

Current Issues Concerning Real Estate Valuation in Europe

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The European Group of Valuers' Associations (TEGoVA)

- Europe's property valuation standards setter since 1977
- 73 member associations
- 38 countries (including Canada, USA, UAE)
- 70 000 qualified valuers

Outputs

- European Valuation Standards
- European Business Valuation Standards (1st Edition March 2020)
- Minimum Educational Requirements & Code of Ethics
- Pan European **REV Designation**
- TEGoVA Residential Valuer (TRV)
- Methodology (European Practice & Methodology Board)

Current Issues in Real Estate Valuation

- Definition of Market Value – Incorrectly translated in many languages
- Highest and Best Use
- Hope Value
- Statistics and Automated Valuation Models
- Desk-top and Drive-by valuations

EU Law - Capital Requirements Regulation (CRR)

The EU has to safeguard the banking system and one of the pillars of that is the 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 ...the property may instead be valued by an independent valuer at or at less than the **mortgage lending value...** “

Capital Requirements Regulation (and EVS 2016)

Definition of Market Value and Incorrect Italian Version

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;

76) "valore di mercato", per i beni immobili, l'importo stimato al quale l'immobile verrebbe venduto alla data della valutazione in un'operazione svolta tra un venditore e un acquirente consenzienti **alle normali condizioni di mercato** dopo un'adeguata promozione commerciale, nell'ambito della quale entrambe le parti hanno agito con cognizione di causa, con prudenza e senza essere soggette a costrizioni;

New EVS 2020 Definition of Market Value

"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller **acting independently of each other** after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion."

"valore di mercato", per i beni immobili, l'importo stimato al quale l'immobile verrebbe venduto alla data della valutazione in un'operazione svolta tra un venditore e un acquirente **che agiscono indipendentemente** dopo un'adeguata promozione commerciale, nell'ambito della quale entrambe le parti hanno agito con cognizione di causa, con prudenza e senza essere soggette a costrizioni.

Highest and Best Use, the Original IVS Position

IVS 2013

*“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” and*

“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”

BUT WHAT ABOUT HOPE VALUE?

What Is Hope Value, Is it Part of Market Value ? An Example



Highest and Best Use, the New IVS Position

IVS 2017 has now expanded the highest and best use concept with these words:

*“To reflect the requirement to be legally permissible, any legal restrictions on the use of the asset eg. zoning designations, need to be taken into account **as well as the likelihood that these restrictions will change.**”*

New TEGoVA Definition of Highest and Best Use Incorporating Hope Value

European Valuation Standards 2020:

5.3.4 *The concept of ‘highest and best use’ (HABU) is integral to Market Value and is characterised as the use of a property that is physically possible, reasonably probable, legal or likely to become so, and that results in the highest value of the property at the date of valuation. (NB: The words “or likely to become so” = Hope Value)*

5.3.5 *In most cases valuers will quickly ascertain that HABU is the same as existing use. Sometimes they may identify a more valuable use but conclude that the costs of such change of use would be too great and therefore HABU would still equal value in existing use at the date of valuation.*

STATISTICAL METHODS AND AUTOMATED VALUATION MODELS

CRR Article 208 provides the following requirements on “**monitoring of property values**” and on “**property valuation**”:

- a. institutions monitor the value of the property on a frequent basis and at a minimum once every year for commercial immovable 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;

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

According to European Banking Authority *CRR does not allow the use of a statistical model as the sole means of undertaking a valuation or review of the property valuation.*

THE ACCURACY of AVMs

How accurate are AVM estimates in comparison to actual sale price?

In Europe, it's hard to tell because the AVM manufacturers refuse to give any information about the accuracy of their figures. **To get any clarity, you have to revert to the US, where manufacturers are much more transparent**

ACCURACY of AVMs in USA

Zillow: On average, the percentage of valuations across 666 US Counties falling within +/- 20% of the sales price is 85%. However they can vary between 37% and 100%, depending on the County. That means that:

- *On average*, 15% of 'Zestimates' are more than 20% off the mark.
- But in some Counties, 63% are more than 20% off the mark.
- This implies that a smaller, but significant number of Zestimates will be much farther off the mark: by 30 or 40%.

And everything points to Europe being well below this level of accuracy.

NEW EUROPEAN VALUATION STANDARD ON AVMs

Last year a new European Valuation Standard and a new guidance note were approved and rendered immediately operational.

In particular EVS 6 states:

“AVMs cannot be used to produce a valuation report that complies with EVS independently of a valuation process founded, inter alia, on inspection of the property by the valuer and the application of valuation judgment by the valuer.”

BUT A WARNING ABOUT VALUATION REPORTING

There is a growing perception that today's valuation reports comprising a few pages of tick-box answers are not much different to the results of an AVM.

That is indeed the central problem: AVMs and dumb-down reports are two sides of the same toxic coin. They feed off of each other. ***If the valuation report is dumb enough and demonstrates no analytical skill at reaching the estimate of value, then why not use an AVM?***

The valuation profession must confront AVMs *and* dumb-down reports .

The future of the profession depends on valuers and their reports demonstrating their outstanding added value – the exercise of their professional judgment.

DESK TOP and DRIVE-BY VALUATIONS

The use of desk-top and drive-by valuations was one of the reasons for the financial crisis, as was stated in 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.”

<https://inquiries.oireachtas.ie/banking/wp-content/uploads/2016/01/02106-HOI-BE-Report-Volume1.pdf>

NEW TEMPLATE ON EVS COMPLIANT VALUATION REPORT

- Methodology and assumptions
- **The selection criteria for relevant comparables** including:
 - ✓ Justification of the criteria chosen for selection of comparables (market area, size, type) with clear links to the property's defined market and competitive area
 - ✓ Judgement on the choice of criteria (criteria's respective and relevant importance and impact on value of property)

EVS-COMPLIANT VALUATION REPORT *continued*

- **The analysis of the chosen comparables and the valuation**
 - ✓ List of comparables chosen
 - ✓ Justification and judgment of each selection
 - ✓ Description of each comparable
 - ✓ Adjustment to the property including appropriate comment reflecting the logic and reasoning for the adjustments provided
 - ✓ Calculation and adequately supported opinion of market value

Thank You!

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