QUALITY AND ELEGANCE OF VALUATION REPORTS

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1. Introduction

The role of valuers is becoming increasingly important and newer fields are opening up for specialists and calling for adoption of modern methods and tools in the process of valuation due to the economic developments around the world. The advisors are required for adoption of modern methods. Therefore, the present valuers are required to extend their prospect and try to equip themselves to face the challenge of economic development. The old traditional technique is slowly giving way for modern business systems. The economic activities in which the valuers are required to take part in the modern world are as follows:

1.1. Commercial

1. Sale / purchase / mortgage, leasehold rights etc.
2. Constitution / partnership firm's dissolution / amalgamation of companies.
3. Fix up reserve price of assets for banking institutions / Customs and Central and State Excise Departments about their goods and vehicles for Auction / sales etc.
4. Brands / Good will / Technical Know-how valuations.
5. Assessment on intellectual property rights, patent rights, copyrights appraisal etc.

1.2. Social

Tourists for visa purposes and creation of Trust for charitable purposes etc.

1.3. Succession

For obtaining succession certificates / will / probate/ partition / gifts etc.

1.4. Legal

For purposes of furnishing security to the court of law and fixation of Fair Rent.

1.5. Statutory

Under the Direct Taxes for the Cost of construction, Capital Gain & Gift tax etc.

1.6. Insurance

Loss assessing of fixed assets, goods, vehicles, fire loss etc.

Whatever may be the field in which a valuer works for whatever purposes, one thing common to all the valuers is that the valuer has to vouchsafe to his valuation and it must commend utmost reliability on the method he has adopted.

The valuation so made should depict its true value in the market on a given date. The beneficiary must be able to derive its true value at the same time serving the social purpose.

“Value on a given date” is significant because, the price of every asset is related to the purpose, time and place. It is never static and sometimes volatile. Hence, the burden on the valuer is more and it is therefore necessary to adopt foolproof methods or under certain circumstances to adopt alternative methods.

At the same time, attention must be given to proper documentation and must be made part of the assessment report. In the place of an abstract opinion, it will be advisable to give a narrative valuation of disclosing the source of information with documents and whenever necessary valuers are required to furnish estimates in alternative methods. Wisdom of the valuer becomes the foundation for future binding contracts for others. The working of future contracts of third parties solely depends on the Valuer report. He will also become author of future disputes if only he is not knowledgeable or acts unscrupulously.

A valuer is a guiding light for all the commercial ventures, be it in any field of economic activity and he becomes a vital tool in the wheels of commercial ventures. This pivotal position of valuer puts on him the burden of being proficient in his own field of knowledge and at the same time with the liability to face the consequences of his own wrong actions.

2.0. Valuation Aspects

As per the client’s requirements and the valuer has to customize the services to help the client to make sound management and valuation decisions by providing:

- Independent & unbiased professional valuation opinion
- High-quality service & in-depth analysis
- Appraisal standards compliant analyses and valuation reports
- Open & professional environment
- Dual-discipline valuation services like business valuation, commercial real estate appraisal and consulting advice

3.0. Real Estate Valuation

3.1. Valuation

A determination of the monetary values at some specified date of the property rights incorporated in an ownership Appraisal, which provides a stated result of valuing a property, making a cost estimate, projecting earnings, or any combination of two or more of these stated results. It is also an act of valuing, estimating cost or anticipated earnings.

3.2. Cost estimation

An estimate of the amount of money that would be required at some specified date, to construct, produce, replace or reproduce some tangible and/or tangible thing, without regard to its ownership. Earnings forecast is an estimate or prediction of the future net monetary returns, deliverable from something owned or considered as being owned.

