Application of the RICS Valuation – Professional Standards in Cyprus

RICS guidance note, Cyprus

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Acknowledgments

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RICS professional guidance

International standards

Globally recognised high-level valuation principles and definitions are now embodied in the International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC). RICS has long been a supporter of the development of such universal standards, and not only fully embraces them itself, but also proactively supports their adoption by others around the world.

RICS Valuation – Professional Standards 2014, commonly referred to as the Red Book, formally recognises and adopts the IVS by requiring members to follow them. It also complements the IVS by providing detailed guidance and specific requirements concerning their practical implementation.

Member and firm conduct is underpinned through the application of the Rules of Conduct and the Global Professional and Ethical Standards and is assured through a well-established system of regulation. The whole ensures the positioning of RICS members and regulated firms as the leading global providers of IVS-compliant valuations.

RICS guidance notes

This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent ‘best practice’, i.e. recommendations that in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the guidance note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this guidance note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this guidance note, they should do so only for good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice.

Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In some cases there may be existing national standards that may take precedence over this guidance note. National standards can be defined as professional standards that are either prescribed in law or federal/local legislation, or developed in collaboration with other relevant bodies.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member’s responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

Effective from October 2016

RICS guidance note, Cyprus
**Document status defined**

RICS produces a range of professional standards, guidance and information documents. These have been defined in the table below. This document is a guidance note.

**Publications status**

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<th>Definition</th>
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<td>An international high-level principle-based standard developed in collaboration with other relevant bodies.</td>
<td>Mandatory</td>
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<tr>
<td>Professional statement</td>
<td>A document that provides members with mandatory requirements or a rule that a member or firm is expected to adhere to. This term encompasses practice statements, Red Book professional standards, global valuation practice statements, regulatory rules, RICS Rules of Conduct and government codes of practice.</td>
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<td>Research</td>
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1 Introduction

1.1 In Cyprus, the valuation profession is regulated by the Cyprus Scientific and Technical Chamber Law No. 224/1990 and even though specific procedures, standards and methodologies are not in place, it is widely recognised and accepted that the RICS Valuation – Professional Standards (the Red Book) must be adopted when undertaking written valuations.

1.2 This guidance note is intended to address several market practices that may differ due to market peculiarities and also to cover any regulatory regime imposed by law, with the aim of clarifying potential ‘grey areas’ between the Red Book and the Cyprus law and/or standard practice. It also aims to provide better understanding and more transparency in relation to the market in Cyprus for members providing valuations and for valuation users and other key stakeholders (auditors, lenders, valuers, governments, and courts).

1.3 This guidance note is effective from the date of publication.
2 Insurance value assessment

2.1 PS 1, paragraph 6.3, Exceptions, states that:
‘a replacement cost figure for assets other than personal property that is provided, either within a report or separately, for the purpose of insurance is not a ‘written opinion of value’ for the purpose of ‘undertaking valuation services’ as defined in PS 1 paragraph 1.2, Mandatory application.’

2.2 It is standard practice for financial institutions to request valuers to include in their report a replacement and/or reinstatement cost figure estimate for insurance purposes.

2.3 In such cases, for the avoidance of any doubt, it is advisable for members to include appropriate disclosures in their report, in order for their client to understand the limitations (if any) of providing such figures. Such disclosures should include some or all of the factors mentioned in the following sample paragraph:
‘The figure calculated is indicative and is based on a rough estimate of the average cost of construction as published by the Cyprus Statistical Service Authority (or any other sources) making adjustments as to the quality of the subject building, age, materials used, etc. If a more detailed cost analysis is needed then a quantity surveyor should be employed.’
3 Agricultural land

3.1 Cyprus is one of the European countries where people used to have a deep personal attachment to their land, due to their agricultural background and the fact that their main source of income was derived from agricultural activities. As a result, agricultural land had significant investment value (or worth) to its owners over the years. In recent years, however, this trend has diminished.

