trade

Costs

- Utilities
- Direct costs / Stock
- Staff
- General
- Any mitigating measures undertaken

[1] Strengths, Weaknesses, Opportunities, Threats

"It is important for the valuer to stand back and determine whether the business is trading at a stabilised level, is over-trading (due to personal goodwill, for example) or has room for growth."

If looking at investments whereby a purchaser will receive a rental payment, it is important to benchmark the rent against trading performance, where possible, to determine rent cover. Can a tenant / operator suffer a challenging trading period, but still be in a position to cover rent payments to the landlord?

Property

Property title – This will be dependent on the jurisdiction, but for Ireland and the UK the main concern is whether the property is held Freehold (or equivalent) or Leasehold (whereby a rent is payable and security of tenure granted for a set period of time).

The condition of the property is another factor to be considered. Has the property been well maintained? Does it require works (and therefore CapEx) to be carried out to keep trading successfully? Are there adaptations to the property that could drive and improve trading performance? Is the building a Protected Structure?

Value-add

With a knowledge of trading licensed premises, it is important for the valuer to stand back and determine whether the business is trading at a stabilised level, is over-trading (due to personal goodwill, for example) or has room for growth.

This value-add / growth opportunity may be a result of an anticipated increase in top line revenues, or potential cost savings. Alternatively, adaptations (physical or operational) may allow the business to re-position itself and add value.

Income Capitalisation / Profits Method

Having carried out a full analysis of the business, identifying strengths and weaknesses, benchmarking performance – you are then in a position to consider value.

The established method of valuation of trading public houses is that of Income Capitalisation (sometimes also referred to as the Profits Method), with the Comparable Method forming a secondary approach (see below). Income Capitalisation entails capitalising a stabilised level of trade (in the form of EBITDA or Profit) at a market derived capitalisation rate[2] and, where appropriate, making adjustments for any required Capital Expenditure (CapEx) and / or Shortfall.

2 When analysing sales to determine an appropriate capitalisation rate to be adopted it's important to compare like with like. This is particularly relevant when looking at market multiples. Are these based on last full year accounts, trailing 12 month figures, stabilised figures, upcoming year projections, etc.?

"The Shortfall is relevant where the property is not presently achieving a stabilised level of trade."

The Shortfall is relevant where the property is not presently achieving a stabilised level of trade. For example, the valuer may determine that it could take 3 years for the property to attain or return to stabilised trade. For ease of explanation, let's say that the valuer projects EBITDA of **A** in Year 1, **B** in Year 2 and (stabilised) EBITDA of **C** in Year 3.

If we were to capitalise **C** in perpetuity, with no further adjustments, we would not be taking account of the below-stabilised trade of **A** and of **B**, resulting in an over-valuation. Conversely, if we were just to take the first year's EBIDTA of **A** and capitalised this in perpetuity, this would result in an under-valuation.

Therefore, the calculation should look like the following:

C x Capitalisation Rate = Gross Value

Less

C – **A** = Year 1 "shortfall"

C – **B** = Year 2 "shortfall"

Up front, **capital expenditure** required, where applicable

Equals

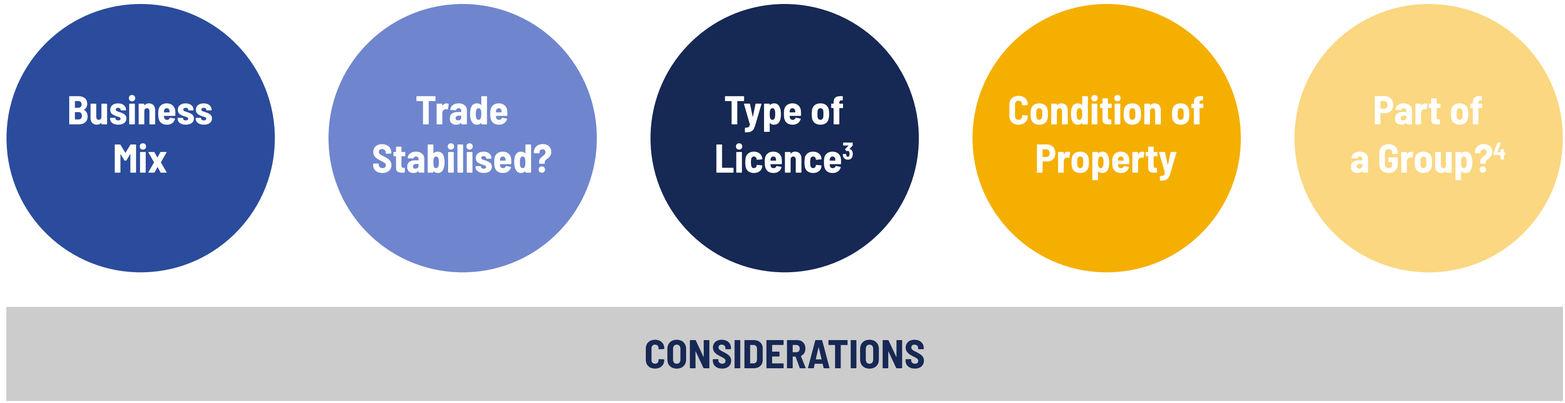
Market Value

Market Comparison / Comparable Method

The comparable method of valuation may be used for smaller assets and where limited information is available for analysis as outlined above.