Therefore, valuation is an estimate or opinion of value, where an estimate is not a statement of value. **An evaluation is only one person's opinion of value.** Different valuers may arrive at different estimates. The accuracy and usefulness of the value estimate depends on the appraiser's skill, experience and judgment

3.3. Value

Means the worth, usefulness or utility of an object to someone for some purpose. Market value is defined as the Highest price in terms of money, that real property is acquired, by a buyer who is willing to buy and a seller who is willing to sell, both of whom have adequate knowledge of the actual and potential use/s of the property, which has been offered for a reasonable time in the open and competitive market

3.4. International Valuation Standards, Definition of Market Value

The definition of "**market value** "viz. "the price offered by a prudent, willing and able purchaser and accepted by a prudent, willing and able Vendor "incorporates all the above four ingredients of value. Prudent means one who has sufficient knowledge of the market and one who can properly think and evaluate merits/ advantages and demerits/ disadvantages in possessing a thing. Willing means one who is not acting under compulsions or extraneous circumstance i.e. one who is not needy. Able means one who has legal right to sell or to purchase an asset and one who has capacity to purchase an asset at a fair market price.

3.5. Value in Use

Refers to the value of a thing or property to the holder which includes the amenities, benefits and income derived from its ownership, all of which are estimated in terms of money. This is subjective.

3.6. Value in Exchange

Indicates the value of the property traded in the market. This is synonymous to objective value or market value

3.7. Price & Cost, Value & Price – value is the distinct attribute of a thing or commodity to attract and complement another thing or commodity in the market while price is the amount paid or offered for a thing or property. To the seller, the price is subjective value. It is value in exchange. The objective value of a property may be higher or lower than its current price.

3.8. Price & Cost, Value & Cost – Cost is not price. Neither is it value. It represents the capital expense in the formation and construction of a finished product. Normally, cost is less than price. The difference is profit.

3.9. Rental value refers to the price fixed for the right to use a certain property for a specific period of time

3.10. Investment value is the present worth of future benefit, or income of the property that the owner, or investor has acquired.

3.11. Going concern value is the value of the business in operation, or property that will continue to be utilized. It includes tangible property such as real estate, equipment and machinery, fixtures and inventories plus intangible assets such as franchises, patents and goodwill.

3.12. Book value is the original cost of an asset or property less accrued depreciation. Firms under receivership may sell its assets at liquidation value or value.

3.13. Salvage value is the amount that maybe recovered minus cost of disposal when the assets will be retired or disposed of at a future time.

3.14. Insurance value is the cost of insurance coverage of the building or improvement to cover its loss due to earthquake, fire or another calamity.

3.15. Scrap value is the value of a depreciated building or the materials recovered from it.

3.16. Guideline / circle rate value is the fair market value of land in a specific zone or area established by the Bureau of Internal Revenue.

4.0. The Insolvency and Bankruptcy Board of India

In exercise of the powers conferred under sections 5, 7, 9, 14, 15, 17, 18, 21, 24, 25, 29, 30, 196 and 208 read with section 240 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), the Insolvency and Bankruptcy Board of India hereby makes the following Regulations, (Vide Notification No. IBBI/2016-17/GN/REG004, dated 30th November, 2016, published in the Gazette of India, Extraordinary, Part III, Sec.4, vide No. 432, dated 30th November, 2016 (w.e.f. 01-12-2016). namely-

4.1. Under Chapter I / Preliminary / 2. Definitions (hb)**, "Fair value"** means <u>the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date</u> between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.

4.2. Under Chapter IX / Resolution Plan / 35. 39[Fair value and Liquidation value. **(**39Substituted by Notification No. IBBI/2017-18/ GN/ REG024, dated 6th February, 2018 (w.e.f. 06-02-2018). Prior to this substitution, Regulation 35 stood as under: -) **Liquidation**

value is the estimated realizable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date.

5.0. Characteristics of Value

❖ **Utility** – ability of the property to satisfy human need

❖ **Scarcity -** Land is not scarce. It is the use for which it is intended or actually established that is becoming scarce. The scarcity, however, is not absolute.

❖ **Effective demand -** The desire coupled with the financial capacity of the buyer/s to acquire a piece of real property

❖ **Transferability** – refers to the quality of the property to be transferred or covered.

