

MORTGAGE CREDIT DIRECTIVE

Art 14 a: Property Valuation

1. Member States shall ensure that **reliable property valuation standards** 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. Where national authorities are responsible for regulating independent appraisers who carry out property valuations they shall ensure that they comply with the national rules that are in place.

1a. Member States shall require 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 and a record of it kept by the creditor.

Recital:

(14d) It is also important to ensure that the residential immovable property is appropriately valued before the conclusion of the credit agreement and, in particular where the valuation affects the residual

obligation of the consumer, on default. It is therefore appropriate to require Member States to ensure that reliable valuation standards are in place, for example through legislation or self-regulation. **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.** This should be without prejudice to existing Union legislation. These high level principles require lenders, amongst others, to adopt and adhere to adequate internal risk management and collateral management processes, which include sound appraisal processes, to adopt appraisal standards and methods that lead to realistic and substantiated property appraisals to ensure that all appraisal reports are prepared with appropriate professional skill and diligence and that appraisers meet certain qualification requirements and to maintain adequate appraisal documentation for collateral that is comprehensive and plausible. In this regard it is also desirable to ensure appropriate monitoring of residential immovable property markets and for the mechanisms in such provisions to be in line with [insert reference to CRDIV]. ●

Message from Roger Messenger REV, Chairman TEGoVA

In these challenging times for valuers, it is a real pleasure to be able to report some really good news.

TEGoVA exists to support and promote the valuation profession across Europe. In summary our 3 main pillars are as follows:

- To produce valuation standards integrating the particular requirements of EU markets and law
- To promote excellence in the European valuation profession and best valuation practice through education, ethics and the Recognised European Valuer scheme and
- To protect the interests of consumers of real estate valuations during the production of valuation-relevant EU legislation

With the Mortgage Credit Directive, we met and surpassed all those goals. TEGoVA and its standards now have the imprimatur of EU law, a game-changing success that opens new horizons for TEGoVA, its members and Recognised European Valuers.

When one considers that this was never initially meant to be, that the European Commission's original proposed Directive never mentioned valuation and that Parliament's Rapporteur got caught up in a simplistic evocation of 'international' valuation (continued on page 2)

Roger Messenger awarding Wolfgang Kälberer (right) the title of Honorary Recognised European Valuer in recognition of his distinguished service to the European valuation profession and his leading contribution to the shaping of the Mortgage Credit Directive.



standards, it is a tribute to TEGoVA's lobbying capacity that we were able to put this right, thanks to the skills we have developed and to the friendship, trust and deeply entwined interests that we have forged with the mortgage banking industry.

Nor is it a coincidence that the European Property Federation, which represents Europe's real estate owners and investors, has now given TEGoVA and REV its support and endorsement. Success breeds success in a virtuous circle.

We are not however, complacent, as success brings with it responsibility. We must ensure that future production of EVS retains the high levels of European relevance reached in the last edition, the elite corps of REV's must continue to grow and to spread to all parts of Europe, and we must continue to work with the banking profession and bank certification bodies to produce key market intelligence for all parties and to ensure that REV's are qualified to be the valuers of preference for European banks.

Our magnificent meeting in Bruges last month, with record numbers attending, was in fact TEGoVA in a nutshell – a celebration of all that we have achieved and hard work building the future. The meeting saw us extend membership to more than 50 associations in 30 countries. ●

Mortgage Credit Directive Gives EU Imprimatur to TEGoVA and EVS

By Michael MacBrien, TEGoVA Secretariat

Photograph inserted by REV Journal with thanks to Michael MacBrien for his role in the mortgage credit debate



The final text of the Mortgage Credit Directive represents a compromise by the Council of Ministers and the European Parliament putting an end to an amendment originating from Parliament's Rapporteur that combined

a reference to 'international standards' with endorsement of valuation principles of an international Financial Stability Board that recommended only International Valuation Standards or the RICS Red Book.