3.2 The Rural Plan, as published by the Town Planning and Housing Department of Cyprus, clearly states that any residential development on land within Agricultural Planning Zones is prohibited – except in exceptional cases, where the authority can exercise its discretion for social reasons and allow, under special circumstances, the construction of residential development, i.e. the erection of a single or few housing units. However, this discretion over the years became a sort of ‘unwritten owner entitlement’, since the planning authority exercised this discretion freely and without much attention to individual circumstances. This unwritten policy created many problems over the years for the following reasons:

- Infrastructure for water supply, electricity, roads, garbage collection, postal services, etc. needed to be available to those agricultural landowners who acquired a planning permission for the erection of residential units – even if such developments were dispersed throughout the urban areas of Cyprus and not agglomerated. This practice increased the government’s expenditure over the years in providing such infrastructure.
- Agricultural land prices did not reflect agricultural values, since such prices included the prospect for residential development.
- Such properties used to be mortgaged, taking advantage of the higher values resulting from their development potential.
- The policy created an unreasonable variation in values, without any consistency, since the prospect for residential development was sometimes unrealistic.

As a result, surveyors often had to follow the trend and adjust their valuations to reflect market practice, taking into consideration the ‘unwritten owner entitlement’, since the comparable evidence in the immediate vicinity area was suggesting so.

3.3 The Ministry of Interior, in an effort to end this environmental stress and the ambiguities arising from the misinterpretation of the Rural Planning regulation, released an internal memo, clarifying that the issue of a Planning Permission for the construction of a residential development should be based not only on the merits of the agricultural property but also on the owner status. This circular had an enormous impact on the Urban and Rural Plan and produced a sharp decline in agricultural prices – with a negative impact on the real estate sector in general.

3.4 As a result of the discrepancies caused in the property market due to the change of the government’s policy on how to treat such properties in terms of development, valuers should be very careful to ensure that they take into consideration the new proposed amendment (paragraph 9.4.8) contained within the Strategic Environmental Impact Assessment for the partial amendment of the written text of the Rural Plan – 3rd Phase as well as the already amended Local Plans as amended, with the addition of the clause that clearly states that all the factors/criteria that should be in place in order to allow the erection of a single housing unit. Therefore, it will be important to carefully analyse the comparable evidence used in the comparative method of valuation, and to carry out a thorough investigation – in particular, with regard to possible future development of the particular property or asset being valued. Where any assumptions have been, or must be, made in carrying out the valuations, these should be clearly stated in the report (see VPS 3 paragraph 7(i)).
4.1 It is generally accepted that the comparative method of valuation is the most widely used, since it is the most direct method of estimating the value of a property – by comparing it to similar properties and by making some adjustments to take into account the dissimilarities of the comparable evidence. This methodology is also used in Cyprus – especially in cases of valuing commercial or residential apartments, where a large pool of comparable data is available for the valuation surveyor.

However, where the surveyor is called to value a property with a housing unit standing on it, the comparable method alone is not always fully representative, for the following reasons:

- Not enough comparable evidence is available for buildings with similar characteristics. This is due to discrepancies in the area of the land (in relation to the building), area of building, quality of materials used, age, etc.
- Discrepancies arise from the fact that there is no available information and transparency of the comparable data in terms of internal area, covered verandas, uncovered verandas, basements, attics, etc. Therefore there is no safe way of adjusting the comparable figures before applying them to the subject property.

4.2 For the above reasons, and also because in certain cases financial institutions request a separate figure for the land and the buildings (housing units) to be included in the valuation report, the comparable method is used to value the land element of the property – where a large pool of comparable data is often available and can be easily adjusted to take into consideration the merits of the subject property. In terms of valuing the buildings standing on the land, the depreciated replacement cost method is applied, which is tailored to take into account the normal wear and tear of the building (depreciation) and the specifics of the property in question – age, materials, state of repair, developers profit (where applicable), etc. (bearing in mind that cost is not always value). It should be made clear that this figure does not represent the cost of construction of the building because of the adjustments made for each case individually, as mentioned above.

