rev
Journal of the Recognised European Valuer

TEGoVA
THE EUROPEAN GROUP OF VALUERS' ASSOCIATIONS

www.tegova.org
October 2014 / Issue No. 9

The Shaping of a European Valuation Culture

By Krzysztof Grzesik REV, Chairman TEGoVA

Krzysztof Grzesik speaking at the international valuation conference in Bucharest last month** **(see report page 2)

The European financial crisis and its resolution have been a turning point for real estate because the reforms necessary to save the euro have armed the EU with property market-shaping power exemplified by the Mortgage Credit Directive, Banking Union and Economic Governance, with game changing impact on valuation.

The Mortgage Credit Directive is designed to protect borrowers by addressing irresponsible lending. A key aspect to that is the provision that member states must ensure reliable valuation standards for mortgage lending purposes. TEGoVA's European Valuation Standards (EVS) are the best for that purpose because they are solely concerned with the valuation of real estate, specially focused on the relevant aspects of EU banking directives and include guidance on market rating and risk-related criteria for valuations. Also only EVS provide comprehensive guidance on *Mortgage Lending Value*. TEGoVA is now helping its member associations in influencing their governments to put the Directive's valuation requirements into practice.

At the same time banking supervision has fallen to the EU. Most banks in Europe are now controlled by the European Central Bank which stipulates that they should value their real estate exposures in line with European Valuation Standards within the *Asset Quality Review*. If other standards are chosen, in case of conflict, EVS prevails.

The EU has also developed so called "Economic Governance" as a non-harmonising way to get governments to confront and compare their policies and agree on reform. Real estate has been at the forefront of this. Some of the most notable EU Economic Governance reforms include reforming planning law, addressing obstacles to retail development, instating or increasing recurrent property tax, updating the cadastral value on which the recurrent property tax is based or broadening the tax base, liberalising rent controls and increasing construction competition or simplifying construction law procedures.

TEGoVA's edge has been to understand the impacts of European integration on real estate and to gear our production to this. Thus our European Valuation Standards, Recognised European Valuer qualification and Minimum Educational Requirements have become the backbone of an emerging **European Valuation Culture**.

TEGoVA will ensure that such culture becomes firmly embedded across the continent, with the aim of raising the profile and status of our real estate valuation profession. ●

A Makeover for Mortgage Lending Value

By the Editorial Team

"… CRE lenders subject to regulatory capital rules, loan-to-value (LTV) based capital requirements should be linked to a long-term measure of collateral value that is insensitive to the investment cycle"(Recommendation 4 – Investment Property Forum Report May 2014)

Who would have thought that the above recommendation whilst not proposing outright adoption of mortgage lending value, comes from a report of a group based in the United Kingdom, the spiritual home of market value? But yes indeed, the report titled *"A Vision for Real Estate Finance in the UK – Recommendations for reducing the risk of damage to the financial system from the next commercial real estate market crash"* has been produced by a cross-industry real estate finance group sponsored by the London based Investment Property Forum.

The authors recognise that *"The UK has an exceptionally strong tradition in market value valuation, underpinning a very liquid and transparent CRE market, but no such tradition of measuring long-term value"*. They conclude that *"while the UK could choose to adopt a model for long-term value already in use elsewhere, a new approach (albeit benefiting from the experience of others) may be better able to meet the specific objectives of the vision in the context of the UK CRE market."*

So is the concept of Mortgage Lending Value, for so long the poor relation to Market Value, about to enjoy a renaissance? It certainly appears that way given that under Article 124 (4) (a) CRR, the European Banking Authority is required to develop draft regulatory technical standards to specify: *"the rigorous criteria for the assessment of the mortgage lending value …"*

The so-called CRR/CRD IV package which transposes -via a Regulation and a Directive- the new global standards on bank capital (the Basel III agreement) into EU law came into force on 1st January this year. In connection with property valuation the CRR sets out two regimes: the market value and the mortgage lending value (MLV).