❖ **Factors that Influence Value:** Social, Political, Micro / Macro-Economic forces and Physical forces and Legal aspects refer to the factors that Influence Value.

❖ **Bundle of rights -** rights which are encompassed by ownership of real estate are:

The right to possess and enjoy the use of the property, the right to dispose, the right to exclude any person from the enjoyment and disposal of the property, the right to recover, the right to convey by inheritance.

❖ **Legal Rights and Interests:** Fee simple, Life estate, Leasehold interest and other legal interests such as easement, encroachment.

6.0. Valuation Reports

There are two types of valuation reports namely informal and formal reports. Informal report is made by almost everyone. They are usually based on a combination of knowledge, experience and intuition. Formal report is usually made by people especially trained for this work and are used in Business and finance, Litigation, Taxation, Insurance

6.1. Valuation Procedure

6.1.1. Collection and analysis of data

Depending on the basis of value, the assumed transaction could take a number of forms like a hypothetical transaction, an actual transaction, a purchase transaction, a sale transaction, and/or a transaction in a particular or hypothetical market with specified characteristics. The assumed date of a transaction will influence what information and data a valuer considers in a valuation. Most bases of value prohibit the consideration of information or market sentiment that would not be known or knowable with reasonable due diligence on the measurement / valuation date by participants.

Most bases of value reflect assumptions concerning the parties to a transaction and provide a certain level of description of the parties. Analysis of highest and best use - Physically possible, legally permitted, economically feasible, maximally productive Vacant site or as if vacant as improved Interim use

6.1.2. Selection of Bases

The basis of value must be appropriate for the purpose and the source of the definition of any basis of value used must be cited or the basis explained. Valuers are responsible for understanding the regulation, case law and other interpretive guidance related to all bases of value used. Valuers must choose the relevant basis (or bases) of value according to the terms and purpose of the valuation assignment. The valuer's choice of a basis (or bases) of value should consider instructions and input received from the client. However, regardless of instructions and input provided to the valuer, the valuer should not use a basis (or bases) of value that is inappropriate for the intended purpose of the valuation

6.1.3. Methods of valuation

Various approaches and methods may be used to arrive at an opinion of value providing they use market-derived data. The market approach will, by definition, use market-derived inputs. To indicate Market Value, the income approach should be applied, using inputs and assumptions that would be adopted by participants. To indicate Market Value using the cost approach, the cost of an asset of equal utility and the appropriate depreciation should be determined by analysis of market-based costs and depreciation. The data available and the circumstances relating to the market for the asset being valued must determine which valuation method or methods are most relevant and appropriate. If based on appropriately analyzed market-derived data, each approach or method used should provide an indication of Market Value.

6.1.4. Assumptions and limitations of each approach to value

Assumptions can have a significant impact on value. They, generally fall into one of two categories: a) Assumed facts that are consistent with, or could be consistent with, those existing at the date of valuation, and b) Assumed facts that differ from those existing at the date of valuation.

They relate to facts that are consistent with, or could be consistent with, those existing at the date of valuation may be the result of a limitation on the extent of the investigations or enquiries undertaken by the valuer. Where assumed facts differ from those existing at the date of valuation, it is referred to as a "special assumption". Special assumptions are often used to illustrate the effect of possible changes on the value of an asset. They are designated as "special" so as to highlight to a valuation user that the valuation conclusion is contingent upon a change in the current circumstances or that it reflects a view that would not be taken by participants generally on the valuation date. All assumptions and special assumptions must be reasonable under the circumstances, be supported by evidence, and be relevant having regard to the purpose for which the valuation is required

6.1.5. Reconciliation and valuation Report

It is essential that the valuation report communicates the information necessary for proper understanding of the valuation or valuation review. A report must provide the intended users with a clear understanding of the valuation. The report must set out a clear and accurate description of the scope of the assignment, its purpose and intended use, disclosure of assumptions, limiting conditions that directly affect the valuation.

