



**Developing Secondary Mortgage Markets in Southeast Europe**

*Issues in primary market development & standardisation*

# Towards Consistent Valuation Standards & Methodology

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# Valuations for Loan Security Purposes

(Why Consistent Standards & Methodology?)

## Equity & Debt Investor Confidence

- PESTEL Analysis
  - Political (country risk/currency)
  - Economic
  - Social
  - Technical
  - Environmental
  - Legal (Title/Insolvency/debt ranking)
- Risk Profile
  - Transparency/Visibility of Markets
  - Market Volatility/WACC & Beta Factors

## Reliability of Valuations

- Institutional – Professional Associations (39 Countries associated with TEGoVA)
- Professional Associations affiliated to TEGoVA in Southeast Europe: -  
Albania/Belarus/Bulgaria/Greece/  
Hungary/Moldova/Poland/Romania/  
Ukraine/Slovak Republic/Slovenia
- Technology Transfer
- Professional Education/Certification

# Real Estate - the key to expanding economies and inward Investment 1

- A dynamic, viable and well regulated market in real estate – land, commercial and residential buildings, and farms - plays a critical role in developing business and in raising living standards. Those countries with the world's most successful economies have strong and successful real estate markets. (UN ECE)

# Real Estate - the key to expanding economies and inward Investment 2

In fully developed market economies real estate and real estate mortgages comprises approximately 25% of all assets and 25% of all debt. Additionally real estate accounts for approximately 70% of all tangible (physical) capital. (source: UN ECE)

# Real Estate - the key to expanding economies and inward Investment 3

## ■ **The Potential Benefits of Mobilising Capital**

- Hernando de Soto, in his book *The Mystery of Capital*, estimates that the total value of this untapped capital in the transition economies is \$2.96 trillion. It has been found that approximately a 30% increase in the amount of market mobilised capital increases the economic growth rate by 1.3% (which is enough to shorten the amount of time it takes to double per capital GNP from 70 to 30 years).

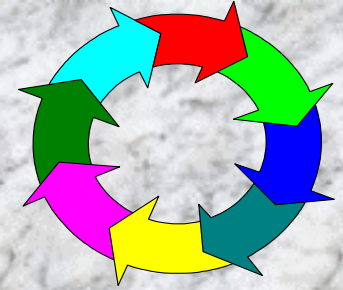
# Real Estate - the key to expanding economies and inward Investment 4

- The challenges faced by the transition economies to make land 'work' for development are threefold: (1) real property must be transformed into capital that can be used to fuel economic growth, (2) real property must be traded as an asset in a free market to ensure its efficient use, and (3) the market for real property should be promoted and sustained by a robust and well-trained private sector.

# Towards Consistent Valuation Standards & Methodology (The Context)

- What is TEGoVA
- Institution Formation
- Standards & Methodology
- Certification

# TEGoVA - Objectives and Implementation



- Assist and support valuers
- Promote consistency
- Provide a quality benchmark
- Promote the use of valuations as a basis for efficient use of property assets
- Assist valuers to meet clients needs
- Enhance the status and role of the valuer
- Publication of Valuation Standards
- Liaison with European Commission and other external bodies
- Develop a pan-European Certification programme (EN 45013)
- Work with IVSC to ensure a sound international framework



# How do we enforce best standards?

- The role of self regulating professional bodies
- Disciplinary procedures
- Certification
- Professional indemnity insurance
- “Hearts and Minds” the challenge of deontology

# Reinforcing the self regulating professional society

- Building on strong foundations
- Democracy and flexibility
- Towards a coherent structure of interdependent and mutually reinforcing standards

# Certification and International recognition

- Origins - HypZert in 1996
- The TEGoVA January 2000 initiative
- Today: Germany and the Czech Republic
- Tomorrow: UK, France, Netherlands, Italy, Ireland, Turkey and Norway...
- Recognised quality and International status

# Risk Assessment in Mortgage Lending

- Banking Systems/Market Mechanisms/Economic Environment/Transparency/Valuation Standards
- Controlling Property Cycles: -
  - ◆ the availability of reliable and comprehensive data on market transactions;
  - ◆ Improved understanding of business dynamics;
  - ◆ the ability to report trends as they happen; and
  - ◆ the development of a screen-based spot market for real estate derivatives.

