The Influence of EU Regulation and European Valuation Standards on Real Estate Valuation

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THE EUROPEAN GROUP OF VALUERS' ASSOCIATIONS

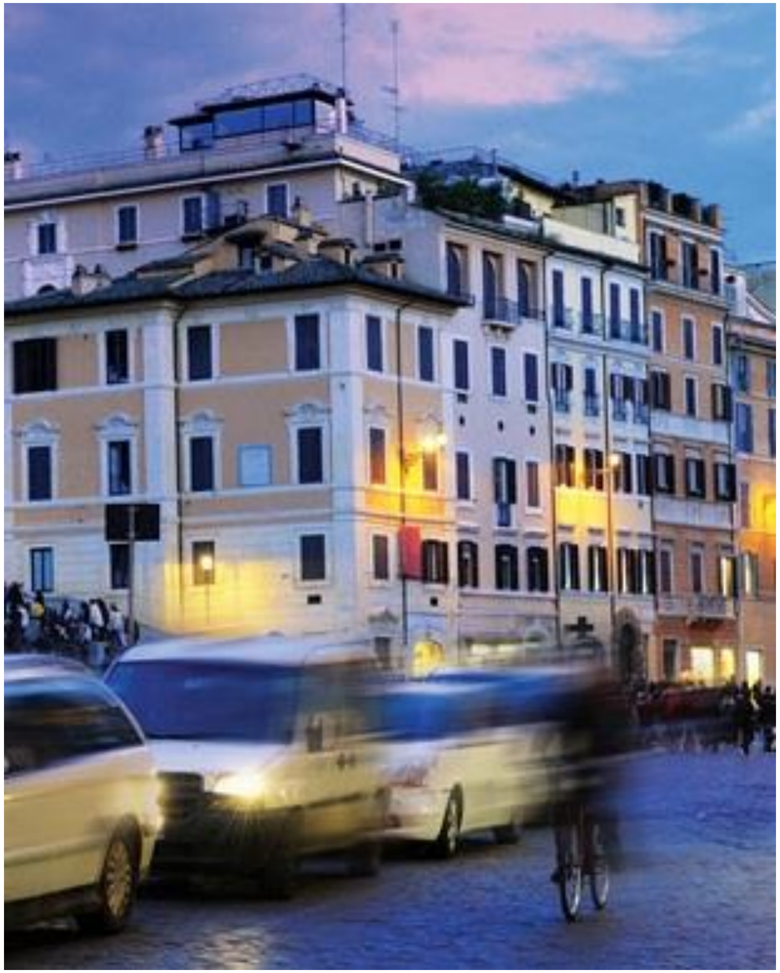
The European Group of Valuers' Associations (TEGoVA)

- Europe's valuation standards setter
- 60 member associations
- 33 countries
- 70 000 qualified valuers

Outputs

- European Valuation Standards
- Minimum Educational Requirements
- Code of Ethics
- Pan European REV Qualification
- TEGoVA Residential Valuer (TRV)

A Game Changing Financial Crisis!



- **Mortgage Credit** regulation has shifted from national level to the EU.
- In the Eurozone, the same has happened for **Banking Supervision.**
- **CRR/CRD IV package** transposes new standards on bank capital (Basel III agreement) into the EU law

The above have brought valuation to the heart of EU policy

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The European Union and The Primacy of EU Law

- **Regulation -** a binding legislative act, applied directly across the EU
- **Decision -** binding on those to whom it is addressed (e.g. an EU country or an individual company) and is directly applicable
- **Directive -** a legislative act that sets out a goal that all EU countries must achieve. However, it is up to the individual countries to decide how
- **Recommendation –** non binding, allowing EU institutions to make their views known and to suggest a line of action without imposing any legal obligation on those to whom it is addressed
- **Opinion -** an instrument that allows the institutions to make a statement in a non-binding fashion

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Mortgage Credit Directive – Valuation Provisions

Article 19: Property Valuation

1. Member states shall ensure that reliable standards for the valuation of residential immovable property for mortgage lending purposes are developed within their territory…..

2. Member states shall ensure that internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation, which shall be documented in a durable medium of which a record of it kept by the creditor.

Recital 26.

…In order to be considered reliable, valuation standards should take into account internationally recognised valuation standards, in particular those developed by the International Valuation Standards Committee, the European Group of Valuers' Associations or the Royal Institution of Chartered Surveyors….”