This standard applies to all valuation reports or reports on the outcome of a valuation review which may range from comprehensive narrative reports to abbreviated summary reports. Compliance with the standard does not require a particular form or format of report; however, the report must be sufficient to communicate to the intended users the scope of the valuation assignment, the work performed and the conclusions reached. Some of the above requirements may be explicitly included in a report or incorporated into a report through reference to other documents (engagement letters, scope of work documents, internal policies and procedures etc.)

6.1.6. Choice of Valuation Approaches

The asset value depends on the purpose, place and time period. The choice of valuation procedure and method rests on the principles of specific purpose, place and time period. Hence to derive the value, the valuer is act judiciously in adopting the suitable valuation procedure and method.

The question of applicability of a particular approach depends upon the nature of the client whether buyer or seller, mortgager or mortgagee, etc., and the purpose of valuation will be based on the value to be certified and for the time period like Distress situation, industry recession, boom / plateau period, etc.

The valuer has to consider various methods of valuation, because each method has strength and weakness, different methods useful in different situations, each gives a different take value, provides a range of valuations instead of point estimates and finally it helps in rationality check.

So, while concluding value, all the methodologies must be considered and then factors of adjustments required as per the facts of the case. In other words, value conclusions must be based on the professional judgement and averaging should be avoided while concluding the value

6.1.7. Standards of valuation consists of Theory, Economics and Methodologies of valuation. Standard of value is the hypnotical conditions under which an asset / business is valued. While in the selection of Standard of value the subject matter of valuation, purpose of valuation, Legality and Statutes, case laws and circumstances are to be taken care of.

7.0. Approaches to Value

7.1. Sales Comparison Approach

A comparative approach to value that considers the sales of similar or substitute properties and related market data and establishes a value estimate by processes involving comparison. Essential concepts in the Sales Comparison Approach are research and selection of comparable elements and adjustment process.

7.2. Cost Approach

A reasonable approach to the value of property or another asset, that considers as a substitute for the purchase of a given property, the possibility of constructing another property that is an equivalent to the original or one that could furnish equal utility with no undue cost resulting for delay. The Valuer's estimate is based on the present reproduction or replacement cost of the subject asset, after (accrued) depreciation.

7.3. Income capitalization approach

A practical approach to value that considers income and expense data relating to the property being valued and estimates value through a capitalization process. Capitalization relates income (usually net income) and a defined value type by converting an income amount into a value estimate. Depending upon the liquidity, security and soundness of income, the valuer decides the yield or real rate of return. A small change in yield makes a large difference in value estimation.

7.4. Reconciliation of final value

When the valuer arrives at the final value estimate by considering all of the evidence supporting the different value indicators, as well as the relevance of the different valuation techniques to the particular appraisal problem at hand.

8.0. Selection of Approaches

Value of a property can be estimated by three different approaches or methods viz.

(i) Cost approach (ii) Income approach (iii) Market approach depending on the types or categories or properties. Real properties are usually classified according to use they are put too such as residential properties, commercial or industrial properties etc. In the context of selecting appropriate approach for valuation, properties are classified as:

8.1. Investment properties i.e. properties fetching income or rent: In case of such properties. Income Approach i.e. investment, income or rental method of valuation is adopted. Residential, Commercial and business properties etc. yield income and hence the annual income / rent, actual or estimated, forms the basis for valuation. The Investment or Income approach is the normal approach to be adopted for valuation of properties since income or fair rent is decided or estimated after taking into consideration, utility or tangible and intangible benefits due to occupation of property, demand for and supply of such properties and thus reflect competitive market conditions.

8.2. Non – Investment, Marketable properties: Some properties do not fetch income, but are sold and purchased in market. There is no evidence available of income yielded by such or similar properties but evidence of consideration price paid for such and similar properties is available. Value of these type of properties are estimated by Market Approach or comparison method.

