# *2009 EMF Study on the Valuation of Property for Lending Purposes*

November 2009

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Article prepared by Paul Trott, the UK delegate to the EMF's Valuation Committee, on AVMs in the EU, entitled "Valuation Technology: A New Approach"

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*Introduction*

## *Towards a Better Understanding of European Mortgage Valuation Practices*

### *The Need for Transparency*

The European mortgage and property markets reflect the variety, traditions and cultural diversity present in all aspects of European life. Since 2004, this rich mix has increased in with the addition of a further 12 Member States to the European Union. Every Member States has its own system for providing credit for the purposes of homeownership or for financing commercial properties. Every Member States also recognises the importance of an accurate valuation of the underlying asset without which the integrity of the lending system would be undermined.

Indeed, accurate and transparent property valuation is essential to the mortgage lending business as it promotes confidence in the collateral system. In this respect, property valuation represents one of the major building blocks of the mortgage system. The lender requires certainty that the asset being taken as a guarantee for a housing loan is of a certain value and will cover losses should the loan default. This confidence in the property value is one of the elements, which make mortgage debt a low risk, inexpensive way of providing housing finance and which in turn makes homeownership a reality for many throughout Europe.

The need for transparency is therefore ever growing as the frontiers of the single market push further outwards and as cross-border activity increases. The introduction of the Euro removed one of the major obstacles to a fully functioning European property market, namely currency risk. Transparency in valuation techniques and methodologies across borders would significantly further reduce the risks associated with mortgage lending. These reductions in risk will lead to greater confidence in European property markets on the part of homeowners, mortgage lenders and investors.

Finally, the performance of the European Covered Bond and Mortgage Backed Security (MBS) markets is primarily driven by the quality of the underlying asset. One of the key elements defining credit quality will be the asset's original valuation when the mortgage was advanced and then subsequent valuations monitoring the value of the underlying asset. Only if the valuation process is transparent, accurate and consistent will investors be willing to purchase Covered Bonds and MBS.

With these previous considerations in mind, two key initiatives at EU level have significant implications for property valuation and will almost definitely shape the future of the 'profession' into the future: the Commission's assessment of the Integration of Europe's Mortgage Markets, and most recently its focus on measures addressing responsible lending and borrowing, and the Capital Requirements Directive:

***Integration of EU Mortgage Markets/Responsible Lending & Borrowing***

Given its integral nature within the mortgage lending process, the valuation of property for lending purposes has been one of the key features of the Commission's work in the field of mortgage policy over the past six years. Significantly, the Commission's initiative to consider the obstacles to and the benefits of integrating European mortgage markets, and the ways in which integration could be achieved, has focused on both the primary (retail) and secondary (funding) market. In this context, the Federation's experts on property valuation have closely followed the evolution of this file and contributed extensively to the Commission's work in this area, through a recommendation on risk-related criteria[1] (Risk Profile) that should be used when interpreting property valuation in order to improve the quality of valuations, and a series of Position Papers. The EMF has recently updated its Risk Profile to take account of environmental efficiency issues in the light of the ongoing discussions on energy performance at EU level.

In December 2007, the European Commission published its White Paper on Mortgage Credit, in which it announces its intention to issue a Recommendation inviting Member States to facilitate the use of foreign valuation reports, as well as to promote the development and use of reliable valuation standards. The EMF welcomed the Commission's approach in the Draft Recommendation, and underlined that reliable valuation standards are both useful and important tools for lenders. The EMF also welcomed the general approach of converging valuation standards. As regards professional qualifications, the EMF highlighted that it considers minimum qualifications for valuers to be very positive for the Industry. Property valuations should only be recognised if valuers can demonstrate that they possess the necessary qualifications with regard to the market concerned, the type of property and the objective of the valuation.

Originally planned for early 2009, the Commission has since announced that it would be postponing the publication of the Recommendation on Property Valuation (Foreclosure and Land Registration) indefinitely. This decision reflects the sensitive nature of policy measures aiming particularly at improving the efficiency of foreclosure procedures in the current particularly difficult political and economic climate. The way in which property valuation will be handled moving forward is at this stage unclear.

***European Capital Adequacy Rules***

In recent years, property valuation has also come into focus in the context of European capital adequacy rules. The current EU regime is contained in two directives: Directive 2006/48/EC on the "Taking up and pursuit of the business of credit institutions" and Directive 2006/49/EC on the "Capital adequacy of

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[1] See Annex I

investment firms and credit institutions", commonly referred to as Capital Requirements Directive (CRD). Both Directives are the European version of the Revised Framework for International Convergence of Capital Measurement and Capital Standards devised by the Basel Committee on Banking Supervision. They apply Basel II rules to all banks, credit institutions and investment firms in the EU, involving major repercussions on the way risk is assessed and how much capital banks will have to put aside to guard against these risks.

One of the main purposes of the Basel II rules was to make capital more risk sensitive, which means making better and more accurate judgements about the risks faced by institutions, resulting in a more efficient allocation of capital. This has a number of implications for property valuation for lending purposes due to a number of requirements relating to the issue across the different approaches (Standardised, Foundation and Advanced).

The most obvious change is that the capital requirement charge for a mortgage is based on a set of criteria some of which will take the loan to value (LTV) ratio into consideration. To achieve the lowest risk weighting for a mortgage of 35% the rules state that *'the value of the property exceeds by a substantial margin the claim'*. This LTV criterion is set according to national discretion but typically varies from between 60% to 80%, with higher risk weightings applying to riskier lending above this limit. This risk-based approach therefore places a much greater importance on accurate valuations. It is also important that property valuations are comparable across borders to ensure a level playing field between lenders of different countries. The use of loan-to-value limits for the treatment of covered bonds also puts increased emphasis on property valuations.