Internationally Recognised Valuation Standards

- International Valuation Standards – 2013 – IVSC
- European Valuation Standards – 2012 – TEGoVA
- RICS – Valuation Professional Standards 2014
- USPAP – Appraisal Foundation

European Valuation Standards 2012

- Based on EU law wherever relevant and contain applications of particular EU importance
- Pan-European valuation tools including a European Code of Measurement, a risk analysis tool (Property and Market Rating) and a Code of Ethics
- Favoured by European Central Bank per Asset Quality Review 2014 document titled "*Collateral and Real Estate Valuation*"

  "*Real estate should be valued in line with European Standards EVS-2012 (Blue Book) and other international standards such as the Royal Institute of Chartered Surveyors (RICS) guidelines – where a conflict is seen EVS 2012 will apply…*"

European Banking Union

- Banking supervision has fallen to the EU
- Banks now controlled by the European Central Bank (Single Supervisory Mechanism)
- European Banking Authority (European Single Rulebook)

European Central Bank and the Single Supervisory Mechanism (SSM)

- ECB is the central bank for the euro currency tasked with maintaining its purchasing power and price stability in the euro area (19 EU countries)

- SSM is a new system of banking supervision for Europe comprising the ECB and the national supervisory authorities of the participating countries. Its main aims are to ensure the safety, soundness and stability of the European banking system

- SSM is one of the two pillars of the EU banking union, along with the Single Resolution Mechanism.

- ECB directly supervises 130 significant banks holding over 82% of banking assets in the euro area.

- Other “less significant” institutions continue to be supervised by their national supervisors, in close cooperation with the ECB which can at any time take over directly supervision.

ECB can order an “ASSET QUALITY REVIEW” including valuation of all mortgaged real estate assets in accordance with its prescribed methodology !

European Banking Authority and the Single Rule Book

- EBA is a London based independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector

- EBA contributes, through the adoption of Binding Technical Standards (BTS) and Guidelines, to the creation of the European Single Rulebook in banking throughout the EU

- The Single Rulebook includes the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD IV) and the Bank Recovery and Resolution Directive (BRRD), the corresponding technical standards developed by the EBA and adopted by the European Commission (RTS and ITS), as well as the EBA Guidelines and related Questions and Answers

- EBA is also mandated to assess risks and vulnerabilities in the EU banking sector through regular risk assessments and pan-European stress tests

- EBA may investigate alleged incorrect or insufficient application of EU law by national authorities

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

The 'CRR/CRD IV' package transposes 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

  - Definition of values
  - General valuation principles
  - Preferential risk weights of mortgage collateral

- Thus 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 Definitions of Value

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;

(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;

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CRR General Valuation Principles: Independence and Documentation

Article 229:

- Immovable property collateral shall be valued by an independent valuer at or less than the market value. An institution shall require the independent valuer to document the market value in a transparent and clear manner

- 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 less than the mortgage lending value. The independent valuer shall not take into account speculative elements in the assessment of the mortgage lending value and shall document that value in a transparent and clear manner

CRR General Valuation Principles: Monitoring and Review

Article 208 (3)

- Institutions monitor the value of the property on a frequent basis and a minimum once every year for commercial property and once every three years for residential real estate. Institutions carry out more frequent monitoring where the market is subject to significant changes in conditions

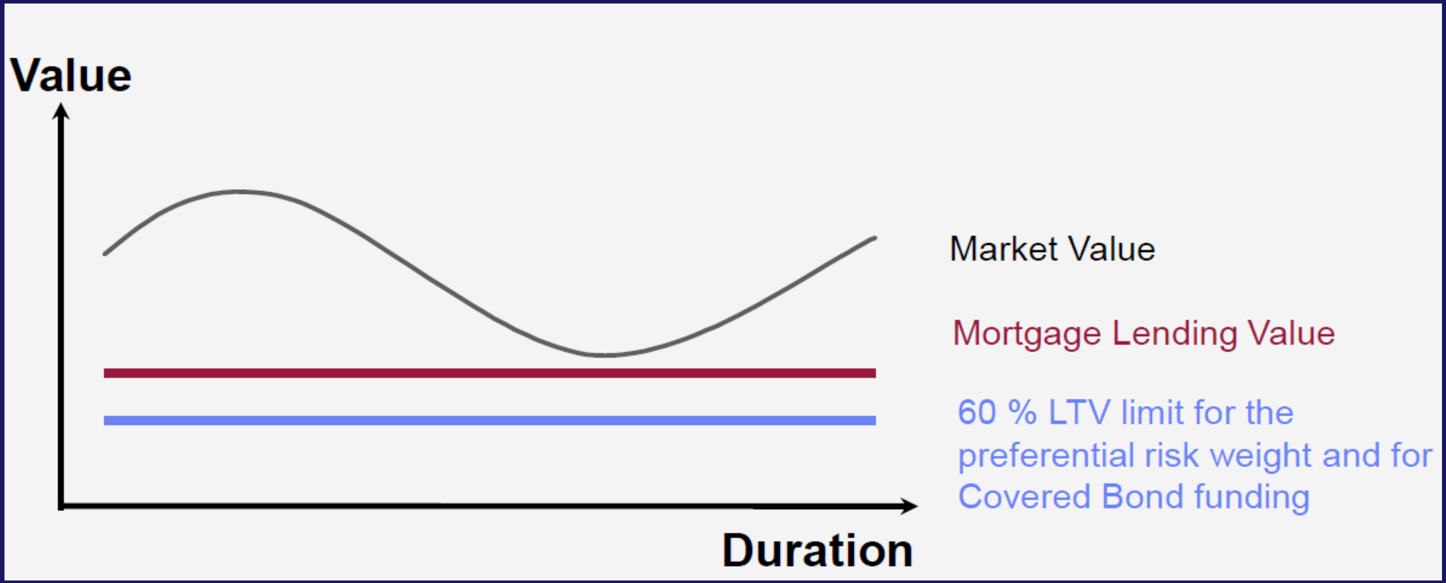
- The property valuation is reviewed when information available to institutions indicates that the value of the property may have declined materially relative to general market prices and that review is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. For loans exceeding Eur 3 million or 5% of the own funds of an institution, the property valuation shall be reviewed by such valuer at least every three years.