Fortunately, it was possible to point out to Council and Parliament that a Directive providing European solutions to European financial and valuation problems must recognise and promote European Valuation Standards at the same level as international ones. The final Directive has achieved this, eliminating all reference to 'international standards' in the Article and, in the Recitals, eliminating reference to the Financial Stability Board and instating TEGoVA and its European Valuation Standards in their rightful place among the internationally recognised valuation standards that member states must take into account when fulfilling their obligation under the Directive to develop reliable national property valuation standards. The task of TEGoVA and its 53 member associations in 30 countries is now to ensure that EVS does in practice inform the national standards developed in the EU and in the EU accession and pre-accession countries adapting their national rules to the *acquis communautaire*, the body of EU law that all candidate member states must adopt and of which TEGoVA and EVS are now part and party. ●

The Mortgage Credit Directive – An Overview

By Wolfgang Kälberer
Hon REV

Two years ago, the European Commission tabled a proposal for a Directive to regulate credit agreements in respect of residential property. On 3 May 2013, after lengthy and complex discussions, Member States, the European Parliament and the European Commission reached a compromise agreement on the final text of the so called Mortgage Credit Directive. The latter is due to be formalised by a plenary vote of the European Parliament in the autumn. The Directive seeks to create a responsible, efficient, fair and competitive pan-European mortgage market that protects and benefits consumers. It should also promote customer mobility and cross-border activity of creditors and intermediaries who will benefit from a level playing field. Whilst establishing a high level of consumer protection the Directive addresses the dangers of irresponsible lending and borrowing which, in recent years, leading up to the financial crisis, has contributed to increased numbers of

unaffordable loans, defaults and foreclosures throughout the EU. It had become clear that not all countries had adequate legislative and regulatory measures in place to protect consumers. The latter will now be protected from being misled. Henceforth they will need to be informed of the consequences and risks of purchasing a property or taking out a loan secured against their home.

The Mortgage Credit Directive covers all home purchase loans as well as certain loans for home renovation. It also covers all consumer loans which are guaranteed by a mortgage or another comparable security.

The Directive will have to be transposed into national laws within 2 years after enactment, thus by around mid-2015.

Member States will have to:

- introduce requirements regulating the advertising of mortgage credit. For example wording that may create false expectations amongst consumers regarding the availability or the cost of credit will be prohibited;
- ensure that all institutions involved in the origination and distribution of mortgage credit to consumers are adequately regulated and supervised;
- establish principles for the authorisation and registration of credit intermediaries (companies which provide information and assistance to consumers seeking mortgage credit and which sometimes conclude mortgage agreements on behalf of the lender) and for the establishment of a passport regime for those intermediaries.

This means that once authorised in one Member State, the intermediary would be allowed to provide its services throughout the internal market.

- ensure that lenders benefit from provisions enabling them to access information in credit databases on a non-discriminatory basis.

Lenders and credit intermediaries will be required to:

- make general information available at all times on the range of credit products they offer;
- issue personalised pre-contractual information to the consumer through a European Standardised Information Sheet "ESIS". This will allow consumers to properly compare the mortgage conditions of different providers;
- give explanations and meet certain standards for the provision of advice;
- assess the borrower's ability to repay the loan.

Borrowers will:

- benefit from extra information at all stages of the mortgage application process allowing them to make better informed decisions;
- benefit from a harmonised annual percentage rate of charge in line with that set out in the Consumer Credit Directive which will facilitate the comparability of advertising and pre-contractual information;
- be obliged to provide the necessary information to enable an assessment of

their ability to repay;

- be entitled to repay their loan before the expiry of the credit agreement, subject to certain conditions to be determined by Member States.

Loans contracted in foreign currencies have also been addressed and pre-contractual information on the impact of foreign currency loans will become mandatory. It should be noted that the Directive takes into account national differences in the real estate markets of the Member States including short-term versus long-term loans, variable versus fixed

interest rates, the right to early repayment etc. This also explains the introduction at a late stage in the legislative process of property valuation clauses (See Cover Story). Indeed the European Commission originally refrained from covering property valuation in its initial proposal because of its lack of experience in this area and the lack of an impact assessment.

Of course, the final valuation clauses are particularly welcome, in particular the balanced reference to valuation standards published by IVSC, RICS and TEGoVA. This is the first time that European Valuation

Standards have been recognized by European law. Obviously, the Recital also creates a commitment on the part of TEGoVA to further develop European Valuation Standards and to provide best advice to markets, local valuation associations and Member States on how to develop reliable national valuation standards. ●

Wolfgang Kälberer Hon REV is a TEGoVA Board Member and Head of the EU Representation of the Association of German Pfandbrief Banks

International Financial Reporting Standards – Fair Value Hierarchy

By Michael Morris

REV FRICS



IFRS 13 deals at length with the notion of a Fair Value hierarchy the purpose of which is to allow readers of financial reports to understand the extent to which the reported value is based on readily observable evidence or derived from other methods.