A second area which sees an increased focus on valuation is the publication of minimum standards for valuation in the Directive.

| **Collateral valuation principles** |
| --- |
| The property shall be valued at or less than the current market value under which it could be sold under private contract between a willing seller and an arm's length buyer on the date of valuation. The value of the collateral shall be based on the value of the property and the nature and extent of the pledge of the property taking into account the existence of prior claims.<br>The property shall be valued by an independent valuer at or less than the market value. In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value. |
| ***Annex VIII, Part 2, Paragraph 63, Capital Requirements Directive, European Commission*** |

The Directive also determines the frequency of the monitoring of valuations and who this should be done by:

| **Monitoring of property values** |
|---|
| The value of the property shall be monitored on a frequent basis and at a minimum once every year for commercial real estate and once every three years for residential real estate. More frequent monitoring shall be carried out where the market is subject to significant changes in conditions. Statistical methods may be used to monitor the value of the property and to identify property that needs revaluation. The property valuation shall be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices. For loans exceeding EUR 3 million or 5% of the own funds of the credit institution, the property valuation shall be reviewed by an independent valuer at least every three years. |
| ***Annex VIII, Part 2, Paragraph 8 Capital Requirements Directive, European Commission*** |

The risk based system introduced by the CRD is clearly a step forward on many fronts and aligns regulatory capital with a more risk sensitive approach to setting capital requirements. The mortgage industry has been supportive of the rules introduced by the CRD, which in our view reflect the particular risk nature of lending secured through real estate collateral.

The European Commission decided to undertake a first review of the rules in place in October 2008. The proposed changes requested banks to hold a higher amount of capital against the risk of failure, focusing on large exposures and securitisation. The proposal was agreed by the European Parliament in May 2009 and later by the Council. In parallel to this initiative, the Commission proposed a new round of reviews of the directives to take into account risks related to trade books, securitisation and remuneration policies within credit institutions, formally publishing its proposal in July 2009. The proposal will now have to be agreed by the Parliament and the Council. Such an unusual move has been justified by the Commission on the basis of the circumstances triggered by the financial and economic crisis as well as a result of the decisions taken at the G20 summit held on April 2009 in London.

A further round of proposals aimed at reviewing the existing CRD rules concerning the removal of commercial and residential-mortgage related national discretions as well as new capital requirements for foreign currency denominated loans, new rules on dynamic provisioning and a simplification of the Bank Branch Accounts Directive is expected for autumn 2009.

Given the ever increasing need for transparency in property valuations as outlined, the EMF's Valuation Committee took the decision to completely revise its Study on the Valuation of Property for Lending

Purposes, first published in 1998 and most recently in 2008, in terms of scope and structure with a view to providing a deeper understanding of the context and technicalities of valuation practices in the EU.

The result is a comprehensive commentary on the valuation practices in 16 Member States, focusing on the valuation itself (regulation/self-regulation, bases and methodology, valuation report, Automated Valuation Models (AVMs)), the valuer (regulation/self-regulation, qualifications, use of title, indemnity insurance), and valuation in the context of the Capital Requirements Directive (covered bonds and data standards). An Executive Summary brings together the key elements of the national chapters in a comparative form. Interestingly, the Study also includes a chapter devoted to Automated Valuation Models (AVM), including an article written by the UK Delegate to the Valuation Committee, Paul Trott, and the EMF's Guidelines on AVM Quality Criteria and for the Use of AVMs in the EU, and a chapter devoted to Independence of the Valuer, including a set of EMF Guidelines drafted by the Committee's Chairman, José Ramón Ormazabal, and the EMF's Note on the Independence of the Valuer.

# *Executive Summary*

## 1. The Valuation

### 1.1 Regulatory Framework

- A legal framework specific to property valuation exists in: CZ, DK, DE, ES, HU, PL
- No legal framework specific to property valuation exists in: BE, FR, GR, IRL, IT, LUX, NL, PT, SE, UK
    - In the absence of a specific legal framework, the sector is self-regulated in: FR, GR, IRL, IT, NL, SE, UK
    - In the absence of a specific legal framework, property valuation is covered by another legal framework in: IRL, IT, LUX, PT, SE
    - Property valuation is neither self-regulated, nor covered by another legal framework in: BE

### 1.2 Valuation Bases & Methodology

*Valuation Bases*

Approaches to valuation differ greatly in the EU Member States, based on different economic and market conditions, and banking and valuation practices.

- The key types of valuation in the EU are:
    - Market value: BE, CZ, DK, DE, FR, GR, HU, IRL, IT (but very cautious so close to MLV), LUX, NL, PL, PT, SE, UK
    - Mortgage Lending Value[2]: CZ, DE, FR (under certain circumstances), ES, PT

- These alternative approaches cover, to a greater or lesser extent, the main competing banking philosophies within the European Union.

*Valuation Methodology*

- Valuation methodology always reflects national, regional or even local market specificities and consequently varies throughout Europe, although there is a degree of convergence in valuation methods in Europe:

    - Residential Properties:

[2] See Annex III for full definition of Mortgage Lending Value

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- Comparison method: BE, CZ (most common), DK, DE, ES, GR, HU, IRL, IT, LUX, NL, PL, PT, SE, UK
- Investment/Income method: DK, DE, ES, GR, HU, IT, LUX, SE (cash flow)
- Depreciated replacement cost method: BE, DE, ES, GR, HU, LUX (most common), NL (rare), PL (rare), PT
- Residual method: ES, GR, PT (for undeveloped land and unfinished construction)

- Commercial Properties:
  - Comparison method: BE, DK (farms), GR, HU, IT, LUX, PL
  - Depreciated replacement cost method: DK (rare), GR, HU, LUX, PL (rare), UK
  - Investment/Income method: BE, CZ (most common), DK, DE, GR, HU, IT, LUX (most common), NL, PT, UK
  - Discount cash flow approach: PT (in some management properties)