4.3 Valuers may comply with requests to provide such valuations, but it is important that the basis of valuation is made clear both in the terms of engagement and in the report, especially when:

- the resultant aggregate figure may not necessarily accord with the market value of the property as a single asset, since the building(s) might restrict the full and optimum development of the land and
- similarly, an apportionment of the market value of the entire property between its constituent parts would not necessarily accord with the individual figures arrived at for those parts in isolation.

4.4 Valuers should note that this method has been accepted by the courts. It is also widely used by property developers for their pricing policies, since it is a good way to understand whether the profit margins for realising such developments are worthwhile, taking into account the market conditions (for the land) and the cost involved (for the buildings) before commencing construction. Furthermore, the Inland Revenue Office may also ask for this separation to be made for tax purposes.
5 Forced sale value

5.1 VPS 4 paragraph 4.7 specifies that the term ‘forced sale value’ must not be used because a ‘forced sale’ is a description of the situation under which the ‘exchange’ envisaged in VPS 4 paragraph 1.2.1 takes place and is not a distinct basis of value. However, in Cyprus there is a recognised convention – reflected in requests for valuation advice by financial institutions – whereby an indicative figure (described either as a forced sale value or a forced liquidation value) is provided as a benchmark for loan purposes. This is normally derived from market value but must not be confused with it.

5.2 The forced sale value represents the sale price that would be expected on a quick disposal (if required). Therefore this value is calculated at a percentage lower than the market value and can vary depending on the merits of the property being valued.

5.3 Since there is no academic approach for the estimation of the forced sale value and it is therefore calculated based on the trend over the previous years, when adopting this figure, valuers should try to follow the trend of the market according to market and property specifics. As noted above, this is only an indicative figure, and it is not used other than as a benchmark for loan purposes.

5.4 In complying with requests from financial institutions for such figures, valuers in Cyprus are instructed to use the term ‘forced sale value’ in this particular context, but must ensure that there is no risk of confusion with market value. Furthermore, any special assumptions made in calculating the ‘forced sale value’ (which must be ‘realistic, relevant and valid for the particular circumstances of the valuation’ – see VPS 4 paragraph 3.3) must be clearly set out in the terms of engagement and the valuation report.
6 Vacant land prime for development

6.1 It is generally accepted that when valuing development land, the residual method of valuation can be used. This approach entails estimating the gross development value (GDV) of the development components and deducting therefrom the development costs to be incurred, to arrive at the residual value. This residual value – appropriately discounted for the period of development and sale – is deemed to be the present market value of the subject property. Care must be exercised in undertaking the valuation to ensure that the end result is realistic, when judged against the available market evidence for comparable sites.

6.2 In Cyprus, this method is also used when the property in question is a field that can be subdivided and disposed of as building plots. This is due to the fact that it is very common for individuals to acquire a building plot that will be used either as a form of investment (ownership of vacant building plots) or to construct a house (of a design of the owner's choosing).

6.3 Most of the sites (building plots) that are considered suitable for single-family houses are part of subdivisions of larger pieces of land. Following this, it has become standard market practice (and accepted also by the courts) that the value of the larger piece of land (field) can also be estimated using the residual method of valuation – where the gross development value is considered to be the total projected sales price of the individual building plots once developed (that are considered as the ‘end product’ and for which there is usually enough comparable evidence). From the gross development value estimated the valuer then subtracts the cost of developing and subdividing the parcel of land, for example:

- construction of road network, pavements, infrastructure to connect to electricity, water network, sewage, etc.
- other incurring expenses (agency fees, marketing, etc.)
- the developer's risk and profit
- cost of financing and finally
- adjusting for the time required to dispose of all the individual sites.
7 Density value

7.1 The valuation of land in Cyprus depends on the physical and legal characteristics of the land to be valued. It is commonly based on comparable sales, subject to checking that the physical and legal characteristics of those comparables are indeed similar. The most important legal characteristic of the land – besides the title of the plot – is its planning zone. This planning zone describes:

- the permitted use of the land
- the density or plot coefficient ratio
- the coverage ratio
- the number of floors and
- the height of the building allowed.