# EVS 2003 - Valuation Standard 6

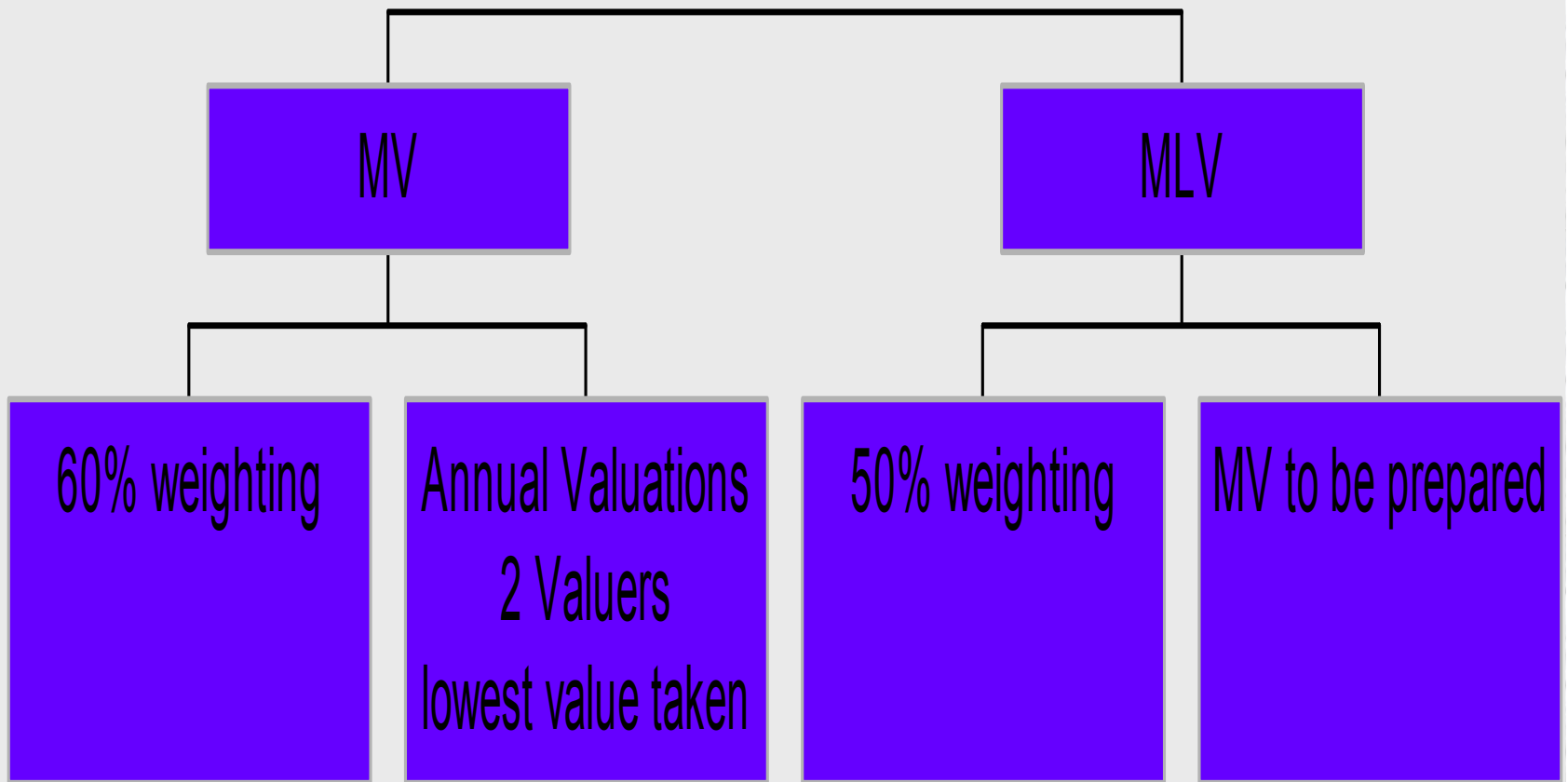
## ■ Key Elements: -

- Emphasis on purpose of valuation
- The valuer's role in risk appraisal
- Sustainable income/capital values
- Loan to value ratios less important than cash flow/interest cover
- Recognition of MV and MLV
- First authoritative definition of MLV