It is likely that any Regulatory Technical Standards on MLV will set out the detailed methodology to be applied in arriving at Mortgage Lending Value. In this respect TEGoVA will be ready to respond to any future consultation. ●

ANEVAR Opens Debate on Mortgage Lending and European Banking Union

Keynote speakers at ANEVAR Conference from left to right TEGoVA Chairman, Krzysztof Grzesik, Michael MacBrien, Director General, EPF, Adrian Vascu, President ANEVAR, Lothar Jerzembek, Head of Financial Reporting, Valuation and Internal Audit, VÖB and Yang Feng, China Appraisal Society.

The National Association of Authorized Romanian Valuers, ANEVAR hosted a 2 day valuation summit, on real estate valuation for mortgage lending purposes in Bucharest on 8th and 9th September, coinciding with a meeting of the TEGoVA Board.

The first day was devoted to a seminar on TEGoVA's Property Market Rating tool as enhanced by The Association of German Public Sector Banks (VÖB) to become the latter's uniform standard for valuing property, namely the " VÖB ImmobilienAnalyse" a web application, which allows valuers to determine the opportunity and risk profile for real estate collateral.

The property market rating tool was presented by Lothar Jerzembek, Head of Financial Reporting, Valuation and Internal Audit, VÖB, Thomas-Andreas Ziesenitz Director of Real Estate, Valuation and Analyis VÖB, Stephan Henkel, Managing Director VOB Service GmbH and Stephan Zerbe of Landesbank Baden-Württemberg.

The following day, 350 local and foreign valuers attended ANEVAR'S international conference on valuation lending. Keynote speakers included TEGoVA Chairman, Krzysztof Grzesik, Michael MacBrien, Director General of the European Property Federation, Yang Feng of the China Appraisal Society and J. Scott Robinson, Vice President of the Appraisal Institute.

Also Lothar Jerzembek gave a rousing presentation setting out a proposed strategy for TEGoVA to secure an even stronger position in the European Union. Other speakers included TEGoVA Board member Silvia Cappelli (ASSOVIB) and Vladimir Ignatov of the Chamber of Independent Appraisers in Bulgaria (CIAB).

The consensus amongst those attending this unique two day summit was that European Banking Union now being implemented by European Central Bank and the European Banking Authority and will have a fundamental harmonsing influence on the valuation profession in Europe. In order to maintain the momentum of this debate the TEGoVA Board announced that the TEGoVA General Assembly in Berlin set for 18 April 2015 will be preceded the day before by a European Valuation Conference titled **"European Banking Union and an Emerging European Valuation Culture"**. ●

CRR/CRD IV Package Forces Immediate Uptake of EVS Compliant Market Value Definition

- **DIRECTIVE 2013/36/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013**
  on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

- **REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013**
  on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

The above EU directive and regulation, the so called 'CRR/CRD IV' package, transposes the new global standards on bank capital (commonly known as the Basel III agreement) into the EU legal framework.

"While Member States will have to transpose the directive into national law, the regulation is directly applicable."

The new rules which came into force on 1 January 2014 tackle the problem of banks holding insufficient capital, often of a poor quality at that, having to be bailed out by national governments. The new framework sets stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity.

The CRR/CRD IV package is not only of significance to the world of banking but also has an impact on real estate valuation.

The new framework divides the current CRD (Capital Requirements Directive) into two legislative instruments: a directive governing the access to deposit-taking activities and a regulation establishing the prudential requirements institutions need to respect.

While Member States will have to transpose the directive into national law, the regulation is directly applicable. It creates law with direct effect in all Member States without any further action on the part of the national authorities.

Areas of the previous Capital Requirements Directive where the degree of prescription is lower and where the links with national administrative laws are particularly important have continued in the form of a directive. This concerns in particular the powers and responsibilities of national authorities, the requirements on internal risk management that are intertwined with national company law as well as the corporate governance provisions. CRD IV deals with the common passport of credit institutions (free market access).

"This EU law will inevitably boost the importance of European Valuation Standards which provide an indispensable guide to the interpretation of both definitions."

By contrast, the detailed and highly prescriptive provisions on calculating capital requirements take the form of a regulation.

Valuers in Europe will know that the previous CRD included the definitions of Market Value and Mortgage Lending Value.