The practice of analysing comparable evidence is also however an essential component when benchmarking and determining market facing yields / multiples to be adopted for the Income Capitalisation method of valuation.

The following chart sets out some key factors to be considered:



Conclusion

As with any valuation, it's important to reflect and consider your market. In Ireland for example, in recent years private equity firms have linked up with local operators for prime assets – a new evolution in a market previously driven by owner operators and, at various times, developers looking at alternative uses (albeit the latter two are still very much a feature of the market).

3 Type of trading licence will impact on value and will differ from market to market depending on local legislation.

4 Where a public house operates as part of a wider-trading group, any group efficiencies should be considered and adjustments made where appropriate where valuing an asset outside of a group scenario i.e. on a standalone basis.

Gareth Williams is Director, Head of Operational Real Estate Valuations Ireland, CBRE

FORESTRY VALUATION

#07

Forestry valuation – *a Latvian perspective on the Baltic States*

Antons Seļezņovs

The Baltic States are situated in a climate zone with similar vegetation milieus, yet each country has its own specific land use systems. In Lithuania, the agricultural sector plays a vital role in the economy: owing to its high-quality soil and historically strong farmers' associations, it continues to enjoy a highly developed agricultural sector. Lithuania's culture is closely tied to its rural regions. At the same time, forestry has relatively negligible impact on the national economy, not only because of comparatively small forest cover (around 28% of the national territory), but primarily due to the small yields of forest stands and complex logging conditions. The situation is totally different in Estonia, where agriculture has a small impact on the national economy, despite the country's extensive forest cover, exceeding 50% of the territory. Due to its geographical circumstances, Latvia finds itself in the middle – both farming and forestry are of significance to the national economy.

"In Latvia, from 1924 to the present day, forest cover has increased from 24% to 52%."

In Latvia, from 1924 to the present day, forest cover has increased from 24% to 52%, for several reasons, mainly urbanisation which grew from 35% in 1939 to 71% in 2000. Abandoned agricultural land in Latvia relatively quickly grows over as a result of succession, and in recent decades, a significant proportion of the agricultural land has also been subject to forest plantation, thus changing its type of use. Given mass emigration post-1991 and falling birth rates, the population numbers in rural areas have fallen sharply, which has resulted visibly in an increase in the proportion of forested land. In the past decade, unusable agricultural land has become an attractive investment for foreign investors, increasing the total area of woodland by around 10%. Foreign investors have acquired over 100,000 ha of agricultural land for the purposes of afforestation, and this land was not especially suitable for arable farming, being primarily put to use as pasture land. The increase in forest cover has a positive influence on the CO_2 balance, increasing greenhouse gas removal and decreasing emissions, but the significant drawback is that in the artificially afforested areas, monoculture stands of the same age are grown, reducing the diversity of the landscape.

"Aid for the afforestation of agricultural land has significantly increased demand for poor quality and unusable agricultural land, increasing the price of the land over fourfold in the last ten years."

Aid for the afforestation of agricultural land has significantly increased demand for poor quality and unusable agricultural land, increasing the price of the land over fourfold in the last ten years, from around 500 EUR/ha to 2,200-2,500 EUR/ha. A similar pattern has occurred in the value of forested land (clearings), which has also increased over fourfold. The value of forested land is a component of the forest property's added value. According to the agreed methodology in Latvia, the value of forest property is assessed as the value of forested land (clearings) and its current forest stand value. The value of the forest stand is established using an income-based approach, calculated using five-year average timber prices, current labour and administrative costs, and by applying a discount rate appropriate to the economic situation. Neither Estonia nor Lithuania uses comparable approaches, and the value is simply established as the average value of forest property (both for the land and for the forest stand). That explains why in Latvia property costs are less on average than in its neighbouring countries. For example, in Latvia the average transaction value is around 2,800 EUR/ha, whilst in Lithuania it is around 5,000 EUR/ha, but in Estonia it even exceeds 6,000 EUR/ha.

Geopolitical events in 2022 caused a significant increase in wood and forest property, and at the time the value of forest land increased by over 60%. This also affected the discount rate, which shrank from 6.5% to 5%. This continued into 2023, when demand for forest property started to wane, and was rapidly followed by a fall in wood prices. Comparing the situation with the start of 2024, it is noticeable that in one year, wood prices have fallen by around 10-15%. The fall in demand has negatively impacted the discount rate, raising its assessment rate for properties of up to 20 ha to 7.50%, and for larger properties with a stable income from economic activities to approximately 6%. The main influencing factor is the stability of the European (including UK) market, within which 80% of Latvia's wood products are traded. Positive signals from the European market may come after reductions in EURIBOR rates, with the forecast recovery of industry and the construction sector. It is expected that if the ECB cuts rates this year, demand for timber will rise. The ECB forecasts that the effect of lowering rates will be felt up until the end of 2024. Until then, changes in demand and prices are not expected. It is predicted that the numbers of transactions will remain around 2023 levels, with identical prices. The most pessimistic scenario also predicts a small drop in value (up to 3%). This situation is also mirrored in other Baltic States, because for them outlets for timber sales are also reliant on the situation of the European market. In Latvia, transactions are carried out on the market involving new-growth stands, middle-aged trees and mature forest stands. Systematising transactions is difficult and the reliability of the data is doubtful, so approximate average values are provided below.