7.2 The density ratio is the covered area allowed to be built on the plot and it relates to the area of the property. It is also described as a percentage. Normally the value of a plot of land depends directly on the level of the density ratio. For otherwise similar properties the higher the density ratio, usually the higher is the value per square metre of the land.

7.3 To be able to convert the value per square metre of the land into a value that may be used to compare land of different planning zones and take into consideration the different density ratio, the value has to be analysed in terms of the density allowed to be built. This problem becomes more apparent in small countries such as Cyprus, where there is limited evidence of comparable sales.

7.4 To make the two values comparable it is necessary to analyse the value per square metre of each plot by dividing the value per square metre of the land by the density ratio expressed as a number. This density value may be adjusted according to the location of the area being valued – whether it is on the ground or the first floor, etc. or whether it is of a different use, such as retail, commercial, or residential, etc.

7.5 Density value is used primarily when calculating the value of the density ratio, which cannot be developed in listed buildings as per The Preservation of Buildings Law (N240(I)/2002 as amended). The valuation is carried out for the purpose of transferring the remaining density ratio to another plot of land. In these cases, under the legislation, there are incentives for transferring excess density area that is not allowed to be developed on the existing preserved building and may be transferred onto another plot of land. In such situations, the total value of the remaining density value is calculated – as well as the density value per square metre of the other plot of land, where the density is transferred to – and these areas are then exchanged based on a certain formula.

7.6 Density value is also very important for the developers in order to compare the proportion of the cost of the land to the total cost of a proposed development – and to decide whether it is profitable.

7.7 The calculation of the density value is based on the net area of the property, i.e. after deducting the area to be used for the construction of the road network and green space, according to the planning conditions and requirements. In extremely low density ratios, the density value includes an amount that reflects the additional amenities value – which is linked to the low density and allows the existence of these additional amenities, such as a large garden or a swimming pool. Depending on the comparable sales, the density value needs to be further adjusted to reflect this.

7.8 This measure of the value of the land is fairly widespread in Cyprus and it is usually used as a cross check method to assess the market value of the land.
Freehold and leasehold valuations (long-term leases)

8.1 Long-term leasing is not a very common means to occupy premises. Most occupiers are owner-occupiers. This makes valuation of the limited number of leasehold interests a complex undertaking.

8.2 In order to value the leasehold interests in properties it is necessary to use the income/investment method and comparable rents. As there are not many comparable rents and the information available on these rents is not always trustworthy, the calculation of the full rental value of a property becomes a difficult task. The sale of leases and leased properties is even more infrequent. Thus it is necessary to adjust the valuation methods in order to arrive at the valuation. This applies both in the case of buildings and land.

8.3 In the case of buildings, analysing the rents is easier – because there is generally more information available. Where there is insufficient information, it is common to estimate the value of the building by using comparable sales and then decapitalise by applying a capitalisation rate (yield). Where this information is scarce, it is possible to use the cost approach as the method of last resort – calculating the value of the land and adding to it the value of the building. The value of the building may include the developer’s profit, in addition to the cost of the building – depending on the type and the use of the property. This value is then decapitalised to arrive at the rental value.

8.4 In the case of land, it is common to calculate the rental value by applying the expected yield for the particular use of the property to the capital value. Comparable values are easier to calculate, as there is more evidence of comparable sales than rents. There are certain regulations for the leasing of state land (ΚΔΠ173/89). In this case for each different category and use of the property the yield to be applied is specified. The full rental value of state land is thus calculated by applying this capitalisation rate/yield to the capital value. These yields are considered to be based on the market yields for each category of the land, especially tourist and industrial land. Commercial land is not specified, so the aforementioned yields are adjusted accordingly (the RICS Cyprus Property Price Index may be used).

