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The European Central Bank Favours EVS Above All Other Valuation Standards

By Krzysztof Grzesik and Michael MacBrien

"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 EVS2012 will apply (for the avoidance of doubt – this should be considered to apply throughout the document). For the avoidance of doubt a full e.g. RICS report is not required."

ECB Asset Quality Review March 2014, "Collateral and Real Estate Valuation", page 144, last indent.

The European Central Bank (ECB) is preparing to take on new banking supervision tasks as part of a Single Supervisory Mechanism (SSM).

The Single Supervisory Mechanism will create a new system of financial supervision comprising the ECB and the national competent authorities of participating EU countries. Among these EU countries are those within the Eurozone and those others which have decided to enter into close cooperation with the Single Supervisory Mechanism.

The main aims of the SSM will be to ensure the safety and soundness of the European banking system and to increase financial integration and stability in Europe.

The ECB will be responsible for the effective and consistent functioning of the SSM, assuming its new banking supervision responsibilities in November 2014.

Under the new system of supervision, the ECB will directly supervise significant credit institutions. It will work closely with the national competent authorities to supervise all other credit institutions under the overall oversight of the ECB. The ECB may decide at any time to take responsibility for a less-significant credit institution.

Deciding on whether credit institutions are significant or not will also be based on:

- the total value of their assets;
- the importance for the economy of the country in which they are located or the EU as a whole;
- the significance of their cross-border activities;
- whether they have requested or received public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF).

A visualisation of the European Central Bank's new nearly completed building in Frankfurt

The significance of the EVS breakthrough must be seen in this context. In preparing for its November takeover of banking supervisory power, **the ECB now requires the biggest banks in the Union** subject to the single supervisory mechanism (SSM) **to value their real estate exposures in line with EVS** within the Asset Quality Review process, emphasising that **if other standards are chosen, in case of conflict, EVS prevails.**

Under the Mortgage Credit Directive, EVS is recommended to the member states along with IVSC and RICS standards. Under the ECB Asset Quality Review, EVS are the dominant standards, to be preferred in case of conflict with any other standard.

This is fundamental as the ECB's instructions are non-negotiable for banks and the knock-on effect is inevitable **– ECB preference for EVS is sure to stoke mortgage banks' interest in commissioning Recognised European Valuers.**

Using the ECB Preferred Valuation Standards

By Pat Davitt, CEO IPAV

As I sat in a meeting of the IPAV board two years ago just after the Central Bank of Ireland issued its draft report on Irish Valuation Standards when it recommended sole use of the "Red Book" for commercial valuations, it was a very dark place. I was sitting last week in the same sort of IPAV board meeting and talk about an attitude change! It was like a miracle. So what's different?

Well in Ireland IPAV valuers have gone from not being allowed to do commercial property valuations for banks because they do not follow the Red Book to now using the European Central Bank's preferred standards, the Blue Book of European Valuation Standards. This is a great achievement only made possible by IPAV's membership of TEGoVA. I would say a job well done TEGoVA, this has been no accident.

In Ireland this has come about by IPAV lobbying the Irish Central Bank. IPAV was able to convince the latter of its professionalism in the field of valuation and successfully argue that its valuers should not be excluded. And so it was that by the time the Irish Central Bank issued its final paper which included reference

TEGoVA Vice Chairman, Krzysztof Grzesik, IPAV President, Ronald Duff and CEO Patrick Davitt amongst Ireland's existing and prospective REVs at training course in Dublin

to the Blue Book/EVS and TEGoVA, IPAV was already at the next door knocking.

This time it was to get TEGoVA to award REV awarding status to IPAV, not an easy task even though IPAV valuers have many years of experience. We had to agree to a system whereby the selected experienced candidates had to undergo an updating university based course in valuation as well as a more intense programme of continuous professional development. We drafted an appropriate curriculum with our University in Dublin and enrolled the first 62 Valuers last year, 66 this year with another 64 ready to start. This will bring the number of REVs in Ireland to 192 by the end of 2015. No mean achievement. Together with our ITT University in Dublin, IPAV is already seeking to take its course to an even higher level (8) to deliver the highest qualification required of an Irish valuer. Our thanks go out to TEGoVA Chairman, Roger Messenger and other TEGoVA activists for their help and support in developing our course and delivering presentations. ●

TEGoVA and National Valuer Associations Help Governments Implement Mortgage Credit Directive

By Wolfgang Kälberer, Hon REV, Head of EU Office of Association of German Pfandbrief Banks and Michael MacBrien, Adviser to TEGoVA

Wolfgang Kälberer

Michael MacBrien

TEGoVA and its member associations help member states develop reliable valuation standards taking account of European Valuation Standards as stipulated by the Mortgage Credit Directive