IFRS 13 states that valuation techniques “shall maximise the use of relevant **observable** inputs and minimise the use of **unobservable** inputs”. “Unobservable inputs shall be used to the extent that relevant observable inputs are not available”.

Observable inputs are “Inputs that are developed using market data, such as publicly available information about actual transactions ... , that reflect the assumptions that market participants would use ... ”

Unobservable inputs are “Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use”.

It is important to note that the Fair Value hierarchy in IFRS 13 applies to the inputs used in valuations, not to valuation methods. The inputs are categorised as levels 1, 2 or 3, as follows:

- **Level 1** inputs are unadjusted quoted prices in active markets for items identical to the asset being measured. As real estate assets are rarely identical to each other, it is most unlikely that level 1 inputs will arise in their valuation. An exception might be where the subject property itself is under a binding contract for sale in conditions that meet all the criteria of the definition of Fair Value.

The valuer’s choice will therefore most likely be between levels 2 and 3 below.

- **Level 2** inputs are inputs other than quoted prices in active markets included within Level 1 that are directly or indirectly observable.

For an input to be level 2, good evidence for the required input must be available from identical or near-identical properties. In particular, this evidence must be sufficiently recent for it to be applied directly without any significant adjustment for the passage of time between the dates of those transactions and the valuation date. Even if the evidence comes from very recent transactions, the valuer will still have to be satisfied that the supply and demand situation remains unchanged between the date of the evidence and the valuation date of his subject property. If an input is derived from Level 2 data that has been subject to “significant” adjustment, that input should be classified as level 3. This may apply in particular to Estimated Rental Values and Yields.

Examples of cases where Level 2 might nevertheless be possible could include sale prices of identical or very similar residential units, rents in respect of identical or very similar light industrial units on the same estate and rents for office suites let off on similar floors of the same building.

- **Level 3** inputs are unobservable inputs. A reporting entity develops unobservable inputs using the best information available in the circumstances, which might include the entity’s own data, taking into account all information about market participant assumptions that is reasonably available.



In many cases, Level 3 is the most likely conclusion for the main inputs, particularly estimated rental values and yield, used in the valuation of investment property.

Once the inputs have been categorised, the Fair Value measurement (i.e. the valuation) will be classified as level 1, 2 or 3 according to the classification of the inputs adopted. It should not be thought that the use of one method or another automatically leads to the valuation being categorised as level 1, 2 or 3 – the final classification will depend on the nature of the inputs used in each case.

If inputs are of different levels, the whole Fair Value measurement will be categorised at the lowest level input that is significant. Thus a valuation that contains a significant input that is at level 3 will be classified as level 3.

It should be noted that the classification of a value measurement as Level 3, rather than Level 2, for example, is not intended to suggest that the valuation on which it is based is of a lower or poorer quality. The distinction between Level 2 and Level 3 is intended to inform readers of financial reports about the nature of the inputs used, rather than being in some way a measure of the quality of the valuation.

In a similar way, classification of a fair value measurement in Level 3 does not in any way imply that the asset is less liquid than others. Indeed, one can imagine that the valuations of certain very liquid assets might be at Level 3 because of a lack of evidence

due to the fact that, as these assets have a high scarcity value they are rarely traded.

Implications for the preparation of valuation reports

Regardless of the hierarchy of the value measurements, a company has to include in its report a description of the valuation techniques used and the inputs used, as well as information regarding the changes made in valuation techniques and the reasons for making those changes.

However, if a measurement is classified as level 3, the report must cover a number of additional points, including quantitative information about the significant unobservable inputs used (if reasonably available), a description of the valuation processes, policies and procedures and a narrative description of the sensitivity of the valuation to significant changes in unobservable inputs.

Valuers may therefore be asked to provide the information needed to enable their clients to comply with these requirements albeit much of this information may already have been included in their reports.

Valuers may also be asked to comment on the hierarchy of the main inputs in their valuations. In doing so they should be advised to identify the inputs that they consider to be “significant” and then state and briefly explain which level they consider to be appropriate for each one. Nevertheless, they should seek confirmation from their clients (and perhaps also their clients’ auditors) of the reporting requirements at an early stage, preferably before confirming their terms of engagement.