8.3. Non – Investment & Non – Market properties: Some properties neither fetch income nor are they sold in the market. There is therefore no evidence available either of income or of consideration price paid. Religious buildings, public buildings like town halls, public libraries etc. are included in this category. Residential buildings, shops and office buildings in a Colony of Public Sector Undertakings, situated in far away, remote and isolated places may also fall in this category since evidence of fair market rent or fair market price is not available. In such circumstances value of property is estimated by Cost Approach.

9.0. Scope of Valuation

9.1. <u>For Bank Purpose</u>

Broadly the property under valuation for Banking can be categorized into Primary security (the property against which loan is to be availed) and collateral security (the additional property to be given along with primary security).

1. Loan for the construction of a new building on plot

To certify the genuineness of the estimate, Stage value of construction, total cost on completion. Advise on adverse matters like violation, encroachment, structural stability and relevant positive and negative factors affecting the property value.

2. Loans for the purchase of ready built property from builder/ developer

To certify the present market value and the stability of the building and to advise the future life of the building.

3. Housing loans for the construction of upper floors over the existing ground floor or extension of ground floor.

To certify the present market value of existing property & certify the cost of new construction in stages or the cost on completion

4. Loan against property or mortgage loan

To certify the present value of the property along with value for land considering depreciation of building and services.

5. Loan for improvement of property (flat or house)

To certify the improvement estimates and existing unit market value.

6. Loan for purchase of plot

To certify the present market value.

7. Top-up loan (while increasing the present limit to a higher limit)

To certify the present value.

8. Takeover loan (transfer of existing loan from one Bank to Another)

If an existing loan of previous bank is to be transferred to another bank for further loan enhancement, to certify the present value, the security can be valued for the present value.

9. Periodical revaluation of assets

To check the security cover of funded property and certify the market value as on the date of inspection

10. To Issue the Letter of Credits, Bank Guarantee

To certify the present market value offered as security.

11. One-time settlement

To certify the probable value assuming that the subject property is going to be sold in open auction by the court or the mortgagor. To find out the present value of the asset as and whereas condition.

12. Liquidation

To Certify Present Value and Forced and Orderly Liquidation Value for as and whereas condition.

13. Valuation for Debt Recovery Tribunal

To certify the auction value. Ascertain the present value. Analyze the negative factors which affect the auction value. Analyze the working condition and estimate the amount required to invest further for the re- operation. Ascertain whether the unit can be used for other purpose.

14. Value of Bank-Owned Assets

To certify the present value. The factor of marketability does not arise.

15. To Fix the Upset Price

To certify the present value, auction value and upset price. Upset price is the minimum price lesser than which, the value cannot be accepted to bank.

16. To fix the Fair Rent for Bank Purpose

To certify the monthly rent to be paid to the landlord of the building proposed to be occupied by the bank.

17. To fix the Ground Rent for Bank Purpose

To issue certificate on the possible ground rent likely to be paid by the bank for the vacant site proposed to be occupied on lease from the private landlord.

18. Insurance Value of the Bank purpose

To certify the insurance value of the buildings. Either by Insurance on depreciated value or by Insurance on replacement / reproduction value depending upon the policy type.

19. Students Educational Loan

To certify the present market value of the property given as security against loan

20. Loan to Educational Institutions for Constructions

To certify the estimates of institutional building submitted and to certify the present market value of the collateral security

21. Loan for Trade Finance and Working Capital

Bank want to advance loan to Entrepreneur for working capital and hence to certify value of assets given to bank. Ascertain the fair market value of property

22. Project Finance for Construction

Financial Institutions want to finance a developer for construction work. To certify the present market value of the project under progress, including site development, amenities, compound wall etc. Ascertain the fair market value of the plot and work in progress on it and also to do project appraisal from profitability point of view.

23. Structural Stability Certificate for Cash Chest / Strong Room

To issue completion certificate. Or to issue fitness certificate as per RBI norms.