Under the Directive's Article 19(1), *"Member States shall ensure that reliable standards for the valuation of immovable residential property for mortgage lending purposes are developed within their territory. Member States shall require creditors to ensure that those standards are used where they carry out a property valuation or to take reasonable steps to ensure that those standards are applied where a valuation is conducted by a third party."*

Article 19(2) requires Member States to ensure *"that internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process …"*

Recital 26 states that *"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."*

It is understandable that the European Parliament and the Council of Ministers included British and Anglo/American influenced standards alongside European Valuation Standards as these have been developed in parallel to European Valuation Standards over the last three decades. However, there is no doubt that EVS are by far the best adapted to the requirements of a Directive aiming at standards for valuation for mortgage lending purposes, and this for three fundamental reasons:

- European Valuation Standards are solely and specifically concerned with the valuation of real estate, not with the wider requirements of accounting and financial instruments or for plant and machinery or intangibles.
- EVS are more risk-sensitive, with special focus on the relevant aspects of EU banking directives (Capital Requirements, etc.), and accompanying special guidance for users on market rating and risk-related criteria for valuations.
- Only EVS provide a detailed and comprehensive Application for Valuation for Lending Purposes and also a standard for Mortgage Lending Value (important for some lenders and some markets).
- The European Central Bank requires the biggest banks in the Union subject to the single supervisory mechanism (SSM) to value their real estate exposures in line with EVS within the Asset Quality Review process, emphasising that if other standards are chosen, in case of conflict, EVS prevails. – *ECB Manual for the Asset Quality Review, p. 144, March 2014*

Rising to the obligation bestowed upon us by the Directive, **TEGoVA has developed guidance for the Member States on the development of reliable standards**. Under the supervision of the European Valuation Standards Board, the Mortgage Credit Directive Valuation Committee has singled out those elements of EVS that are central to reliable valuation for mortgage lending purposes. TEGoVA recommends that in order to be considered reliable, valuation regimes of Member States shall feature the following characteristics:

- Valuation basis: clear definition of values should exist at Member State level
- Market Value definition
- Valuation bases other than Market Value (e.g. Mortgage Lending Value etc.)
- Valuation basis shall be applied consistently throughout the regulatory framework
- Valuations should be carried out by qualified valuers
- There should be a clear description of the valuation process
- Member States should define requirements regarding the content of the valuation report
- Member States should promote the implementation of tools designed to
  - collect market data
  - ensure market transparency and
  - assess the risk sensitivity of real estate (rating tools etc.)

The Guidance develops those points.

The wording of each standard as it appears in EVS 2012 is scrupulously respected and posession of EVS 2012 by all transposing civil servants is highly recommended, but it is extremely helpful for government officials to have all they need for proper enactment of the Directive's valuation provisions in a highly didactic 15-page document designed specifically for them in their mother tongue.

Half the battle is delivery, and for this **all of TEGoVA's resources have been mobilised with members contacting their governments with TEGoVA central support**. Indeed, the fact that TEGoVA has 57 member associations from 31 countries is not just a logistical advantage; it highlights the very reason for EVS excellence: **European Valuation Standards were imposed by no dominant national real estate culture**; they are the result of decades of development by all European valuers. **They are the proud and tested property of the entire European valuation profession**.

At the time of writing, all government departments responsible for MCD valuation implementation in all member states and in the European Economic Area and candidate member states have been contacted. TEGoVA and its members are now in the process of deepening this dialogue which often stems from longstanding relations between the local TEGoVA members and their government. TEGoVA is organising information exchanges and seminars so that all civil servants know that in their capital and in Brussels they have a constant source of support now and into the future. Top of the agenda at the TEGoVA General Meetings in Oslo in May and in Riga in October will be a progress review of action in the various countries. For information on developments in your country, please contact the TEGoVA Secretariat. ●

Internationally Recognised Valuation Standards – Differences in Interpretation of Market Value

By Krzysztof Grzesik REV

Krzysztof Grzesik REV

The Mortgage Credit Directive, the most important EU law concerning real estate valuation in Europe to date, has focused attention on differences between International, European and RICS valuation standards. It should be noted that nearly four decades of standards setting by the RICS, TEGoVA and IVSC has ensured that their standards are largely harmonised with similar definitions of value and reporting procedures, albeit they all have a different emphasis and aim, which explains their continued separate existence.

Whilst on the one hand, the RICS supports IVS, on the other, it continues to develop its own "RICS Valuation – Professional Standards", the latter providing the necessary detail absent from IVS, including mandatory instructions needed to regulate its own members.

However the RICS Professional Standards (Global), neither tackle European law nor specific issues relating to the valuation of real estate in Europe. Guidance on European valuation matters is provided by TEGoVA's European Valuation Standards (EVS 2012).