**1.3 Valuation Report: Form and Content**

- Minimum requirements for the form and content of the valuation report are provided by the legal/professional framework in: DK, DE (MLV), ES, IRL, NL, PL, SE, UK
- There are no formal minimum requirements for the form and content of the valuation report in: BE, CZ (banks' own methodology), IT (banks' own methodology), LUX, PT (banks' own methodology)

**1.4 Use of AVMs**

- AVMs are currently used in DK, DE, ES, IRL, IT, NL, SE, UK to determine a property value for a variety of purposes according to the MS:
  - *Mortgage Origination:* DK, IRL, SE, UK
  - *Quality control tool in the mortgage origination process:* DK, ES, IRL, NL, SE, UK
  - *Underwriting of non-purchase mortgage loan products:* DK, IRL, SE, UK
  - *Monitoring and adjusting of values in the context of the CRD:* DK, DE, ES (likely in the future), IT, PT, SE, UK
  - *Securitisation:* IT, SE, UK
  - *Others:* NL & PT - for taxation purposes, UK – for auditing purposes.
- Guidance on the use of AVMs is provided by the legal/professional framework in: DK, DE, UK
- No (legal or professional) guidance is provided on the use of AVMs in: ES, SE
- AVMs are currently not used in: BE, CZ, GR, HU, IT, LUX, PL

**2. The Valuer**

### 2.1 Regulatory Framework

- A legal framework relative to property valuers for lending purposes exists in: CZ (partial), DE, ES & PL (general legislation on Real Estate Management)
- No legal framework relative to property valuers for lending purposes exists in: BE, DK, FR, GR, HU, IRL, IT, LUX, NL, PT, SE, UK
  - In the absence of a specific legal framework, the sector is self-regulated in: DK (valuers can be certified), FR, GR, HU, IRL, IT, NL, PL, SE, UK
  - There are no professional or legal requirements specific to property valuers in: BE, LUX

### 2.2 Education/qualifications

- Minimum requirements regarding valuers' qualifications are provided by the legal/professional framework in: CZ, DE, ES, FR, GR, IRL, IT, NL, PL, SE, UK
- There are no minimum requirements regarding valuers' qualifications for lending purposes in: BE, DK, HU, LUX, PT

### 2.3 Use of Valuer Title

- The use of the title of valuer (or equivalent) is protected by the legal/professional framework in: DK, ES, GR, NL, PL, SE, UK
- The use of the title of valuer (or equivalent) is not protected in: BE, CZ, DE, FR, HU, IRL, IT, LUX, PT

### 2.4 External v. Internal Valuer

- Legislation/rules governing banks and lenders as to whom they may use to value properties are provided by the legal/professional framework in: DK (internal and external), DE, ES (internal & external), LUX (internal & external), PL (internal & external), SE (internal (particularly big banks) & external), UK (internal & external)
- In the absence of legal or professional requirements, lenders in the following MS, use external and internal valuers as follows: BE (internal & external), FR (predominantly external), GR (internal & external) & HU (external valuations controlled by internal valuers), IRL (internal & external), IT (internal & external), NL (internal & external), PT (predominantly external)
- The choice to use internal as opposed to external valuers will depend on various criteria, ranging from legal constraints to the importance the bank attaches to ensuring the quality of its valuations.

**2.5 Professional Indemnity Insurance**

- Legislation/rules requiring valuers to have professional indemnity insurance are provided by the legal/professional framework in: CZ, ES, FR, IRL, PL, PT (for securities valuations), SE (authorised valuers need indemnity insurance), UK
- Legislation/rules requiring lenders to use only valuers covered by professional indemnity insurance are provided by the legal/professional framework in: CZ, ES, NL, PL
- Legislation defining the responsibility of the valuer vis-à-vis his clients exists in: DK (Tort Law), DE (General legislation applicable to work and labour contracts), ES (specific legislation), PL (specific legislation)
- In the absence of legal or professional requirements:
    - In DE, in practice, valuation applications are only accepted when the valuer can prove insurance covering the expected value of the property
    - In IT, such Policies are required neither by regulation nor by professional bodies. Some valuers indeed do have professional indemnity insurance cover but such Policies make almost no difference to the lender.
    - In LUX, there is no legal or professional framework specific to valuers. However, property valuations may be carried out by members of professions, which are regulated by law and who are obliged to have PII.
    - In PT, there is no legal obligation for valuers to have professional indemnity insurance cover for mortgage valuations.

**3. Capital Requirements Directive & Property Valuation**

***Covered Bonds***

- Legislation on real estate backed covered bonds exists or is planned in: CZ, DK, DE, ES, FR, IRL, IT, LUX, PL, PT, SE, UK
    - Maximum eligible LTVs for residential and commercial real estate are:
        - CZ: 70% (both) of the MLV of the property
        - DK: 80% (residential) & 70% (commercial)
        - DE: 60% (both) of the MLV of the property
        - ES: Between 80 and 95% (residential)
        - FR: 80% (residential) and 60% (commercial)
        - HU: 70% (residential) and 60% commercial)
        - IRL: 75% (residential) and 60% (commercial)
        - IT: 80% (residential) and 60% (commercial)

        - LUX: No maximum LTVs
        - NL: 125% (residential)
        - PT: (residential) and 60% (commercial)
        - SE: 75% (residential) and 60% (commercial)
        - UK: 80% (residential)
    - Interpretation by regulator of the "frequent monitoring.." provision:
        - Yes: DE, ES, PT, SE, UK
        - No: CZ, DK, IRL, IT, LUX
    - Interpretation by regulator of the "individual revaluation.." provision:
        - Yes: DK, DE (but not as a result of CRD), ES, IRL, SE, UK
        - No: CZ, LUX, IT, PT
    - Insurance requirements:
        - Yes: DK, DE, ES, PT, UK
        - No: CZ, IRL, IT LUX, SE
    - Interpretation by regulator of "independent valuer" provision:
        - Yes: DE, ES, PT, SE, UK
        - No: CZ, DK, IRL, IT, LUX
    - Issuance of guidelines by regulator on "market value" and "mortgage lending value":
        - Yes: DK, DE, ES, LUX (for the MLV), PT, SE
        - No: IRL, IT, UK