9.2. <u>Statutory Purpose</u>

1. For Wealth Tax, Cost of Construction and Capital gain Tax

Different types valuation formats and different types of valuation procedure have to be carried out as stipulated in the Acts for the above

2. For Stamp Duty purpose

The valuation report is annexed in support of property value for fixation of Stamp Duty Value.

3. Fixation of Fair Rent

To certify the monthly fair rent to be paid to the landlord for the premises for the Court to determine the Standard Rent to be fixed in the Court of Law.

4. Valuation under Insolvency and Bankruptcy Code

To derive the Liquidation value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date.

5. Valuation as per Companies Act

Different types of valuation procedure to be carried out as stipulated in the Acts for the above

9.3. <u>Other Purposes</u>

1. Advice for buyer as well as seller in dealing with properties

2. In Exchange, Release, Partitions, Relinquishment, succession, will, probate, gifts etc**.**

3. Dissolution of Partners in a Firm or Amalgamation of Company

4. Lessor interest and Lessee interest, Surrender of lease or Pre/ Post-termination of lease

5. Leave or Licensed properties

6. Insurance purpose, Tourists visa purposes, Trust for charitable purposes, etc.

10.0. Valuation Report Contents

1. Introduction
2. Purpose of Valuation (market value, investment value, insurance value, etc.)
3. Function (Use of the report for - purpose, place, time & clientele)
4. Identification / Description (Asset Factual Data, Legal description, Factors affecting value)
5. Presentation of value (Procedure, Adopted method and conclusion)
6. Summary of Salient Evidences, Inputs, weightage adoption
7. Assumptions and Limiting Conditions
8. Final Certificate

10.1. Valuation Report

The report therefore, in addition to providing a well-supported valuation, needs to present a complete and balanced picture of the adverse and beneficial features of the proposed security and the market for it. Anything less than this potentially exposes the mortgagee to a loss and therefore the valuer to a claim. The report should assume that the client relying on the report, unaware of the nature of the asset. Each report should stand alone, address all the relevant issues and place the client in a sound position to make an informed lending decision on the subject proposed security.

It is however appropriate to just note the existence of a certain aspect under the relevant heading and then explain more fully in 'Additional Comments' what the impact of this is on the value and marketability of the security. Identify issues by inspecting property, neighbourhood and documents carefully, and researching the market and its dynamics.

A professional report can only result from an adequate inspection of the property and neighbourhood, perusal of relevant documents as well as due inquiry and research.

The report should provide evidence of the inspection by notes, sketch plan/s with dimensions, photos, documents and research.

While the absence of material from a report may be an obvious problem, material that is in the report can however indicate that a task has not been properly researched. It is not uncommon for reports to show documents with important information that has not been mentioned in the report and therefore suggesting that the valuer has not properly perused the documents that have come to hand.

10.2. Risks Indication

It is possible that an aspect could reflect in two or more grading. For example, close proximity to a congested main road with heavy traffic, could adversely affect the appearance of the neighbourhood, detract from the outlook from the land and cause noise nuisance to the property. It could therefore affect the property risk ratings with both positive and negative factors. There may be signs that the market is starting to become significantly oversupplied or less demand as a result of a political, government regulations and legal factors exploiting the mortgage stress. This could impact on risk ratings for reduced value next years to come, in local economy impact and market segment conditions.

10.3. Risk Ratings

The report format and its supporting communication make it very clear that there must be a comment on any risk rating on the asset valuation. Comments have to be made, on the pattern of a rating level, that has been applied.

However, at the same time, good reporting would see comment provided on the reason for any risk ratings, even if only one or two of them. Similarly, if a significant or important issue is explained in the report, it needs to have an appropriately high-risk rating to draw attention to it.

The risk ratings are an integral part of the report and without applying an appropriate rating the report would clearly be failing to fulfil one of the report requirements. Risk ratings and comments are mutual and intrinsic parts of the report and one must reflect the other.