Thanks to the efforts of the three internationally recognised standard setting bodies, valuers worldwide now adhere to a single definition of market value as follows:

"The estimated amount for which the asset should exchange on the valuation date 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 compulsion"

Unfortunately such a common definition has not led entirely to a common interpretation. For example, in the valuation of property with future development potential a significant difference remains between the emphasis which is placed by the IVSC on the one hand and RICS/TEGoVA on the other in the treatment of the concept of *"Highest and Best Use"*.

Highest and Best Use v Hope Value

IVS 2013 states that "*The market value of an asset will reflect its highest and best use. The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset's existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid"* (IVS Framework paragraph 32)

Whilst on the one hand the latest 2014 edition of the RICS Red Book makes several references to *"highest and best use"* on the other, RICS VPS 4 paragraph 1.2.7 provides that *"… where the price offered by prospective buyers generally in the market would reflect an expectation of a change in the circumstances of the asset in the future, the impact of that expectation is reflected in market value. Examples of where the expectation of additional value being created or obtained in the future may have an impact on the market value include: the prospect of development where there is no current permission for that development …"* In the past, RICS Valuation Standards referred to such *"expectation of additional value"* as *"Hope Value"*.

However the concept of hope value is at odds with IVS which states that *"to reflect the requirement to be legally permissible, any legal restrictions on the use of an asset, eg zoning designations, need to be taken into account"* (IVS Framework 34b).

In permitting consideration of a use which might become permissible in the future but not at the valuation date, the red book appears out of kilter with IVS. Fortunately RICS may count on the support of TEGoVA.

EVS 2012 emphasise that the market value of a property reflects the full potential of that property so far as it is recognised by the market place. It may thus take account of the possible uses of the property which whilst not legally permissible at the date of valuation may become so in the future. EVS 1 paragraph 5.4.4 states:

*"**Hope value** … is used to describe an uplift in value which the market is willing to pay in the hope of a higher value use or development opportunity being achievable than is currently permitted under development control, existing infrastructure constraints or other limitations currently in place … Hope value is not a special value as it represents the market place's reasonable expectations as to the opportunities offered by the property"* and paragraph 5.4.11 *" … As each point of the definition of highest and best use … places some constraint on the definition of market value, **the highest and best use assumption will not necessarily be the same as market value**, albeit that it might be higher than existing use value. The most obvious common point of difference lies in the exclusion of potential permissions or other future opportunities for which the market might express hope value and in doing so judge the prospects, risks and costs of that future opportunity"*

The above differences in the interpretation have already been the subject of debate in several countries and there have been cases of contested elements of hope value assessed at many millions of Euros, for example, in the case of a city centre site suitable for shopping centre development but zoned residential or agricultural land suitable for modern warehousing development. In both cases there is a realistic expectation that the relevant planning authorities will agree to a favourable re-zoning in the future.

To make matters worse, revised International Financial Reporting Standards (IFRS13) which came into effect last year, have imposed a *"fair value"* regime in the valuation of real estate which appears to exclude any reflection of hope value and is already leading to some contentious debates between valuers and auditors.

It would appear that agreement amongst the standard setters in this area is urgently required to ensure complete harmonisation of the interpretation of the definition of market value and close the first chapter towards achieving cross border valuation transparency. ●

ASSOVIB Promotes Successful Development of REV in Italy – Recurrent Property Tax a Top Priority for Italian Valuers

from left to right: Antonio Campagnoli (IsIVI), Silvia Cappelli (ASSOVIB) and Luke Brucato (CCS)

Thanks to an agreement signed in September 2013 between CCS (CRIF Certification Services, the only ISO 17024 accredited Personnel Certification Body in Italy) and IsIVI (Italian Institute for Real Estate Valuation) and to its promotion by ASSOVIB (Italian Association of Property Valuation Companies for the Banking Sector), today all CCS certified valuers may become Recognised European Valuers.

At TEGoVA's forthcoming General Assembly in Oslo on 16th May, 106 valuers will be awarded REV status, taking the total of REVs in Italy to 150 within the last 8 months.

All of these valuers from across Italy are ISO 17024 certified professionals. Most are engaged in the valuation of properties for mortgage lending purposes, mainly by valuation companies, members of ASSOVIB.