The definitions which are the same as those set in European Valuation Standards 2012 are set out under Article 4 of CRR as follows:

(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;

(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;

It should be made clear that the above definitions only apply in law when banks intend to use a preferential risk weight for their mortgage loans. Thus they do not necessarily need to apply in the case of all lending valuations but only for reduced capital allocation purposes. However in practice, banks normally go through a preferential risk weight because equity is scarce. Therefore there are good reasons to believe that most of the banks' mortgage books will be valued on the basis of the CRR definitions of Market Value and Mortgage Lending Value.

Thus whilst existing national statutory definitions of market value, to the extent that they differ from the above, may still be valid, most valuations for lending purposes are now subject to the CRR definitions. This EU law will inevitably boost the importance of European Valuation Standards which provide an indispensable guide to the interpretation of both definitions.

As an aside, the CRR/CRD IV package also mandates the European Banking Authority to draft Binding Technical Standards (i.e. Regulatory and Implementing Technical Standards – BTS). These are aimed at ensuring consistent harmonisation in specific areas. BTS are always finally adopted by the European Commission by means of regulations or decisions and they are legally binding and directly applicable in all Member States. The EBA is now drafting a number of BTS for the implementation of particular aspects of the CRD IV and CRR.

Already it has launched a consultation on draft Regulatory Technical Standards (RTS) setting out the general criteria against which a valuer should be assessed to determine whether (s)he complies with the legal requirement of independence when performing valuation tasks with respect to a bank under resolution. The consultation runs until 11 October 2014 and TEGoVA is considering a response. The EBA will be consulting soon on the methodology associated with Mortgage Lending Value. ●

The Greening of Valuation Practice

By Michael MacBrien, Adviser to TEGoVA

A major theme of TEGoVA's next European Valuation Conference in Riga to be hosted by the Latvian Association of Property Appraisers (LIVA) on 24th October will be '**The Greening of Valuation Practice**'.

Today under the Energy Performance of Buildings Directive, every EU member state must provide for energy performance certificates (EPCs) the nature of which is to some extent harmonised in the Directive but there is still lots of room for differentiation and the proof is that many countries have poor certificates. In the residential sector in particular there is much dissatisfaction with such state of affairs with 500 € being spent on average for a certificate which is unreliable and has no bearing on the sale value. In April, this year, 60.000 Finns rose up against this and have begun what will come to be known as the 'Nordic Spring'.

As a first step in the right direction, The European Property Federation managed to get the European Parliament to insert an Article in the Directive, obliging the Commission to come up with a voluntary single pan-European certificate for non-residential properties.

However on the question of broader sustainability the EU has been a lot slower because it considers that the carbon footprint of buildings is overwhelmingly down to energy and not water or waste. It believes that throwing energy, water and waste together and trying to make sense of them would be very complicated and would run the risk of diluting the hard won outcomes of the pure energy exercise.

Whilst the property industry is against multiplying certificates (one for energy, one for water, etc.) there would certainly appear to be room for a Pan European sustainability label for buildings. In this connection the European Commission has drafted an agenda to discuss objectives and indicators for assessing the sustainability of buildings and the practical implementation of a framework containing core indicators.

Working alongside the European Property Federation, TEGoVA hopes to make a significant contribution to this initiative. It is hoped that the debate in Riga will add value to this process. ●

The Value of Sustainability

By Jeremy Moody Hon REV, CAAV

The valuation profession faces a challenge in the growing political emphasis on sustainability issues. Concerned over climate change and resource management, the EU is driving a legislative and policy programme on energy efficiency as well as water and other concerns. Many of these measures will affect property and so, potentially, its value. Policy makers wish to find that these measures do affect values and do so in ways that then drive intended changes in behaviour when 40 per cent of energy emissions are ascribed to buildings. Their first hope is that efficient properties are seen as more valuable (so stimulating investors and the market). Failing that – and with the large issues over the existing building stock – they would look for poorer properties to be penalised (encouraging improvement or replacement).

Yet valuers can only describe the market and values as they find them. They would not be useful to clients if they recorded changes that do not exist. Where the market takes account of these pressures, then reported values will reflect them. TEGoVA has responded in European Valuation Standards 2012 with the specific commentary on *Property Valuation and Energy Efficiency* (EVA8) and the wider review in the section, *Sustainability and Valuation* and will give further help in EVS 2016.