8.5 Leasing is more common in industrial estates. Elsewhere, leasing is not very common, and the leases as such are not very onerous, either to the landlord or to the leaseholder. Usually, their obligations are not described in detail and therefore, depending on the contract, the outgoings to be accounted for in the valuation are not necessarily very high. It is expected that the owner undertakes the repairs and the insurance of the building, and the leaseholder is responsible for the main fair wear and tear costs associated with the occupation of the building.

8.6 For the valuation of leaseholds, the yield applied to capitalise the profit rent is higher than the one used for the freehold interest – reflecting the higher risk involved. Leases for commercial/industrial purposes sometimes contain clauses for the payment of premium, which has to be taken into consideration for valuation purposes as well as any capital expenditure/improvements made.

8.7 For retail and residential tenancies the Rent Control Legislation applies (Ν23/1983 as amended).
9 Buildings without final certificate of approval

9.1 Until the economic crisis became tangible in Cyprus, an unissued title deed, particularly for buildings or building plots, only provided a ‘helping’ tool for the potential buyer in negotiating and was, at the most, a small burden for the seller. When the economic crisis became more apparent, an unjustifiably prolonged period of issuing the title provided a valid reason for dispute between buyers and sellers – who may have had a contractual agreement dating from some years before. The main reasons for the delay of the issuance of the title deeds are:

(a) delay by government authorities, due to bureaucracy or inefficiency in dealing with the workload
(b) delay due to changes made by the owners during the construction works – thereby departing from the relevant building permissions and thus starting the process all over again
(c) delay due to the monetary deficiencies that many of the construction/development companies/owners are facing because of the crisis – leading to non-payment of the taxes required to be paid before the issuance of the title deeds and
(d) delay, or even refusal, by the lenders (mortgage institutions) to transfer the mortgages over to the new title deeds – without first paying off the existing loans or fixing the non-performing loans.

Thus valuers in Cyprus face a major uncertainty insofar as the above cases are concerned and must be extra cautious.

9.2 The above delays led the government authorities to change the law. Since 2011, if owners/developers do not apply for the issuing of the title deeds, the buyer has the option of applying to start the process. The same can be done by the government (ex-officio cases).

9.3 In the Memorandum of Understanding that has been agreed with TROIKA (the European Union, the International Monetary Fund and the European Central Bank) and, in particular, in paragraph 5.3, the Cyprus Government has to focus on issuing the remaining unissued title deeds. This has led to a serious reduction in the outstanding title deeds.
10 The plethora of planning zones in the Cyprus planning and housing system

10.1 Since 1 December 1990, when the Town and Planning Law came into force in Cyprus, planning zones became one of the most dominant factors to take into account when estimating the market value of a property.

10.2 Since 1990, the different kind of planning zones have grown in number. As legitimate as these planning zones may be, they do not help the process of estimating the market value. On the contrary, the plethora of very similar planning zones – that may in some cases cover only a few plots, add complexity for valuers. For instance, there exist – in the same area – several residential planning zones that differ from each other by only 10% in building density. This makes it much more difficult to find comparable sales that fit the planning zone under study.

In other words, due to the great variety of planning zones, due to the minor differences among similar planning zones, and due to the scarcity of comparable sales, no real difference can be detected easily by valuers when estimating market value, and thus extra caution should be taken when analysing data to arrive at the market value.
Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 118,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers valuation and commercial property practice; property finance and investment; project management, planning & development; quantity surveying as well as facilities management.

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We believe that standards underpin effective markets. With up to seventy per cent of the world’s wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres in the world, we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all. We are proud of our reputation and we sustain it, so clients who work with an RICS professional can have confidence in the quality and ethics of the services provided.