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EVS 2020 – Continuity and Disruption

Michael MacBrien, TEGOVA – IPAV Conference 28 October 2020

It's a given that there's a lot of continuity in valuation standards, but a singularity of EVS is the continuous effort to put our Standards in lock-step with EU law and policy.

That paid off, because the European authorities appreciate that, they recognise it, the European Central Bank gives EVS precedence over all other standards, which in turn has raised and sharpened our profile, and all this has been a very important 'intangible' in the doubling of TEGOVA's membership to 72 associations, 70 000 valuers.

Disrupter n° 1: EVS 6 Valuation and Energy Efficiency

"Continuity" is a good way of defining our relationship with the European Union, but it's not a good way of portraying the Union itself, because we rely on the EU to face the great challenges of our time and that brings Disruption. The greatest challenge of our time is climate warming and it brings the greatest disruption, and the greatest disruption of all is for real estate.

The European Council and the European Parliament are on the verge of agreeing a **European Climate Law** that sets the goal of climate neutrality by 2050 but none of us can focus on that, too far away, it'll keep the kids busy, and that's exactly why, because of the extraordinary lightness of the human spirit when the problem's not in our faces, that the Law also sets down a 55% reduction in Green House Gas emissions by 2030, and that's another kettle of fish altogether, because that one's on us, and I mean *us*, property people, because 36% of all EU carbon emissions come from buildings, so **the 2030 target will never be met without a doubling or a tripling of the rate of renovation and deep renovation at that**.

Now, the EU has been working on this for twenty years. That's how we got the Energy Performance Certificate and energy performance requirements when there's a major renovation. But **EU law** never cracked the real nut. It **never *forced* anybody to *undertake* that major renovation**. ***But what it does do is tell the member states to demonstrate what they're doing to meet that 2030 emissions target.***

And that is where we are finally getting action:

In France, for all 'F' and G'-grade residential (25% of the housing stock)

- It all has to be renovated by 2028.
- No upward revision of rents as of this January unless there's a renovation

In the Netherlands, office buildings that don't have 'C'-grade energy performance certification won't be rentable as of 2023. 'A'-grade as of 2030.

Most member states have done nothing like that yet – **Ireland** seems to be an extreme case; it didn't even reach the 2020 target and its transport and building emissions are actually going *up* – so a few days ago the Commission served notice that it's going to table *EU* legislation forcing owners to renovate.

How can this not impact valuation? For years we talked about energy renovation in EVS, dutifully recounting what was in the EU Directives, but we never, ever suggested that valuers needed to take account of that in their determination of Market Value. How could they? And why should they, seeing as there was no real pressure on the owner, the landlord, the buyer, the seller.

But when you know that within three years the building will have to be renovated, or that it won't be rentable if it isn't, then you have a valuation issue.

That's' why **in EVS 2020 energy efficiency valuation has been upgraded to Standard status** and the standard says:

> "A legal obligation to renovate a building to a higher level of energy efficiency by a fixed date or at a certain inflection point (e.g. rental, sale) creates an unavoidable major cost that impacts Market Value, as the owner at that date or inflection point will have to pay for renovation works.
>
> Valuers must be aware of these legal deadlines and inflection points and when they appear, must estimate the cost of a renovation deep enough to meet the required new level of energy efficiency or future requirements that are sufficiently close to coming into force and consider the extent to which these costs affect the Market Value at the date of valuation."

How's that for disruption?

TEGOVA's Chairman Krzysztof Grzesik and Roger Messenger foresee some interesting methodology guidance to work on going forward: We can integrate the renovation cost in Market Value, but how? What is our starting point? What comparables do we seek out in order to adjust them for the cost of the works? Or do we go for a residual method of valuation incorporating not only hard costs but all other costs including financing and developers profit? And what happens when we arrive at a negative figure? Do we then assume a vacant site to be redeveloped with a new energy efficient building?

Of course we did it to stay in step with EU law, but more simply we did it because this time regulation really *will* impact Market Value and we'd better not miss the bus.

Next page: Disrupter n° 2: EVIP 7 Advanced Statistical Models

Disrupter n° 2: EVIP 7 Advanced Statistical Models

I've had the honour of speaking to you all of the past three years and it was always partially or completely about AVMs, which shows how much we put into this. About how much we fought to get the European Commission to enforce EU law upholding the indispensable role of the qualified valuer at least for the first valuation, the valuation at origination in the lending process.

That matter is still not resolved, but it doesn't matter any more, because in the end it's the European Banking Authority that smashed through our defences and finished us. I tried my best in Paris in their new offices that still had the price tags on the furniture and that should have been in Dublin, but I was stone cold alone in a room with forty bankers and AVM manufacturers pulling in the opposite direction.

On 29 May 2020 the European Banking Authority published Guidelines on Loan Origination and Monitoring that end it once and for all.

You would hardly imagine it if you read the default Article:

> "209. At the point of origination, institutions should ensure that the value of all immovable property collateral for loans to consumers and micro, small, medium-sized and large enterprises is assessed by an internal or external valuer using full visit with internal and external assessment of the property."

You must be thinking "What's wrong with that? That's cool, what's his problem?

The problem is the next paragraph:

> 210. As a derogation from paragraph 209, for the purposes of a valuation of residential real estate in well-developed and mature property markets, the value may be assessed by means of a desktop valuation, carried out by an internal or external valuer and supported by advanced statistical models. The valuer remains responsible for the valuation, while the advanced statistical models should be used as supporting tools, blah, blah, blah.

There's all sorts of blah-blah about how the AVM's value has to be "robust", otherwise back to classical valuation with inspection, but that won't stop the banks who'll be the Lords and Judges of 'robustness'.

How did that happen? Two main reasons:

First, the banks and their AVM manufacturers probably managed to convince the EBA that 'Advanced Statistical Models' – the very latest in AVMs – are good enough, close enough to Market Value most of the time, not to be a systemic risk to the financial system. Sure, borrowers with atypical outlying properties might get burnt, but the banks are supposed to use real valuers in those cases anyway.

The second reason is the nature of EU law and even of its banking guidance.

The whole corpus of EU law and policy is founded on basic principles that we give fancy names to like conferral and subsidiarity and proportionality but that mean in essence, that the EU should only do what it absolutely has to do and that everything else should remain in the hands of the member states.

Our Achilles heel in this whole campaign was always that we were asking for hard EU law *telling* the member states exactly when a stand-alone AVM can or cannot be used without an inspecting valuer.

All the banks and AVM manufacturers had to do was say "Why should the EU decide that? Aren't the Dutch or Irish banking supervision authorities big enough to do that themselves? And they know the local ground better."

And the killer argument surely was that EU law is relatively inflexible and takes time to change, whereas AVM technology is progressing rapidly so national authorities should have the freedom and the flexibility to adapt their banking regulation to technological change.

That's it folks, game over. And because the game is over and we absolutely cannot afford to have European Valuation Standards that contradict EU law or guidance, we had no choice in EVS 2020 than to ditch the AVM Standard and replace it with an Information Paper putting the EBA Guidelines in the best light we can and that starts with the words "EVS adheres to the European Banking Authority's Guidelines."

You've understood that **now, for you, everything is in the hands of the Irish banking supervision authorities**. They can impose valuation with valuer inspection or drive-by for all valuation at origination, or they can allow desk-top with AVMs.

But there will be no more EU arbiter. You're alone with your own authorities.

Actually, as you'll see in the November issue of European Valuer, there may be more opportunity than risk for valuers in all of this, but for valuers whose main source of income is basic housing, the future is not clear.

I hope you nonetheless like EVS 2020.