TEGoVA
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European Valuation Standards (EVS) 2016 can lend a timely hand following the Irish banking crisis

Whilst its conclusions are only designed to refer to the banking crisis in Ireland, a key inquiry explaining the causes of the crisis incorporates messages which should be heeded throughout the EU. Shoddy valuation work was identified as one of the causes and the need for high level valuation standards was made clear during the hearing. The launch of a new edition of EVS next month is in part a response to criticisms levelled at the valuation profession since the collapse of Lehman Bros in 2008.

The Irish economy experienced rapid economic growth in the period 1995 to 2007. It was one of the fastest growth rates in the EU, often referred to as an **"economic miracle"**, with the country dubbed the **"Celtic Tiger"**. This period of economic expansion saw a major boom in the construction sector, which by 2008 accounted for 25% of Irish GDP and 20% of Irish jobs. It was financed by rapid growth in bank lending.

> ***"I informed them that following detailed analysis and in the absence of national valuation standards, IPAV adopted the "Blue Book" European Valuation Standards (EVS)."***

Irish banks took on increased risk and ramped up lending on the back of optimism over the continued growth of the economy. A government-commissioned report on the sources of Ireland's banking crisis by **Klaus Regling** and **Max Watson** found that a critical weakness in bank risk management was the concentration of bank assets in activities related primarily to property, and more specifically commercial property. And a high concentration of lending was to a small number of borrowers. The risk concentration in a few institutions meant they were potentially very vulnerable to an economic downturn, let alone a more severe market shock. The **global credit crunch** of 2007/08 hit the Irish economy hard. Irish banks saw huge losses due to their exposure to sub-prime mortgage defaults in the US. The tightening of credit led to a dramatic drop in property prices. One of the biggest property crashes in the world, by 2013 property prices were over 50% lower than at their peak in early 2008. Eroding household wealth led to a fall-off in consumer spending, precipitating the recession of 2008.

The night of 29th September, 2008 will forever be etched in the minds of Irish people. The then government issued a systemic banking guarantee that potentially made the State liable to cover **€440 billion** of customer deposits and banks' own borrowings. The government agreed to recapitalise the major Irish banks. However, even this proved insufficient.

In November 2010, the government signed a memorandum of understanding making provision for an **€85 billion** package of financial support for the country by the EU, through the **European Financial Stability Fund** and the **European Financial Stability Mechanism**, loans from the UK, Sweden and Denmark and funding from the **International Monetary Fund's** (IMF) **Extended Fund Facility**. This shocking conclusion followed weeks of intense speculation and denial that Ireland was about to enter a bailout programme.

Banking Inquiry

Following a change of government in February 2011 and much political debate about the public's right to understand fully the root causes of the calamity, a Committee of Inquiry into the banking crisis, more commonly known as the **"Banking Inquiry"**, was undertaken by a Chairman and 11 member cross party committee of the Houses of the Oireachtas (Parliament). Established in November 2014, six years into the financial crisis, the Inquiry would examine "*the reasons Ireland experienced a systemic banking crisis, including the political, economic, social, cultural, financial and behavioural factors and policies which impacted on or contributed to the crisis and the preventative reforms implemented in the wake of the crisis.*"

Welcome …

Welcome to the latest edition of the European Journal. Once again we are pleased to be able to showcase the role of TEGoVA in the valuation workplace, evidenced on this occasion through the launch of revised standards, in the form of European Valuation Standards (EVS) 2016.

This issue also highlights the work being carried out in the controversial area of energy efficiency and real estate, together with a contribution from Ireland exposing weakness in the banking sector that has paved the way for a more robust approach to valuation standards – enter EVS once again.

And don't forget that your contributions are always welcome – in any language. Whether you want us to publish articles on a new topic of interest to our readers, or you simply want to comment on what others are saying, contact me on **jcroberts54@hotmail.com** and join the debate. ●

John Roberts, Editor

One of the most controversial aspects of the Inquiry was the role and influence of the **European Central Bank** (ECB) on the question of burden sharing with creditors. **Minister for Finance, Michael Noonan**, told the Inquiry that on his way into the Dáil on 31st March 2011 he ditched plans to burn investors in Anglo Irish Bank after a last-minute call from **Jean-Claude Trichet**, then head of the ECB. "*He* (Mr Trichet) *said if you do that, a bomb will go off, and it won't be here, it will be in Dublin*", Mr Noonan told the investigators.