Also of note has been a conference organized by CCS in Milan on 11th April at the Chamber of Commerce. The event was focused on the reform of the cadastral system in Italy, its effects on the real estate market and property taxation but with other hot topics including valuer certification, the Asset Quality Review being undertaken by the European Central Bank and Bank of Italy and the Mortgage Credit Directive. The main speakers included TEGoVA Vice Chairman Krzysztof Grzesik, ASSOVIB's Vice President Silvia Cappelli, CCS Manager Luke Brucato, IsIVI Manager Elena Delsignore, Internal Revenue Authority Representative Mauro Iacobini and ISO 17024 certified REV valuer Antonio Penna. ●

A Taxing Time for Valuers

By Roger Messenger REV, Chairman of TEGoVA, IRRV

Roger Messenger, TEGoVA Chairman congratulates Danijela Ilić President NAVS on successful implementation of REV programme in Serbia

A key objective of EU Economic Governance is to shift the burden of taxation from labour to taxes less damaging to employment. That's why the EU has Property Tax in its sights. This follows an International Monetary Fund Working Paper on 'Taxing Immovable Property' which has looked at Revenue Potential and Implementation Challenges.

Currently, the EU is pressuring ten member states to either update cadastral values on which their recurrent property tax is based or reassess the tax base (Austria, Cyprus, Germany, Greece, Italy, Latvia, Luxembourg, Romania, Slovakia and the UK), Denmark has been asked to end the freezing of its property value tax in nominal terms since 2002, and Ireland and Lithuania have been cited for their successful reforms.

Many member states have not updated property values for years and regardless of whether or not any taxation or collection system is in itself efficient the highlighted shortfall is in the need for regular revaluations. Some States are now in the process of reassessing real estate values with a view to bringing them in line with market values.

This is an opportunity for valuers and the valuer profession to play a critical role in updating property tax in their countries.

For economies that have been ravaged by the recession property tax has been an important part in a recovery plan as it can be cheap and efficient to collect and can and does fund Government and Local Government services in many member states.

On this level we are really considering recurrent taxes rather than transactional taxes and in considering updating or reforming an outdated tax the following points are a common requirement.

- Must be an ad valorem tax
- Must be kept up to date
- The coverage of the tax base must be a conscious decision
- The importance of exemptions, reliefs and hardships
- The need for an effective appeal system

In designing any modern property tax decisions need to be made on who and what is to be taxed. Is it a tax on owners, a tax on occupiers, or maybe both? Is the tax levied on capital values or rental values? Is it to be applied to residential and commercial properties and if both should different systems apply?

In these discussions the valuer should play an integral part.

- Advising Governments
- Valuing the tax base
- Providing evidence
- Challenging values
- Acting for taxpayers

Revenues and potential revenues vary considerably. For example, income from recurring property tax in the UK is based on a long established and sophisticated property tax system, albeit in recent times the lack of revaluations has been to its discredit.

Valuation techniques vary according to the tax base to be assessed and the volume of real estate to be valued. In the US mass appraisal techniques are common. In Europe the need for such applications is not so apparent, and arguably greater accuracy and taxpayers acceptability can be achieved from a more individualistic approach to an assessment valuation.

This is the role of the valuer.

Current property values are a key to an efficient property tax that is sustainable and capable of being accepted.

It is not for the valuer to set tax levels or increase or decrease levels of taxation, that is a political decision within member states.

David Magor, CEO of IRRV and I presented a paper at the Autumn 2013 General Assembly in Lisbon on this topic and suggested that TEGoVA should be at the forefront of the reform process and the engaging of the valuation profession.

For some there will be new skills to be acquired, but we can benefit from a wider exchange of knowledge and valuers must influence the shape of reforming property tax.

The IRRV (UK) specialises in property tax and they have undertaken to work in concert with TEGoVA to provide advice and consultancy on property taxation wherever it may be helpful. If you are involved in property tax valuation reform, or wish to be and need some help you can either contact the Secretariat or indeed me directly, **rmessenger@wilks-head.co.uk**. ●

An Emerging Valuation Profession in Serbia

By Danijela Ilić REV, President NAVS

Guided by TEGoVA's clear core values, principles of practice, and ethics, Serbian valuers are contributing to EU integration and the development of the profession. By embracing European Valuation Standards and the REV mark of excellence, 26 members of the National Association of Valuers of Serbia (NAVS) are fostering a sense of community amongst valuers in the west Balkans region.

Real estate valuation is emerging as a professional activity in Serbia giving rise to questions about the qualifications, competence, ethics and education of valuers. So far, court experts in civil engineering have assumed the role of property valuers albeit most of them have not been properly trained in this field.

NAVS was founded in 2006 with the mission of introducing best international valuation practice in Serbia, providing education for valuers and building a network of qualified and competent valuers. In this connection NAVS has implemented a 120 hour educational programme comprising 5 modules followed by a written and oral examination. Most applicants are civil engineering court experts.

In 2011, NAVS translated European Valuation Standards and has been effectively promoting them along with the REV mark of excellence. Most of the participants in the NAVS educational programme wish to become Recognised European Valuers.

The growing number of Recognised European Valuers in Serbia will undoubtedly benefit the public interest as well as that of clients who are beginning to appreciate the quality of NAVS educated members. ●