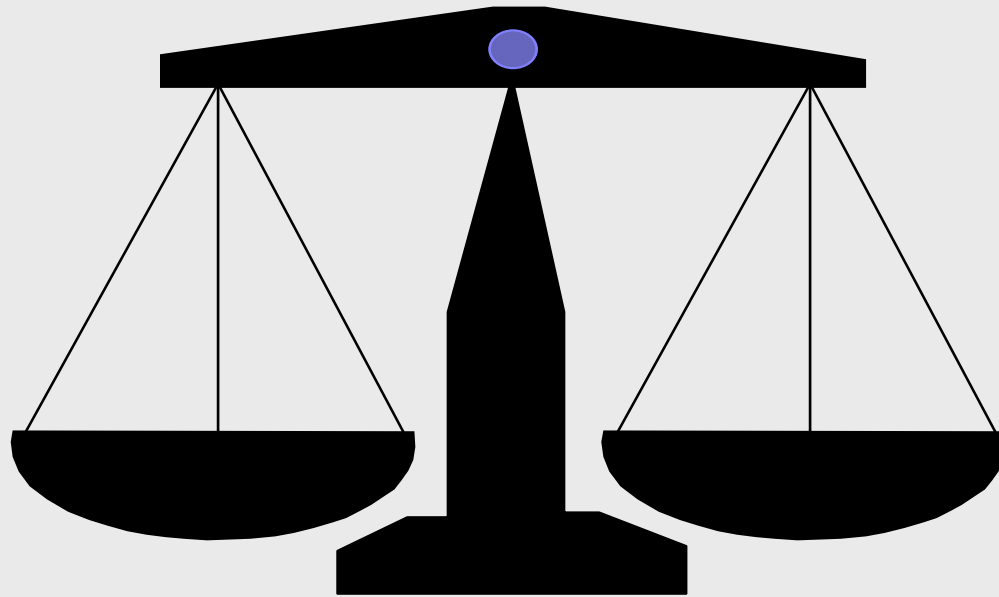
# European Mortgage Lending Value (MLV) - The Context

- Lending Risk
- 1995 Research for the European Commission - Solvency Ratio Directive 89/647/EEC & EC Directive 98/32/EC.
- Basle 2 & CAD 3 Proposals on Capital Adequacy
- EVS Guidance following liaison with the European Mortgage Federation

# Comparison Market Value (MV) and MLV



# Market Value and the the Myth of the Perfect Market





# Definitions 1: MV

- *Market Value shall mean the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal; period having regard to the nature of the property, is available for the negotiation of the sale.*