On behalf of Irish valuers and the **Institute of Professional Auctioneers and Valuers** (IPAV), the only professional valuers' institute called, I was among 131 witnesses to give evidence at the inquiry. The actual experience was a traumatic affair for me personally. That there are no national property valuation standards in Ireland came as a surprise to some members of the investigation. I informed them that following detailed analysis and in the absence of national valuation standards, IPAV adopted the **"Blue Book"** European Valuation Standards (EVS) and now acts as the Irish administrator for these standards, educating its valuers through its specifically tailored valuation courses.

I also informed the inquiry that **"Market Value"** (MV) was and is the only standard required by Irish lenders. This internationally recognised assessment of the value of a property estimates the price that could be obtained for that property at the valuation date, notwithstanding that this value could alter over time – sometimes very rapidly. I went on to suggest that the time may be opportune to examine the concept of MV and perhaps consider other valuation standards, to ensure that **non-residential properties** bought on mortgages or credit would be **sustainable** through the mortgage lending term and prevent credit bubbles.

Following completion of its investigation, and amid much political wrangling as the deadline loomed for another general election, the Committee published its final report on 27th January 2016.

Among its many finding were:

- banks became over reliant on wholesale markets and new and aggressive lending arose from increased competition
- developers became heavily reliant on bank debt to fund developments
- as the property boom took hold, reliance on informal "desktop" and "drive by" valuations, which did not involve any physical inspection of a property, became more prevalent
- the Financial Regulator had sufficient powers to deliver prudential supervision in a more intrusive manner
- the Central Bank and Financial Regulator were aware in 2003 that the banking sector was increasingly relying on lending to the property sector
- the Financial Regulator allowed banks to breach sectoral lending limits on property
- government's tax policy contributed to the structural deficit
- the income tax base was eroded in the years leading to crisis
- the information available to decision-makers about the underlying health of the banks was inadequate
- the ECB said the State must ensure that no bank would fail
- the government was advised by the Central Bank and the Financial Regulator that all six banks were solvent on the night of the guarantee
- the IMF favoured imposing losses on senior bond holders in October/November 2010
- the ECB position contributed to inappropriate placing of significant banking debts on Irish citizens. ●

Pat Davitt FIPAV REV MCEI is Chief Executive Officer with the Institute of Professional Auctioneers and Valuers

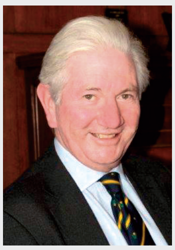
A message from the Chairman

Dear colleagues,

Welcome to Brussels, host city of the launch of **European Valuation Standards 2016**. The event on 13th May at The Hotel Brussels will mark the end of another four-year cycle in the work of **TEGoVA**. Congratulations and thanks are due to **John Hockey** and his **European Standards Board team**, for delivering truly "European" standards fit for a "European" valuation profession striving for ever closer union. A summary of what we can expect from **EVS 2016** is included in this edition of European Valuer and whilst we celebrate the timely delivery of this flagship product, the TEGoVA Board is already planning new initiatives for the next few years, including the establishment of a **European Practice and Methodology Board** and plans for standards dedicated to the valuation of residential property, to guide our growing group of **TEGoVA Residential Valuers**.

All will be revealed at the **TEGoVA General Assembly on 14th May**. ●

Krzysztof Grzesik FRICS IRRV REV is Chairman of TEGoVA.



EVS 2016 – John Hockey showcases another TEGoVA milestone

EVS 2016, the eighth edition of European Valuation Standards (EVS), will be launched in **Brussels** on **13th May**, taking effect from **1st June 2016**.

The two-year journey from initial consultations through to sign-off for printing has been fascinating. With the benefit of considerable feedback, including the valuable open session during the TEGoVA meeting in Riga, it is clear what is needed by valuers, what is required by regulators and clients and what is necessary for legislators. This can be summed up in a simple phrase – **"more of the same"**. It is equally clear that EVS should remain clearly focused on real estate, provide additional guidance and technical information and continue to concentrate on high level principles. This is exactly what you will discover in EVS 2016.