One focus of this challenge lies in the widespread sense that, among the many factors that drive property values, the market does not pay particular attention to Energy Performance Certificates (EPCs). That is now driving work to see if large scale statistics show relationships between energy efficiency and value. One issue here is that higher energy standards will generally be found in newer property which the market may anyway favour for other reasons. Owners of existing properties may be resistant to the scale of spending for "deep renovation".

Are EPCs (based on formulae and varying between countries) even the right tool for this task? What might have an effect: tax rebates, loans, grants, using funding from savings in energy bills or deterring the letting of properties with poor EPCs?

For property, this is a part of the debate about sustainability, a fluid concept based on resource management, resilience and risk, perhaps better seen as an evolving process. Perhaps it is necessarily about issues that have not yet crystallised to influence the market – when they do so, they become part of the market and its interplay of supply and demand. Meanwhile, regulations develop new standards and knowledge, public attitudes and political concerns change.

An interesting parallel is offered by the recent flooding. Very destructive in countries like Serbia, it also struck parts of Britain and Ireland. Here, we wait to see whether values will be affected for properties that are now seen to be vulnerable. In the past, this risk has been ignored but will the attitudes of buyers, tenants, lenders and insurers now drive changes in demand or requirements for adaptation to make buildings more resilient – as in the Netherlands after the 1953 floods? The CAAV is about to conduct a survey on this. It may prove useful to have comparables from sales or lettings of properties that have flooded so that a valuation can be sustained in the event of later challenge. However, if buyers' attitudes are unchanged, it may be that values will not change on this account.

It will become more important for valuers to be able to identify, understand and judge the possible effects of undertaking (or failing to undertake) sustainability measures, whether they be boilers, wall insulation or flood gates. These may vary greatly and will not always be obviously identifiable, easy to assess or exist. Reducing assessments to a single index will not suffice. The skills lie, as always, in appraisal and judgment taking these factors into account as relevant.

Throughout, the valuer's job is in the real market relying on real evidence of market behaviour and relevant technical knowledge for the different types of property, not policy assumptions. ●

A Certain Future for Valuers in an Uncertain World

Bernhard Bischoff REV demonstrating the use of statistics in comparative approach valuations.

Over 60 real estate valuers and academics from 9 Baltic Sea countries (as well as Bulgaria and USA), contributing to one of the best established valuer networks in Europe, gathered in Espoo, Finland on 5th September for the 24th Baltic Valuation Conference hosted by The Finnish Association for Real Estate Valuation. This year the conference focused on valuation accuracy and uncertainty and emerging challenges in the field of valuation. In this connection amongst the 15 speakers, TEGoVA Chairman Krzysztof Grzesik pointed to the growing influence of the European Union on property valuation and presented TEGoVA's recent Information Paper on Valuation Certainty and Market Risk.

Ari Laitala from Aalto University outlined the problems of valuation accuracy on the basis of open data available from sale of apartments in Finland and Bernhard Bischoff demonstrated how the use of simple statistics can significantly enhance the accuracy of comparative approach valuations.

On the theme of data reliability, Ina Viebrok-Hörmann, Vice Chairman of BVS (Real Estate Valuation Section) described the German system of gathering data and analysis by local Committees of Experts.

There were also presentations of valuation software. Daniel Helgesen of the Norwegian Valuers and Surveyors Association demonstrated the latter's latest software for comparative approach valuations and Þórunn Björk Sigurbjörnsdóttir from Registers Iceland showed the use of free software in data analysis. Also Victoria Tatti and Ollie Wiklund presented developments in web based real estate information in Sweden.

In a concluding address, Professor Kauko Viitanen, Chairman of The Finnish Association for Real Estate Valuation, raised questions about internationally established concepts and definitions of value including market and fair value implying that there is still much to be done in the pursuit of clarity in real estate valuation.

The 25th Baltic Valuation Conference will be hosted by the Estonian Association of Appraisers in Tallinn on 17th to 19th September 2015. ●