***Data Standards***

- Interpretation of the provision regarding "monitoring using statistical methods" in the minimum requirements for valuation in subpara. 8b:
    - Yes: DE (statistical methods may be used), ES (statistical methods may be used), PL (statistical methods may be used), PT, SE, UK (statistical methods may be used)
    - No: CZ, DK, DE, IRL, IT, LUX, SE,

- Data requirements specifically relating to property valuation
    - Yes: SE
    - No: DK, DE, ES, IRL, IT, LUX, NL, PL, PT, UK

***Country Chapters***

# *Belgium*

### *1. Macroeconomic Overview*

In 2008, economic growth was weaker than in 2007, but yearly GDP growth was still positive (1.1%). However, this figure reflects a steady deterioration during the year and an outright collapse of economic activity in the fourth quarter.

In Belgium, the macroeconomic slowdown caused the government to abandon public debt reduction targets. Public deficit rose from 0.3% of GDP (in 2007) to 1.1% of GDP, partly as a result of the slowdown in activity, so that Belgium's stability programme target was not achieved.

Belgian Debt to GDP ratio had been in continual decline since reaching a peak in 1993 (133%) In 2008 the trend was reversed when Debt to GDP increased once again from 84% in 2007 to almost 90% in 2008.

A drop in domestic demand lowered both final consumption (0.8%, against a 2.0% increase recorded in the previous year) and investment in construction of new houses and renovation of existing houses (1.0%. against 1.3% in 2007).

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

In 2008, the cost of a dwelling amounted to an average value of 172,509 Euros. Having reached an average annual growth rate of almost 10% from 2004 to 2006, the average growth rate in average house prices gradually slowed in 2007 and 2008. In contrast to the abrupt correction seen in some EU countries, the deceleration in the growth in price increases was quite moderate: in the first half of 2008, average house prices continued to rise by more than 5.0% on a year-on-year basis, but at the end of 2008 growth slowed down to 3.0% on a year-on-year basis. Over the last quarter, growth in house prices turned out to be slightly negative.

As at end of 2008, residential mortgage lending outstanding amounted to approximately 137 billion Euros (against 126 billion Euros as at end of 2007). During 2008, the total amount of new mortgages granted (refinancing operations excluded) decreased by 2.2% compared to what was recorded in 2007 (following a 3.9% year-on-year decrease in 2007). The number of mortgage loans granted, however, slightly increased (0.4%) as compared to 2007 where a 5.5% drop was recorded over the previous year.

The level of new credit granted (refinancing operations excluded) during the first half of the year 2008 was slightly above the 2007 level (2.5%). It should be recalled, however, that the first two quarters of 2007 were very weak compared to the same quarters in 2006. The results of the second half of the year 2008 recorded a sharp decrease (-6,7%) compared to the 2$^{nd}$ half of 2007, mainly due to much weaker activity in the 4$^{th}$ quarter.

In 2008, «loans for house purchases» represented 46,3% (-0.3% in comparison with 2007) of the number of contracts signed in 2008, which corresponded to 58.7% (1.2%) of the amounts granted. The market share of construction loans out of the total number of contracts stood at 13.4% (-1.0% on 2007) and at 15.9% as a proportion of loans granted (-0.8% on 2007). The market share of renovations, instead, grew considerably and represented 23.8% of the number of contracts (+3.7% on the previous year). The average amount of mortgage loans for renovation purposes dropped by nearly 3.0% and amounted to 34.500 Euros.

### *3. The Valuation*

#### 3.1 Regulatory Framework

There is no legal framework specific to the valuation of property; neither is there a general certification body.

#### 3.2 Valuation Bases & Methodology

In Belgium, generally the market value is used for valuation for mortgage lending purposes.

Three main valuation methods are used: Cost, yield and comparative. For residential properties, the cost and comparative methods are mainly used, while for other types of real estate the yield and comparative methods are normally preferred. A fourth method, the prudent market valuation is also used by some credit institutions.

#### 3.3 Valuation Report: Form & Content

There is no standard valuation report in Belgium. As such, the expected content of the valuation report might best be described in a mission statement or in the conditions of engagement between the bank and the valuer.

#### 3.4 Use of AVMs

AVMs are currently not used in Belgium.

## *4. The Valuer*

### 4.1 Regulatory Framework

There is no legal framework and as indicated above, there is also no general certification body. Valuers holding the titles "valuer", "expert" and "real estate expert" will normally follow the codes of their federation.

### 4.2 Education/qualifications

Educational requirements for valuers are changing rapidly in Belgium. Only recently (1995/1996) post-graduate courses on real estate management have been introduced at some universities (Leuven – KUL and Antwerp – UFSIA).

Most valuers have a degree in land-surveying (in Belgium valuers of real-estate by tradition), architecture, engineering, economy, law, or brokering and have become valuers by practice.

### 4.3 Use of valuer title

The titles "valuer", "expert", and "real-estate expert" are not protected in Belgium.

### 4.4 External v. Internal

Most credit institutions work with external valuers (from various origins and qualifications) although they also have a few internal experts on their pay-roll either to audit those valuations or to carry out valuations themselves.

Valuations of residential real estate are mostly performed by smaller (often 1-person) firms, while commercial real estate valuations are mainly carried out by larger companies (the major real estate agents, consultants, auditors, etc.) who have specialised knowledge in their fields.

### 4.5 Professional Indemnity Insurance

Information not available.

## *5. Capital Requirements & Property Valuation*

Information not available.

## *Czech Republic*

### ***1. Macroeconomic Overview***

In 2008, the Czech economy experienced a slowdown in its annual growth rate (3.2%), which almost halved in comparison with 2007 (6.0%), but remained by far above the EU27 average (0.9%). The second half of the year saw a major slowdown which was the result of the initial phase of the global financial crisis. Gross fixed capital formation in equipment provided the strongest contribution to GDP growth (10.5%).