The format and content follows the direction of previous editions, being informed by existing and emerging European regulation, acknowledging that EU law is the origin of an increasing amount of the local property law underpinning valuation. However, Union regulation can presume outcomes that are not always evident in the market. Energy efficiency is an example in point. EVS helps raise the valuer's consciousness of energy efficiency issues and EU instruments, but at the same time upholds the scientific and professional obligation on the valuer to value energy efficiency on the basis that values set must reflect verifiable market reality.

EVS 2016 provides harmonised European standards, guidance and technical information for use by all sectors of the European valuation profession. **Corporate governance** and **ethical considerations** are embedded and reinforced within the standards, confirming, for instance, that a valuation produced in accordance with these standards is signed by a qualified professional, whose experience, qualification, diligence and ethical behaviour are appropriate to the instruction.

Providing a valuation in accordance with EVS may appear to be consistent with normal everyday practice. However, commercial pressures remind us that taking the easy option and cutting corners can appear necessary to meet a deadline or to satisfy a client that only requires the opinion of value as soon as possible and is unlikely to read the remainder of the report. It is for these reasons that the requirement for independence is reinforced in EVS 2016. I have spoken to many valuers who are informed by a lender that the valuation is expected to report a certain figure. Yes, in 2016, when bank regulation has been increased. **EVS 3** now states that each valuation must provide an informed and independent opinion of value, supported by a recognised basis or bases of valuation. This will require evidence to support that independent view.

"It is equally clear that EVS should remain clearly focused on real estate, provide additional guidance and technical information and continue to concentrate on high level principles. This is exactly what you will discover in EVS 2016."

Appreciating that formats of some reports are determined by the client, particularly valuations of residential property, a key message is **"record, report and retain"**. The information and knowledge necessary to provide an opinion of value must be recorded and retained to enable justification of the figure reported, even if the client does not require this data.

EVS 2016 is divided into four parts:

Part 1: European Valuation Standards and Guidance Notes

EVS continues to set five Standards. They have all been refined and reinforced from those published in 2012. By way of example:

- EVS 1, **Market Value** (MV), is expanded to include a definition of Market Rent, derived from and consistent with its definition of MV
- EVS 2, **Valuation Bases other than Market Value**, extends the commentary relating to Mortgage Lending Value (MLV), explaining the conceptual value-at-risk approach to manage the risk exposure of credit institutions taking into account special safety requirements
- EVS 3, **The Qualified Valuer**, expands the requirements that determine that the valuer be, and be seen to be, not only competent to act, but also independent, and without any undisclosed potential conflicts of interest which are actual or possible and which can be foreseen at the time when the instructions are accepted
- EVS 4, **The Valuation Process**, incorporates and amends guidance published in May 2013 relating to terms of engagement
- EVS 5, **Reporting the Valuation**, cites the European Union's Capital Requirements Regulation 575/2013, and also provides commentary on situations where opinions of "value in the longer term" are requested.

Guidance Notes (formerly referred to as Applications) follow on from the Standards. They have been reinforced to provide detailed analysis and explanation of key issues and approaches to be followed. For example, EVGN 4, Assessment of Insurable Value and Damages, has been expanded and incorporates an updated Information Paper relating to insured damage published in May 2013. There are two new topic areas covered by Guidance Notes:

- EVGN 9, **TEGoVA Commercial Loan Specification** – this specification was initially published in October 2014 and is designed for use by valuers when providing valuations for secured lending to lenders that are members of the European Mortgage Federation
- EVGN 10, **Valuations: Compliance with EVS** – this provides clarification on those valuations that will be compliant and explains the main reasons that a valuation would not need to comply or would depart from TEGoVA requirements.

Part 2: European Codes

Two updated and extended codes are provided, namely the European Valuers' Code of Conduct and Ethics, and the European Code of Measurement.