For example, a comment that increased mortgage stress resulting from higher interest rates, increased petrol prices and job losses have caused a significant oversupply of property for sale and a reluctance of people to buy could lead to price correction, would clearly warrant more than a rating. Indeed, where many valuers have quite correctly been applying ratings for reduced value during the boom and peak or recession periods, it is highly likely that there will be many markets where the rapidly deteriorating environment will now be warranting ratings.

This might be frightening for valuers and not please brokers and even some lenders, but if the rating was appropriate before, it would be hard to argue that the risk of reduced value was not now higher (and more imminent) and therefore a higher risk rating is justified and required.

The bigger the issue the bigger / longer the warning flag to wave. A simple but effective way to decide what rating an issue warrants is to think of the level of concern or impact it might have on value and marketability of the security for the client and how strongly it should be brought to the client’s attention. The following could be used as a guide:

Rating ‘1’ – No readily identifiable issue

Rating ‘2’ – Minor issue only not warranting comment

Rating ‘3’ – There is an issue for the client to note (valuer notes is for the client)

Rating ‘4’ – There is an important issue in the report for the client to consider

Rating ‘5’ – There is an extremely important / urgent issue in the report that could have a major impact on value and / or marketability

It may be appropriate for a high-risk rating not only to have suitable comments but also to be accompanied by a suitable recommendation. For example, inspection may reveal significant cracking in a dwelling. It could be appropriate to refer it to an Engineer and to be referred back to the valuer for further consideration.

There has been an increasing tendency for valuers to have no rating and the base minimum rating applied seems to be as a matter of course. While this might seem a safe thing to do, the problem with this is that it depreciates minimum ratings adopted by the valuer. It is not correct to apply minimum ratings as a base level just in case there are any issues that are not known about.

A minimum rating says there is a minor issue (but not one that needs to be commented upon). A minimum rating should not be used to give a margin to cover a disordered inspection and / or superficial research and inquiry. If there is no readily identifiable issue or a valuer has no reason to suspect that there might be an issue after the valuer has carried out a proper inspection, made due research and inquiry, then there is no problem with applying a minimum rating.

10.4. Understanding Market Dynamics

Traditional education and training have taught valuers about the importance of sales evidence and the sales comparison approach. Unfortunately, an over-emphasis on this can lead valuers to be backward looking or previous history. However, the clients want to be forward looking and to warn them of the risks of future downturns in the market.

To have an idea of where the market is going it is vitally important to have an understanding of market undercurrents especially the current relationship between supply and demand, what is influencing each and the trend in each. This is particularly so in a period where the market is thinly traded.

A lack of sales can be the product of distinctly different market conditions. On the one hand there may be a lack of sales due to a lack of supply at a time when there is firm demand. But there may also be a lack of sales due to lack of demand – a condition that in time will usually see an increase in supply and some price correction.

Valuers who hang on to price levels indicated by sales months and months old at a time when the market has become very thinly traded, without also having regard to market dynamics, could produce an over or under valuation. The sale property may still be physically comparable but the market conditions may no longer be the same as when the sale occurred so it is not necessarily still a comparable ‘sale’ (even though the property itself may be comparable).

A prudent valuer will read the change in market dynamics and adjust earlier sales to allow for the likely market movement since the sale. After an extended period of price growth and prolonged peak or boom conditions, many markets are starting to become very thinly traded due to lack of demand and supply is starting to build up. These dynamics may well be indicative of some substantial price corrections over the next few years in many different market segments.

Markets are likely to become difficult to read because of a lack of sales evidence. But making an effort to examine market dynamics will help valuers to form an opinion of just where the market is likely to be at the time of valuation. Getting the valuation number anywhere near right could prove to be more difficult on a thinly traded down-turn in the market than it was on the rapid upturn phase (when at least there was much more market activity).

it will be prudent for valuers to let clients know about the reasons for a lack of market evidence and at the same time cautioning the increased difficulty in establishing just where within a likely market range the most probable selling price sits.