IFRS 13 imposes new reporting requirements on property owners and on their valuers. It is being applied from this year, particularly for valuations as at 30th June for the consolidated accounts of listed European companies. Valuers and their clients are therefore at the start of a learning curve and the writer would welcome feedback from valuers about their experiences in applying this new standard. ●

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Belgian Notaries Prepare for REV Scheme

On 16–18 May a record 72 delegates from 22 European countries, as well as from South America (UPAV), the UAE (Taqyeem) and the US (Appraisal Institute) attended TEGoVA's Spring General Assembly in Bruges.

The two day meeting which was hosted by the Royal Federation of Belgian Notaries (FRNB-KFBN) kicked off with a Valuation Conference headlining the added value which the notarial profession in Belgium contributes

to property valuation in the light of the first-hand market knowledge possessed by local notaries as well as their extensive transactions database (Le baromètre des notaires) maintained by FRNB-KFBN.

A major topic for discussion was the proposed implementation of the REV scheme in Belgium by FRNB-KFBN. Most speakers agreed that this would significantly enhance the status of the valuation profession in Belgium. ●

Reliable Valuation Standards Respect Local Markets and Cultures!

The Mortgage Credit Directive is a charter for national valuation standards which should have regard to internationally recognised standards developed by IVSC, TEGoVA or RICS. To those of us practicing valuation on the ground this makes good sense. The need for reliable country standards is no clearer than in the case of Dubai, a relative newcomer to the valuation world but one which attracts many property professionals from Europe. The article below by Mohamad Kodr Al-Dah, Head of Valuation at the Dubai Land Department's “Taqyeem” shows the way forward in developing local standards which respect the peculiarities of the local market, law and culture. ●

Krzysztof Grzesik REV, Editor

Dubai – Why Local Valuation Standards?



Mohamad Khodr Al-Dah presents memento from Dubai to Philippe De Jonghe of The Royal Federation of Belgian Notaries, Organiser of TEGoVA General Assembly, Bruges.

The Valuation world today is inundated with various standards: there is the Red Book, and of course the IVS and going west there are the USPAPs as well as our very own EVS. So, why does Dubai need its own Valuation Standards when there are so many to choose from?

I believe that culture is the main reason behind this. Arab culture, especially in the Gulf, tends to be preserved “verbally” rather than “in writing”. For example, the Quran was memorized during the time of the Prophet

Mohammed, and only written down many years after his death. In the UAE today, poets still prefer to share poetry between them verbally rather than to write it down. Hence, when the Dubai Land Department decided to embark and write its own Valuation Standards, we avoided simply adopting a well-known international standard and decided to write our own, in a culturally-sensitive way.

The Emirates Book Valuation Standards (EBVS), written in 2010, takes on the main points of all the international standards. EBVS has three main Standards:

- EBVS1 : Ethics
- EBVS2 : Market Value
- EBVS3 : Reporting

Most valuation reports in Dubai tend to be one-page reports authored by property brokers and not qualified valuers. The EBVS aims to educate property professionals about the need to distinguish between brokers and valuers and also to raise the standard of the valuation profession significantly given the importance of real estate for the economy of Dubai. You can download a free copy of the EBVS via www.dubailand.gov.ae.

Taqyeem also conducts its own Valuations, mainly for Government use and for its biggest customer the Dubai Municipality. Last year it conducted 2781 valuations totaling EUR 20.1 billion.

We are hopeful that Valuation Law for Dubai will be signed soon. This will transform Taqyeem from a valuation provider to a valuation regulator of private sector valuers.

Dubai Market

We have seen property prices increase 10 to 20% in key freehold areas over the last 6 months.

The largest Dubai developers, Emaar and Nakheel are showing some positive signs. Emaar is responsible for the famous Burj Khalifa tower and continues to be a market leader, well managed with a very strong product. Nakheel, the developer of the Palm Jumeirah is still struggling a bit due to recent restructuring post-2009. Both Emaar and Nakheel declared good profits at the end of 2012 with the former seeing its share price jump from 2.39 to 5.7 in the last 52 weeks.

Finally (Notaries please note! Ed) Dubai Land Department offers a unique service called the “E-Step Bag”. If you want to buy or sell a property and don't have time to come to the Land Department in person to register the sale, for an extra fee of 4000 Dhs (820 EUR) a specially-modified Louis Vuitton bag with laptop, 3G Internet, scanner and printer will be transported to your office or hotel by a specially-trained Dubai Land Department employee and the sale can happen on the spot. You will be issued with your title deed immediately! ●

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