National GDP data reflected the general deterioration of the international macroeconomic environment, which resulted in a pronounced slowdown in exports (6.9% in 2008, after much more buoyant growth rates in the previous years), mainly to Germany, while the year-on-year increase in households` private consumption (2.9%) was also weaker than in 2007 (5.3%). These developments led to a wider current account deficit in 2008 (3.1% of GDP) than in 2007 (1.5% of GDP). Government budget balance as a percentage of GDP was also slightly more negative (1.5%) than in 2007 (0.6%). The slowdown in the economy did not affect labour market data, which proved to be still very positive, whereas the unemployment rate decreased from 5.3% in 2007 to 4.4% in 2008, which was the historical low since 1998.

### ***2. Property Market Overview***

#### ***2.1 Residential Property Market Overview***

Residential construction in the Czech Republic was flat in 2008, coming at the end of a long positive housing cycle of which the year 2007 had represented a peak. Permits for residential buildings were stabilised (-0.2% on 2007), and housing starts decreased by a mere 0.6% on the previous year but they remained at very high levels. A heavier year-on-year fall was recorded in housing completions (by 7.8%), but when put in its historical context, this data reveals that housing activity was still buoyant in 2008. As far as the housing demand side is concerned, no average national data on house prices is available.

At the end of 2008 there were a total of 17 banking institutions operating in the Czech mortgage market. The four largest institutions represented 89% of the market. Volumes of gross residential lending dropped by 18% (in CZK) in 2008 compared with 2007 volumes, but despite this 2008 was the second best year in terms of the volume of mortgages provided.

Outstanding residential mortgage lending recorded another favourable performance in 2008 and increased by 27.9%% on 2007, reaching 16,014 million Euros, which was equal to 10.8% of Czech GDP, so that in

2008 the ratio of outstanding mortgage lending to GDP was above 10.0% for the first time on record. The year-on-year growth rate in outstanding mortgage lending was much lower than what recorded in 2007 (55.4%), but largely outpaced annual growth rates recorded in all EU15 mature mortgage markets.

### *2.2 Commercial Property Market Overview*

In 2007, the total number of outstanding commercial mortgage loans amounted to 52,400 CZK. The volume of outstanding commercial mortgage loans corresponded to 1.5% of Czech GDP.

## *3. The Valuation*

### 3.1 Regulatory Framework

The valuation of real estate is regulated by law in the Czech Republic. Specifically, the valuation of the real estate security is covered under Act no 190/2004 Coll., on debentures.

### 3.2 Valuation Bases

The typical valuation base for both residential and commercial properties is the market value. The Mortgage Lending Value can also be determined..

The definitions of the valuation bases are those published by TEGoVA and the IVSC.

The administration Value is also used in the Czech Republic for tax purposes.

### 3.3 Valuation Methodology

Valuers use the comparison, capitalisation and cost methods. However, the comparison method is most commonly used for residential property, while the capitalisation method is most often used for commercial property.

### 3.4 Valuation Report: Form & Content

There is no obligatory comprehensive legal framework for valuation reports in the Czech Republic. Banks use their own methodology, but the form and content of the valuation report is similar – structured information, most often in electronic form.
The recommended form and content of a valuation report has also been published by the Czech Bank Association.

### 3.5 Use of AVMs

AVMs are currently not used in the Czech Republic.

## *4. The Valuer*

### 4.1 Regulatory Framework

There is only a partial legal framework relative to valuers based on the Trades Licensing Act (Živnostenský zákon) in the Czech Republic – this Act determines minimum requirements regarding valuers' qualifications, evidence of valuations, classified information and indemnity insurance.

Each bank can choose its own valuers and also trains them. There are some courses and certification institutions (4 institutions) in the Czech Republic.

### 4.2 Education/qualifications

The Trades Licensing Act lays down requirements relating to specific education and experience (number of years depends on the type of education).

In addition to this, banks require specific education (e.g. special training by the Banking Institute) and/or membership of a special certifying company. Banks also provide special training on rules of valuation and/or banking methodology for cooperating valuers. The banks also check regularly the quality of the valuations.

### 4.3 Use of valuer title

The title valuer, "odhadce", is not protected by law in the Czech Republic.

Lenders protect themselves against the risk of 'unqualified' valuers, by only cooperating with certificated appraisers and regularly verifying their valuations.

### 4.4 External v. Internal

Banks use their own methodology and employ both internal and external valuers. The choice depends of external v. internal valuer depends on each individual bank.

As far as legislation/rules that valuers have to comply with in order to guarantee that the valuations are unbiased and are not subject to undue pressure are concerned, valuers should act independently and comply with the rules on valuation which were agreed in contract between bank and valuer. The lender has the final responsibility to properly assess the value of the real estate and for this reason lenders carry out checks on the quality of valuations from external valuers. In the event of a valuation of poor quality, the lender may terminate the contract with the valuer. Contracts also contain provisions on liability for damages caused by poor quality valuations.

### 4.5 Professional Indemnity Insurance

Valuers are required to have professional indemnity insurance according to the Trades Licensing Act. As a result of this legislation, lenders are required to use only valuers with professional indemnity insurance.

## *5. Capital Requirements & Property Valuation*

***Covered Bonds:***

There is legislation in the Czech Republic on real estate backed covered bonds (Act no 190/2004 Coll., on Debentures and the Czech National Bank Regulation no 5/2004 Coll, on Minimum Contents and Guidance Rules of the Cover Registrar), and in the context of the CRD, the national regulator has made the following interpretations:

- *Maximum eligible asset LTV ratios for different types of residential and commercial real estate:*

The maximum for both types of real estate is 70% of the MLV of the property.

- *Monitoring:*

Under the CNB Regulation no. 5/2004 Coll, the Cover Registrar must be continuously up-dated including LTVs.