And what is even more important is providing a risk rating that reflects the risk of the price falling (or falling even further) in the next years to come. Many valuers quite rightly used an average rating for reduced value through much of the latter phases of the market upturn. But with so many signs emerging in the local, national and world economies that the road ahead could be very unpredictable and bleak (not just for real estate but for finance, business, shares, jobs, superannuation, energy, climate etc, etc), it is necessary to consider by providing stronger cautioning through the risk ratings and related comments if we aren’t already doing so.

10.5. Risk Ratings Adoption

Valuers come under pressure to manipulate risk ratings. There have also been reports, due to lack of information or knowledge about the site conditions the valuers do not exercise to put more than two or three ratings in a report.

It would seem some valuers have been succumbing to such pressure but this may come back to haunt them as the market down turns and even old reports come under further scrutiny. It takes strength and professionalism to do the right thing but providing properly weighted risk ratings backed as necessary by adequate and appropriate comment will become highly valued by those responsible for recovering mortgage loan funds. Valuers providing mortgage valuations on any sort of property should also be providing risk ratings and comments under headings appropriate to the type of property.

There is no doubt that many valuation reports are going to come under scrutiny in the years ahead as valuations already relied upon are challenged after lenders incur losses. Even if valuer think his reports are adequate, read the client's requirement as it relates to not just the file but also what could be expected to be in his report. The valuer could find that he is at risk due to things that have not been done in addition to how done things have been done.

One of the most important aspects of a valuer's report is adequate documentation of valuation methodology and the insurance assessment. It is surprising that many valuers still only document a summation approach and fail to provide any indication of their sales comparison approach beyond setting out the basic sales details and comparison comments in the report. <u>Even if component rate per square metre is derived from sales, it should be realised that its use is part of a summation approach and not a sales comparison approach.</u>

The valuers are required, strongly promoting the use of a simple **Adjustment Grid Model or Hedonic Pricing Model** to show how the sales have been adjusted in arriving at a figure that each sale comparison suggests. As well as providing for adjustment of factors related to the property there should be one for adjustment for movement in the market since the sale and / or circumstances of the sale. Reports should clearly show how sales have been adjusted.

The days are long gone when a valuer can merely quote three or more sales in a report. Some valuer's try to re-assure their client by stating that the valuation has been arrived at by a sales comparison approach, yet the report contains no documentation of such methodology beyond the noting of sales in the report.

There has been a trend towards electronic valuation systems to simplify and speed up inspection, methodology documentation and reporting. However, if there is too great a focus on saving time, there is a danger that sufficient attention may not be paid to the inspection, research and inquiry and important aspects may be missed. Further, methodology documentation may be scant and not include sales adjustments.

Where reporting in such systems encourages adoption of standard clauses with just the odd word inserted by the valuer, or make it difficult for the valuer to insert tailored comments, or provide useless generic statements, there is a risk that adequate advice will not be provided. However, if advice to the client later proves to be inadequate or the valuer cannot show that due process has been followed, there could later be pain that greatly outweighs the earlier gain of a job done quickly and cheaply. The claim (and excess) could be many times the fee.

11. Conclusion

The valuation profession presents many challenges and risks. It could be perceived as like working on a rifle range trying to find, identify, describe and hit a moving target while being a potential target ourselves. It is an inherently risky profession.

While we might have Professional Indemnity Insurance to cover part of the risk, we also need to manage the risk by taking due care in the quality of the advice we provide.

Inspection, research, inquiry and valuation documentation need to be carried out professionally and in accordance with the Client’s requirements, Risk Management Module and Professional Indemnity Insurance requirements.

It should be remembered that the requirements of the report and clearly put an obligation on us as valuers to ensure that our mortgage clients are properly advised through the use of the risk analysis and appropriate comments, of the risks involved in dealing with the security property and the marketplace in which it is situated. The importance of valuers providing adequate advice to their mortgage clients cannot be over-emphasised.