TEGOVA

EU Law on Valuation for Bank Lending

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IPAV VALUATION CONFERENCE

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The European Group of Valuers' Associations

- Europe's property valuation standards setter since 1977
- 72 member associations (including IPAV)
- 36 countries
- 70 000 qualified valuers
- Minimum Educational Standards
- Code of Ethics
- Pan European REV designations in Real Estate, Business and PME Valuation

Outputs

- European Valuation Standards (real estate)
- European Business Valuation Standards
- European Plant, Machinery and Equipment Valuation Standards

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The IPAV/TEGOVA Relationship

- A game changing 10 year relationship boosting the fortunes of both.
- IPAV, a mover and shaker in the development of the European valuation profession
- 148 REVs
- 335 TRVs
- Also active in development of European Business Valuation Standards
- A pioneer in the education of valuers
- None of this would have been possible without the dedication and active participation in the work of TEGOVA by IPAV's Representatives Pat Davitt, Ella Dunphy and successive IPAV Presidents

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A Trilogy of European Valuation Standards

The Irish Banking Crisis

Extract from the final report of the parliamentary committee of inquiry of 27 January 2016 regarding the Irish banking crisis

"More widely, however, the demand for asset valuations increased significantly as the property boom took hold and reliance on informal valuation standards, such as 'desktop' and 'drive-by' valuations, became more prevalent. These did not involve any physical inspection of the property, but were a limited (and sometimes fully automated or computer generated) process of estimating value. A Central Bank review of financial institutions found that many used these informal valuations as if they were formal valuations."

The Use of Automated Valuation Models

The Capital Requirements Regulation (CRR) limits use of AVMs to monitoring property values and identifying property that needs revaluation.

But the European Commission had sought to revise CRR in order to allow use of AVMs even at loan origination until the European Central Bank entered the fray with the following intervention:

"The use of statistical models should remain restricted to monitoring the need for revaluation. Institutions should not be allowed to exclusively rely on models for valuation of immovable property. Immovable properties in need of revaluation should always be evaluated by an independent qualified valuer. "

Thus it is almost certain that the current CRR position of AVMs only for monitoring will remain.

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The Optimism of Valuers?

Some of the blame for the Financial Crisis of 2008 was levelled against valuers for allegedly over optimistic valuations, enter:

The Bank for International Settlements (BIS)

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The Bank for International Settlements (BIS)

- International organisation serving central banks and other financial authorities across the globe
- Owned by 63 member central banks
- Supports aim of monetary and financial stability
- Acts as a bank for central banks
- Supports works of 6 committees including The Basel Committee on Banking Supervision

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The Basel Committee on Banking Supervision (BCBS)

- Develops global regulatory standards for banks and seeks to strengthen micro and macro prudential supervision
- Provides a forum for regular co-operation on banking supervisory matters
- In 2017 the Basel Committee made recommendations to guard against another real estate related global financial crisis including the concept of ‘prudent value’ for real estate valuation defined as follows:

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The Basel Committee Recommendations on Prudent Valuation

- *"…the valuation must be appraised independently using **prudently conservative valuation criteria**. To ensure that the value of the property is appraised in a prudently conservative manner, the valuation must exclude expectations of price increases and must be adjusted to take into account the potential for the current market price to be significantly above the value that would be sustainable over the life of the loan. …"*
- The European Commission is now implementing above in its revision of the Capital Requirements Regulations (CRR).

EU Law Impacting Valuation for Bank Lending

Capital Requirements Regulation and Capital Requirements Directive (CRR/CRD IV)

- The 'CRR/CRD IV' package transposed new standards on bank capital (Basel III agreement) into the EU law from 1 January 2014

- Tackles the problem of banks holding insufficient capital by setting stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity and sets rules for the treatment of mortgage collateral capital

- The CRR/CRD IV package is not only of significance to the world of banking but also impinges on real estate valuation

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Capital Requirements Regulation

Article 229(1)

"For immovable property collateral, the collateral shall be valued by an independent valuer at or at less than the ***market value****…*

In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or at less than the ***mortgage lending value…*** *"*

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Capital Requirements Regulation
Market Value and Mortgage Lending Value

Article 4 *(76) 'market value'*

means, for the purposes of immovable property, the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion;

Article 4 *(74) 'mortgage lending value'*

means the value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property;

European Union's Proposed New Valuation Basis: "Property Value"

Proposed Addition to Article 4

(74a) 'property value'

means the value of immovable property determined in accordance with Article 229 (1)

Proposed Revision To Article 229 CRR

Valuation principles for eligible collateral other than financial collateral

paragraph 1 is replaced by the following:

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

(a) the value shall be appraised independently from an institution's mortgage acquisition, loan processing and loan decision process ***by an independent valuer*** *who possesses the necessary qualifications, ability and experience to execute a valuation;*

(b) the value is appraised using ***prudently conservative valuation criteria*** *which meet all of the following requirements:*

(i) ***the value excludes expectations on price increases;***

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

(c) the value is not higher than ***a market value*** *for the immovable property where such market value can be determined…*

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TEGOVA's Interpretation of Prudently Conservative Valuation Criteria (i)

the value excludes expectations on price increases;

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

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TEGOVA's Interpretation of Prudently Conservative Valuation Criteria (ii)

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

- *"market price*" should be understood as the same as market value.
- This criterion requires an adjustment to be made to the estimated '*value*' to reflect any risk that this *'market price (market value)'* may be significantly higher than the value that would be sustainable over the life of the loan.

TEGOVA's Interpretation of Prudently Conservative Valuation Criteria (ii) continued

- No need for a valuation which is separate from the assessment of "value" but an arithmetical '*adjustment*' to the latter.
- Valuer advised to undertake an analysis of the market in the context of its cyclicality.
- If the market value of the property is assessed when the market is at the peak of the market cycle, there is likely to be a risk that the price will be significantly higher than the value that could be sustained over the term of the loan. By contrast, if the market value is assessed when the market is at the bottom of the market cycle, there is probably little such risk.
- In addition, all other known factors should be taken into account in the assessment of the described risk. For example, the oversupply of a particular type of property may lead to a decrease in prices in the future and thus to a decrease in the value of the assessed property in the future.

THANK YOU

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