Part 3: European Union Legislation and Property Valuation

Introduced in the 2012 edition, a complete section is devoted to the body of EU law impacting real estate and valuation, with many updates to take account of the EU real estate policy advances over recent years. Based on comments received since 2012, this section is of particular value to academics, researchers, civil servants and advisers involved in the real estate aspects of EU policy.

Part 4: Technical Documents

Eight Information Papers are included within Part 4. New topic areas include Valuations for Recurrent Property Tax Purposes, Automated Valuation Models and Valuation Methodology. The remainder papers have been updated and refreshed.

EVS 2016 will be available online and in hard copy. Further details will be found on the TEGoVA website after the Brussels meeting. ●

John Hockey MSc FRICS IRRV (Hons) REV is Managing Director of Meyler Denton Hockey and Editor of EVS 2016.

EU policy makers have lost their way on energy efficiency and hope that valuers will somehow make it right, says Michael MacBrien

The Union has played a historic, world-leading role in addressing climate change in general and energy efficiency in buildings in particular. It got going with buildings fifteen years ago, when only a couple of member states had done anything at all and EU law has been the bedrock and benchmark for all Europe ever since.

There's a lot of regulation, but it boils down to three fundamentals:

- an obligation to energy efficiency renovate whenever the renovation costs are more than 25% of the value of the building or cover more than 25% of the building's outer shell
- an obligation on building owners to produce an energy performance certificate (EPC) whenever a building is constructed, sold or rented out to a new tenant, and
- individual and smart metering rollout.

Those are major achievements, a key part of the energy transition, but the worm in the EU apple has been not so much the regulation itself as overzealous interpretation and implementation.

The stressor that triggered this is the political and administrative Zeitgeist.

You have to see it to believe it. Climate warming is **humanity's greatest challenge** and many people in European and national government have a crusader mentality, which is splendid, until it blinds you.

Everybody knows that high energy efficiency and broader sustainability are already part of the Grade A office marketing mix, so those buildings don't need regulatory push. So everyone is focused on lower-end commercial and especially on housing – understandably so, as that's the bulk of the building stock. This is often referred to in Brussels as **"low hanging fruit"**, meaning a win-win sector where if only home owners would just do those renovations there would be a massive decrease in emissions, coupled with rapid **"payback"** on the investments through low heating bills. The problem is that the whole policy has come up against some "inconvenient truths" stemming from the complexities of real estate and human nature.

Concerning the renovation and metering rollout requirements, in the legislative debate over the Commission's proposals, the **European Property Federation** and its allies won a safeguard that the provisions must take account of cost-effectiveness. Sadly, misguided officials and insulation and metering industry lobbies have the safeguards in their sights: right now for individual metering, the Commission is churning out cost-effectiveness **"Guidance Notes"** for the member states, decreeing that most buildings are in a Commission consultant-invented, technically skewed **"viable class"** and won't be allowed to invoke the cost-effectiveness safeguards. Worse, the Commission is indulging in "policy creep" by interpreting the metering rollout provisions in a too-extensive manner.

More harmful still is that the Commission **"kill cost-effectiveness"** culture has trickled down to some member states, like Germany. For energy efficiency renovation, a recent German study[1] enumerates all the ways the German government has miscalculated cost-effectiveness. The law states that regulations may only demand thermal measures that are **"economically realisable"** (*wirtschaftlich vertretbar*) and defines this as paying back, through fuel savings, within these measures' technical lifetime. But the author of the study qualifies this as no more than a "bookkeeping trick" for six reasons:

1. The calculation method compares pre- and post-retrofit theoretical, calculated consumption levels rather than actual, measured consumption levels and the average gap between the two is 30% because, *inter alia*, real people don't heat their leaky homes as much as comfort demands.

2. Government bookkeeping takes account only of the thermal improvement costs, not the full costs of a retrofit. That makes sense only if the building has to be renovated anyway, but the study points out that "*German homeowners do not generally regard their buildings as candidates for serious comprehensive maintenance*" and I suspect you can safely replace "German" with "European" or even "human".

3. The government's assumptions about fuel prices are based on the expected average price of heating fuel over the lifetime of the retrofit measures (25 years). That time horizon is wise in terms of the credibility of any fuel price projection, but it's far too long a for a homeowner, especially as he'll be out of pocket for 14 years!