  Institutions may use statistical methods to monitor the value of the value of the property and to identify property that needs revaluation

Market Value vs. Mortgage Lending Value

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*;*

Graph illustrating current German approach



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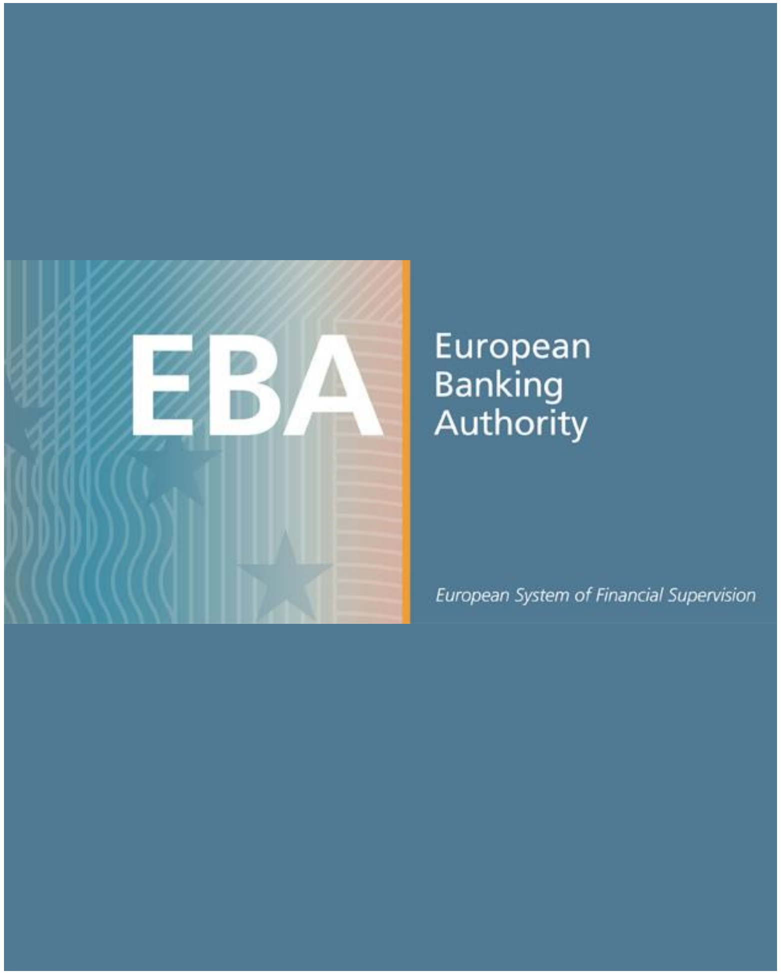
EU to Regulate Mortgage Lending Value Methodology



- European Banking Authority to consult on Mortgage Lending Value Methodology before drafting EU Regulation
- TEGoVA Position Paper advocates a move away from strict German methodology
- Essential that under the new regime MLV is assessed by properly qualified valuers

Conclusion

- Developments in property valuation and the profession are fast moving, mirroring that of the EU
- The game changers have been Mortgage Credit, Banking Union and CRR/CRD IV
- European Central Bank and European Banking Authority now call the shots on Valuation for Mortgage Lending
- The valuation profession is developing a dual persona: National and European

Thank You!

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