- *Revaluation:*

The Act on Debentures stipulates basic rules on valuation. The bank is responsible for the assessment of the final value of the real estate based on Act on no. 151/1997 Coll., on valuation taking into consideration: a) long-term sustainable features of the real estate, b) revenues attainable by a third person upon due management of the real estate, c) rights and charges on real estate and d) local conditions of the local real estate market including forecast of the future development. The Mortgage Lending Value may not exceed the market value of the real estate being assessed.

- *Insurance:*

No, but the standard Policy of Czech mortgage banks is that real estate which serves as security for a mortgage loan shall be insured against damage. Another standard is that the client pledges the receivables from real estate insurance as a security for the mortgage loan.

- *Independence of the Valuer:*

No, at the moment there is no specific interpretation regarding independent valuer.

- *Market Value & Mortgage Lending Value:*

*Market value (common price) - Common price (cena obvyklá) pursuant to § 2 of Act No. 151/1997 Coll., On Property Assessment*

For the purposes of this Act, a common price is understood to be a price that would be attained upon the sale of the same or similar property or upon the provision of the same or similar service in domestic common business contacts as of the day of the Assessment. In that, all circumstances influencing the price are considered; but influences of exceptional circumstances of the market, personal relationships of the seller or of the purchaser or the influence of special popularity are not reflected in its amount. Extraordinary circumstances are deemed to be e.g. condition of distress of the seller or purchaser, or consequences of natural or other calamities. Personal relationships are understood to be, in particular, property relationships, relationships in the family or other personal relationships between the seller and purchaser. A special popularity is understood to be a special value attached to the property or service following from the personal relationships to it.

*Mortgage lending value*

The mortgage lending value represents a common price pursuant to the Act on the Property Assessment, while taking into consideration the following:

a) long-term sustainable features of the real estate;
b) Revenues attainable by a third person upon due management of the real estate;
c) Rights and charges on real estate;
d) Local conditions of the market with the real estate, including its influences and expected development.

The mortgage lending value may not exceed a usual price or market value of the real estate being assessed.

***Data Requirements***

As far as interpretations by the regulator of the provision regarding “monitoring using statistical methods” in the minimum requirements for valuation are concerned, the Czech National Bank publishes public information and regulations. Currently, no obligatory methods or models exist in the Czech Republic.

In terms of data requirements specifically relating to property valuation, the quality of the valuation is guaranteed by the lender, which is responsible for the quality of the valuation. Lenders also monitor fluctuations of prices and trends in the real estate market.

## Denmark

### 1. Macroeconomic Overview

Danish real GDP contracted by 1.1% from 2007 to 2008, marking the toughest period in the Danish economy since the oil crises in the 1970s. The abrupt tumble came after several years of expansion which boosted asset values and brought production capacity to its limit. Denmark is a small open economy and economic growth in 2008 has been highly influenced by the unfolding meltdown in global credit markets, which spilled into the real economy. Parts of the real economy, however, have shown some resilience to the crisis in credit and asset markets. The Danish labour market remained strong. The number of unemployed as a share of the labour force decreased by 0.5% on average in 2008 (3.3% against 3.8% in 2007).

Given that the Danish currency is pegged to the Euro (ERM 2), the Danish National Bank's interest rate and hence the Danish money market rates fluctuate with European rates. The Danish Krone came under pressure in the fall of 2008 and the spread to ECB rates widened. Despite several years of increased pressure on production capacity, consolidated Danish consumer prices have only risen moderately in past years. In 2008, the Danish final consumption deflator rose somewhat faster by a rate of 3.1% over the year while the Harmonised Index of Consumer Prices, HICP, rose by 3.6%, thereby accelerating in comparison with the 2.3% rate recorded in 2007.

### 2. Property Market Overview

#### 2.1 Residential Property Market Overview

Danish home owners were not spared the housing shocks of 2008. Average prices on single family homes decreased by 5.1% on the previous year. Falling house prices have yet to become a problem at the aggregate level, but first-time buyers that have acquired a home since early 2007 are in danger of technical insolvency. Danish mortgage institutions are bound by law to Loan-to-Value ratios not exceeding 80%. First time buyers however rarely bring a down payment exceeding 10%, financing the remainder through banks or in the unregulated secondary mortgage market.

Home owners, in the meanwhile, had to deal with more problems on the housing market side. During 2008, the number of transactions dropped rapidly, leaving some home owners stuck with a new house and an old house that they could not sell. The fourth quarter saw the lowest number of transactions for the past several years. The gridlock in the housing market has been somewhat self reinforcing. Potential buyers have been reluctant to close a deal before having secured the sale of their existing home. Hence, economists have increasingly looked toward first time buyers for the tie breaker. Looking at the

Copenhagen market, the housing costs as a share of first time buyers' disposable income had climbed to a staggering 68% by the summer of 2006. By the end of 2008 this ratio had come down to 58%. The fall could partly be explained by the falling house prices, partly by decreasing interest rates and energy prices.

While the owner occupied ratio in Denmark remains relatively constant at approximately 54%, the receding demand on the housing market led to an increasing number of homes put up for sale in 2008. The negative effects have spilled over into the construction industry. The number of housing starts was down by 27%, housing completions were down by 30% and building permits were down by 25% compared with 2007. On top of dealing with a nearly frozen housing market, home owners refinancing initial fixed mortgages in December 2008 had to accept a premium due to the currency pressure and international investors partly withdrawing from the Danish market. It could be argued that Danish home owners had to pick up part of the tab for Denmark opting to remain outside the Euro.

Despite the pressure on the national currency, Danish mortgage banks have kept their access to funding throughout the year. The ready access to financing has held a hand under the housing market and home owners have enjoyed flexibility to manage mortgage debt according to their personal appetite for risk.

Gross residential lending as well as net residential lending decreased on the previous year by 14.7% and 27.2% respectively. At year - end 2008 outstanding residential loans had reached 222 Billion Euros. The outstanding residential loans reached 95.3% of GDP, 3 percentage points above the level recorded in 2007.