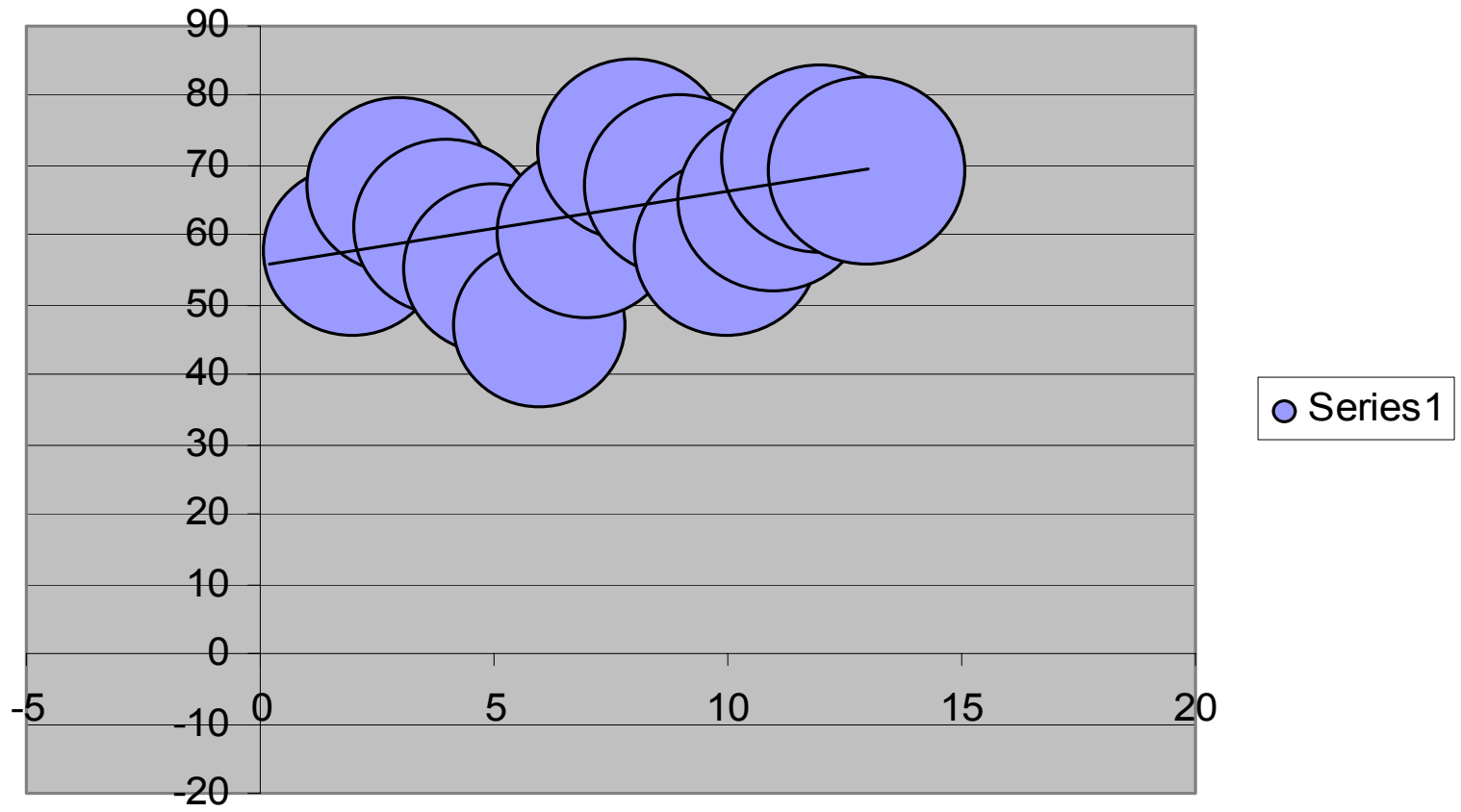
# Definitions 2: MLV

- *Mortgage Lending Value shall mean the value of the property as determined by a valuer making a prudent assessment of the future marketability of the property by 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. Speculative elements may not be taken into account in the assessment of the Mortgage Lending Value. The Mortgage Lending Value shall be documented in a transparent and clear manner.*

# Definitions 3: Beleihungswert

- *The mortgage lending value is determined by the value that can be expected, at the time of valuation, over a long period of time in the normal course of business, based on experience derived from long term market trends and taking into consideration the sustainable aspects of the property.*

# MLV Graphically illustrated



# MV SWOT Analysis

- Strengths: Verifiable
- Weakness: A spot market figure which in an inefficient market will not reflect trends and sustainability
- Opportunities: Can be enhanced by research based advice and improved market efficiency
- Threats: Can induce valuer myopia

# MLV SWOT Analysis

- Strengths: Addresses the issue of sustainability
- Weaknesses: Not verifiable
- Opportunities: Should be refined to reduce the risk of variation in results and as required in the Directive compared to MV.
- Threats: Lack of control can lead to manipulation

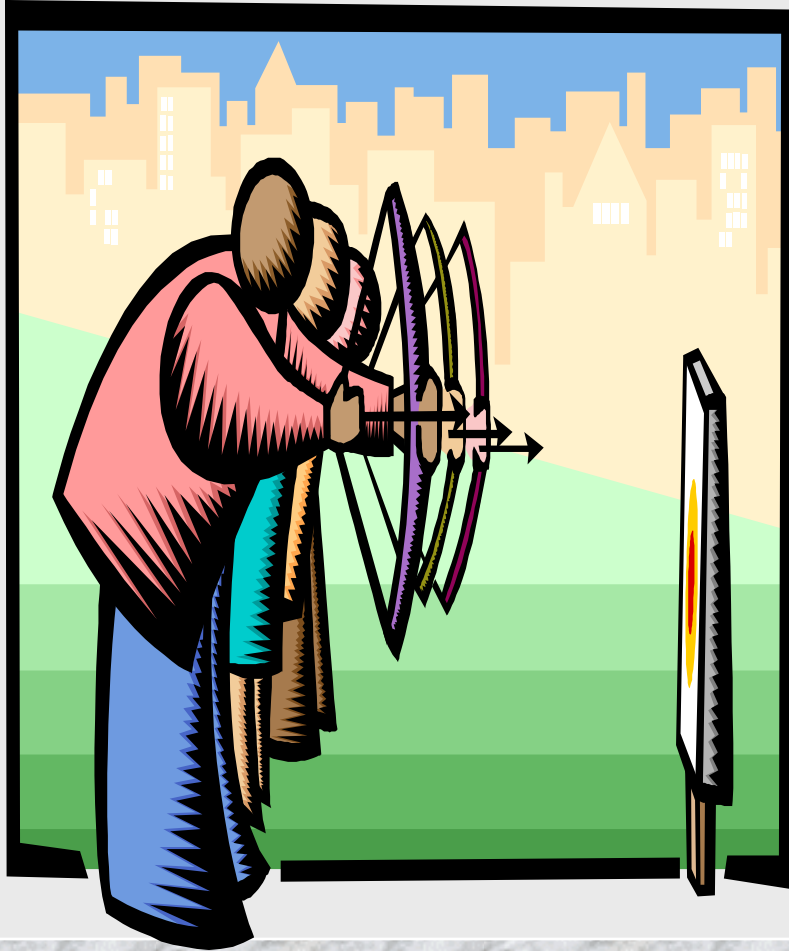
# What are the appropriate valuation methodologies?



- Direct comparison
  - Regression analysis
- Income approach
  - Capitalisation of income
  - Discounted cash flow
- Depreciated replacement cost

# EVS

## *The Way Ahead*



- Globalisation
- Transparency
- Research
- Standards
- Education
- Professionalism
- Protocols