4. Human factors – people don't necessarily have 25 years to wait around for this "dividend". They move, divorce, lose their jobs or go to a retirement home prematurely.

5. Buildings are stubborn, especially in Europe, where they often have aesthetic features that don't accommodate ever thicker layers of insulation, not to mention that people actually prefer to be able to stand upright in their basements.

6. And when the retrofit is finally done, people heat more than the theoretical calculations would have it because they feel they can afford it, or they don't optimally control the new heating technology, etc.

Result – **the German government, long eager to super-implement the EU Directives by tightening thermal standards ever more, is stepping back because it's backfiring. People are renovating less and less.**

Another top-down EU mistake is the exclusive **obsession with deep renovation**. Member states are under EU obligation to devise policies to stimulate deep and staged-deep renovations, and there's lots of EU funding for it, but not a word about, nor a eurocent for, the modest step-improvements that building owners would actually be prepared to envisage with a little encouragement. Perversely, step-improvements are viewed as a disincentive and a retardant for **"real, deep"** renovation!

"The final mistake has been the recommendations for energy performance improvements in the EPC for buildings. Just like the renovation requirements, this too is a good start gone wrong."

The final mistake has been the recommendations for energy performance improvements in the EPC for buildings. Just like the renovation requirements, this too is a good start gone wrong. EPCs all over Europe were a great achievement. The fact that many of them have energy performance indicators that are anything but reliable can be excused as a growing pain that will eventually work itself out. But here again, too bad that at EU level, instead of keeping to the indicator and making it reliable, they just couldn't resist also imposing that the **"expert"** producing the EPC must also make recommendations for energy performance improvements. Even the most energy-sophisticated governments have been unable to implement this, because it's way beyond the competence of Europe's legions of EPC **"certifiers"**. Buildings are comprised of many systems which interact with each other closely and energy experts need knowledge and qualifications in many disciplines to be able to make cost-effective suggestions for enhancing energy efficiency in buildings. No expert understands all building systems.

And how about the valuer in all this?

He is the centre of current European attention! The high and the mighty expect the valuer to put a price – and a good one – on energy efficient buildings and to advise the owner on the advantages of energy efficiency renovation. But given all of the above, for the valuer, as Vladimir Ilyich would have asked, **"What is to be done?"** We've seen that in places like Germany, owners are being told by the authorities that they should only energy efficiency renovate under conditions that are clearly not cost-effective, while all over Europe the subsidies that could compensate for cost-ineffectiveness are being cut back due to budgetary constraints. Confronted with requirements to renovate to cost-inefficient standards, owners are simply not renovating at all, or are renovating whatever way they want, secure in the knowledge that the state doesn't have the big brother infrastructure to control and sanction deviant renovations. How is a valuer supposed to pull a value out of such a hat? What do **"comparables"** mean in such circumstances? Compare EPCs? EPCs are **"from a valuation point of view, next to absolutely useless"**.

Some say the only way out of this hole is to dig deeper – that the valuer must get the full historical technical information on the building from the owner. Good luck with that! And more fundamentally, what would the valuer do with the information and on who's time?

Giving advice

One could make abstraction of value-setting and take the view that the valuer needs this information for his important role as an adviser on energy efficiency renovation. I have my doubts.

A professional valuer does a systemically important, highly complex and sophisticated thing – he sets a value. His training and experience serve that high purpose – they don't make him an energy nerd. What I wrote above about EPC certifiers applies equally to valuers. No single expert has enough knowledge of construction, heating, cooling and ventilation, building physics and building economics to advise on cost-efficient energy efficiency improvements.

For renovation, certification and metering, too much of a good thing gives less, not more. The Commission and many member states need to refit, rollback, regroup and plan a new regulatory phase interconnecting buildings with the rest of the urban environment and gauging renovation in the context of a truly circular, waste-conscious economy. That process has already begun. ●

FOOTNOTE:

1 Ray Galvin (2014) Why German home-owners are reluctant to retrofit, Building Research and Information, 42:4, 398-408, DOI: 10.1080/09613218.2014.882738

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