## *3. The Valuation*

### 3.1 Regulatory Framework

The Danish provisions concerning valuation for mortgage lending are laid down in Chapter 2 of the Mortgage Credit Act and in the executive order concerning Mortgage Banks' Valuation. The Danish Mortgage Credit Act states that the Danish Financial Supervisory Authority should ensure that the mortgage banks respect the Act's provisions and rules, which have been made in pursuance of the Act. This includes the Act's rules on valuation and the Regulation on Mortgage Bank's Valuation.

Danish mortgage banks have modernised the valuation of property and the lending process, including the replacement of manual routines, the collection and electronic treatment of property data and the use of statistical information on loss and risk indicators. Irrespective of these steps and the detailed information made available, the properties to be valued must normally be inspected both externally and internally, and for loan offers the valuation by inspection must be less than 6 months old.

### 3.2 Valuation Bases

The market value is the basis for mortgage valuations, taking into consideration the general economic situation and the general trend in prices.

### 3.3 Valuation Methodology

The comparison method is used for private residential properties. According to the regulation for the valuation of most types of commercial properties (with the exception of agricultural properties, which are valued using the comparison method), the investment value is used for mortgage lending purposes. The investment value is derived from capitalisation of the net rentals. The basis for the calculation is primarily the actual rent or the market rent, depending which is lowest, calculated on an annual basis.

The depreciated replacement cost method is used for industrial, manufacturing properties and properties for educational, social and cultural purposes. However, for loans funded by covered bonds the cost method can only be used for properties that are never or rarely sold in the market, and according to the Danish FSA guidelines this method can only be used for very limited types of properties (waterworks, power plants etc.)

### 3.4 Valuation Report: Form & Content

Each mortgage bank has its own report and differences are mainly stylistic, as the reports must meet regulatory requirements.

### 3.5 Use of AVMs

In 2005, the Danish FSA authorised a mortgage bank to carry out automatic valuations in a number of situations. Recently other mortgage banks have got approval. The precise basis of the mortgage banks application and the given authorisation has not been published. The precise terms of the Danish FSA's authorisation have not been published either. In the application, the mortgage banks in question has put forward a number of calculation models and models for collecting data on property values on the market.

## *4. The Valuer*

### 4.1 Regulatory Framework

Valuers can be certified, but this is not a statutory requirement for valuation for lending purposes.

### 4.2 Education/qualifications

The executive order on valuations for mortgage lending with covered bond funding stipulates that the valuation must be done by a valuer who has the necessary qualifications, ability and experience. There is no requirement of formal qualifications

### 4.3 Use of valuer title

"Real estate agent" is a protected title and individuals wishing to work as real estate agents must fulfil certain legal requirements.

### 4.4 External v. Internal

Valuers may be either internal (employed in a mortgage bank) or external to the lending institution. However, there is a long tradition in Denmark that the individuals carrying out property valuations in connection with mortgage lending work for the lending mortgage bank. The mortgage banks consider that valuation is an integral part of the lending process, for which the management of the mortgage bank is responsible.

External valuers are mostly real estate agents. External valuers must comply with a number of conditions.

### 4.5 Professional Indemnity Insurance

Many of the individuals carrying out valuations for the mortgage banks are employed in the mortgage bank. They do not have insurance covering mistakes in valuations. Such mistakes are the risk of the mortgage banks as employer.

A considerable number of the valuations for lending purposes are carried out by non-employees. The legislation draws up a number of criteria for non-employees to carry out valuations for mortgage banks. The requirements are as follows:

- The mortgage bank must provide detailed valuation instructions.
- Disregard of these instructions will be sanctioned through the immediate discontinuation of the cooperation between the mortgage bank and the person making the valuation.
- The payment must not depend on the fixed lending values.

- The mortgage banks must carry out representative spot checks of the valuation carried out on a regular basis. In practice, a spot check is made in about 5% of cases. If the mortgage banks' lending value differs from the non-employee's valuation, the loan being offered should in general be adjusted.

The above implies that questions are very seldomnly raised regarding indemnity between the mortgage bank and the non-employed valuer.

In practice, estate agents typically carry out valuations for mortgage banks. However, other individuals may also provide this service. These "external" valuers are under no obligation to have insurance covering the risk of mistakes made in connection with the valuation task. In the agreement between the mortgage bank and the valuer, insurance may be requested but it is not usual practice. Estate agents are legally obliged to have indemnity insurance in relation to their purchasing and selling activities. The insurance does, however, only cover estate agent valuations ordered directly by the consumer, and not valuations ordered by professionals including mortgage banks.

There is no legislation which determines exactly what the valuer is responsible for vis-à-vis his client. However, the valuer can be liable according to general Tort Law and based on the contract between the lender and the valuer regarding the valuation. There is however a special regulation regarding estate agents' liability.

## *5. Capital Requirements & Property Valuation:*

### *Covered Bonds:*

New covered bond legislation was introduced in Denmark on 1 July 2007. Until this time, Denmark had a specialist bank principle, according to which only mortgage banks could issue covered bonds. However, as a consequence of the new legislation, all credit institutions may issue covered bonds. Grandfathered bonds could be issued under the old legislation until the end of 2007. This new legislation has made Danish covered bonds CRD compliant and will mean that certain ways of valuing must be changed. The law sets LTV ratios for eligible residential and commercial mortgage assets. The LTV limit for residential assets is 80% of the market value of the property; the LTV limit for commercial assets is 70%, but for LTVs over 60% only against extra collateral.

- *Monitoring:*

The Danish FSA has not published any interpretations regarding the provision in the CRD regarding "more frequent monitoring where the market is subject to significant changes". When applying for FSA authorisation to issue covered bonds, the mortgage banks must however convince the FSA that the intended procedures are sufficient.