Tree species	*Coppices (new-growth), EUR/ha*	*Middle-aged growth, EUR/ha*	*Mature forest stand, EUR/ha*
Conifers (pine, spruce)	up to 5,000	up to 13,000	up to 25,000
Birch	up to 3,500	up to 11,000	up to 17,000
Poplar, black alder	up to 2,000	up to 7,000	up to 10,000
White alder	up to 1,000	up to 2,000	up to 4,000

"The main threat to the forest property market is restrictions on forestry activities, especially the ban on clear-cutting."

The average prices summarised in the table apply until 31.12.2023. Over 2023, the average prices for mature conifer stands on average fell by 7%, whilst they did not change for the other age groups. Prices for birch stands in all categories remained stable, whilst for the other tree species, prices fell on average by 10% in all age groups. The situation characterises wood prices, which in the case of coniferous softwood have fallen due to weak industry and construction demand, whilst white alder prices have fallen owing to a drop in energy wood (firewood) demand. Birch prices have remained stable, as within a year the value of veneers has risen by 13%, but the value of pulpwood has dropped by around 15%. In the future, it is expected that birch will become the dominant tree species in Latvia's forests due to the high value of its wood. The advantages of birch include a comparatively rapid growth rate, resistance to destruction by biungulate animals, as well as comparatively straightforward silviculture measures, meaning that birch stands can be successfully planted. The biggest role in the market continues to be played by conifer pine wood, although destruction by biungulate animals means that conifers cannot be grown naturally and can only be planted in targeted afforestation areas. These factors have reduced the appeal of conifer softwood as the dominant tree species. The existence and management of spruce is threatened by the spruce bark beetle. In spite of the difficult situation, the overall current picture in terms of forest properties looks stable, as neither sharp rises nor sharp falls are anticipated.

The main threat to the forest property market is restrictions on forestry activities, especially the ban on clear-cutting, which both lowers the value of properties and complicates pine tree forest management, as the pine is an avowed sun-worshipper. The final version of the forestry component of the EU taxonomy has yet to be implemented, giving hope that solutions to the problems will be found. In Latvia, one such solution may be to leave ecological tree groups in place, as well as special clear-cutting regulations in wet milieus, to avoid soil destruction, and in developing access roads in specially designated places. It is vital that the solutions include the interests of forest owners and of society, given the role of individual forest stands in the protective functions provided by the forest ecosystem. Currently, economic activity is prohibited in around 10% of forest coverage, and subject to varying degrees of restriction in another 10%. Due to these restrictions a significant part of the area is becoming unattractive to forest owners, this land only being purchased to meet the Forest Stewardship Council's existing requirements regarding the proportion of protected areas held by forest management companies. A property loses around 80% of its value in the event of significant restrictions on economic activity, and over 90% if economic activity is prohibited. The coming years will see heated discussions concerning protected areas and their degrees of enlargement and restriction. Judging by afforestation statistics, Latvia has achieved good results in sustainable forestry by skilfully managing existing forests and planting forests in new areas.

"The coming years will see heated discussions concerning protected areas, and their degrees of enlargement and restriction."

A relatively stable situation is also expected in the agricultural land market where a small rise of up to 5% can be expected. The main influencing factor is the ECB's rates, because most properties are purchased on credit. Rate reductions can see the value of agricultural land climb by as much as 10%. The next value-influencing factor is the amount of land offered on a market where there is practically no land, causing farmers to pay higher than market value, just to acquire land for their property. Until now, too little assessment has been made of the impact of the European Green Deal, which in many regions is expected to prohibit the ploughing of land, permitting it to be used solely for the preservation of meadows or pasture grassland. It is anticipated that property values will fall by 30-40% in regions where restricted-use areas are expected to be created. Conversely, areas with no restrictions on economic activity will undergo a sharp rise in value, becoming attractive investment opportunities. These factors may be negative for Latvia's rural areas, because not all farm holdings will survive these turbulent years. What solutions might there be to resolve these situations? One might be to provide financial compensation for owners of restricted-use land in exchange for responsible land management practices. That will not be an easy task.

Macroeconomic prospects over the next few years look difficult for Latvia's forestry sector. There are still no clear forestry strategies that would meet all of the interests of forest owners, nature and rural populations. Within the strategy, compromises and support for the economy of rural regions need to be found. It is vitally important to retain the regional economy, to ensure a sustainable future and to raise the quality of life in rural regions.

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