As far as the provision regarding individual revaluation is concerned, if the ordinary or extraordinary monitoring of the property value shows that the LTV exceeds or might exceed the maximum LTV, the property must be inspected both externally and internally and the valuation must be monitored on the basis of up-to-date data. The Danish FSA has not published any provisions regarding desk top monitoring of LTVs. When applying for approval, the mortgage banks must convince the FSA that the banks procedures for statistical identification of properties for individual and for desk top monitoring are satisfactory.

- *Insurance*

Only insurance against fire and flood is required by legislation. If at the loan approval stage, the mortgage lender makes sure that there is adequate fire insurance, the property will remain insured against fire and flood, while the lenders will have to monitor/check if the property is still insured against storm damage.

The Danish FSA has not published any interpretations regarding the provision relevant to "procedures to monitor that the property taken as protection is adequately insured against damage”. When applying for approval the mortgage banks must convince the FSA that the banks procedures monitoring insurance are sufficient.

- *Independence of the Valuer*

The Danish FSA has not issued any guidelines on the provision regarding the “independent valuer”.

- *Market Value & Mortgage Lending Value*

The Danish FSA has issued a comprehensive executive order on the “market value” and the “mortgage lending value”. There are detailed provisions for the comparison and capitalisation methods.

***Data Standards:***

The Danish FSA has not published any interpretations regarding monitoring using statistical methods. When applying for FSA authorisation to issue covered bonds and during RFSA inspections, the mortgage banks must convince the FSA that the procedures and methods for monitoring are satisfactory, i.e. documents that show that there is an acceptable difference between model values and actual sales prices.

## *Germany*

***1. Macroeconomic Overview***

In the first half of the year 2008 the economy continued to grow as in the year before. From the second half of 2008 onwards, Germany, too, felt the impact of the worldwide economic downswing. The demand for capital goods, which make up a large portion of German exports, receded. Whereas the Gross Domestic Product developed favourably in 2006 and 2007, rising in real terms by 3.0% and 2.5% respectively, overall economic growth in 2008 was considerably less strong (+1.3%).

As in the years before, private consumption remained almost unchanged in 2008. Due to the economic upturn in the first half of the year, the number of unemployed persons declined from 8.4% (2007) to 7.3 % (2008). Inflation increased from 2.3% (2007) to 2.8% (2008).

***2. Property Market Overview***

2.1 Residential Property Market Overview

In 2008, investments in residential construction increased slightly (0.8%). In recent years investments in housing were affected by several special effects, for example households' ambitions to beat tax deadlines. Especially in 2006 demand has been brought forward to a large extent, because the VAT increased from 16% to 19% effective from January 1, 2007. Many home owners and private landlords brought modernization investment forward to 2006 in order to avoid the higher VAT rate. Thus, the demand that had been brought forward was missing in the year 2007 and to some extent also in 2008. Building permits declined by 4.2% to 175,000 units. The number of transactions is relatively stable since several years. In 2008 the number of transactions decreased slightly by 2% to 446,000.

In 2009, the residential property market continued its slight downward trend, coupled with a further slight decrease of new build residential units. However, this market development did not have an impact on property prices. Beyond 2009, increasing unemployment rates and reduced labour hours will probably confirm the downward trend of the German residential property market.

House prices in Germany developed differently from house prices in most other European countries. Most of existing data sources report only slight changes in house prices for a long period. With regard to measuring the pure price development, quality-adjusted price indices over the period 2003 to 2008 for single family houses and apartments were generated by vdp[3]. Over this period both indices show on the whole a positive development, albeit with declines in individual years. The average annual price increase for single family houses (2,3% p.a.) is slightly higher than for apartments (1.5% p.a.). In 2005 in particular, a strong rise in prices for both property types of approx. 5% compared with the previous year could be noticed. This corresponds with a surge in demand towards the end of the year. Many private households brought forward the purchase of a single-family house or owner-occupied apartment to the year 2005 because the government-allowance for homebuyers would be abolished for purchases from January 1, 2006 onwards. This entitled them to claim the allowance and led to a pronounced price increase. Following this jump, prices – with slight fluctuations around the zero line – again reverted to a more subdued development. In 2008, the prices for single family houses rose by 5%, reflecting the recent rising of construction costs.

At the end of 2008 mortgage rates in Germany were slightly lower than at the end of the previous year. Given an almost unchanged demand for house purchases and modernisation and renovation, gross residential lending remained on the same level as in the previous year. Since repayments of existing loans exceed new lending business, the volume of outstanding residential loans decreased slightly. In 2008 outstanding loans amounted to € 1,148 billion (-0.7%).

### *2.2 Commercial Property Market Overview*

The upward trend in investments in construction since 2006 was continued in 2008, although the development in this sector too was more restrained in the second half-year. Including all credit institutions operating in Germany, Deutsche Bundesbank reports for the year 2008 total domestic lendings for commercial properties of € 250,3 billion. Pfandbrief Banks are the most important providers of commercial property loans. The vdp member banks took a market share of 61% in 2008.

Since end of 2008 and throughout 2009, the German commercial property market entered into a downward cycle as a result of the financial crisis. While the German commercial property market is less dependent from macro-economic cycles compared to other European Union Member States, vacancy rates increased and property prices came under pressure. As insolvency rates of companies and users will continue to increase in 2010, the commercial property market is more affected by the crisis as the residential market. Further vacancies and declining rents are expected, primarily in the storage,

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[3] For the Pfandbrief banks that make up the Association of German Pfandbrief Banks (vdp), gauging house price movements within the scope of the implementation of Basel II has become a major topic. Together with its member banks, the vdp set up a project to generate property price indices for several regional and sectoral markets. Rents and purchase prices for individual properties as well as their value-influencing factors are systematically collected in the vdp transaction database. On the basis of these data, hedonic methods are applied to make detailed evaluations of the development of property prices.

manufacturing and large-scale retail premises segments. 2010 will still be characterised by difficult market conditions, reflecting the fact that property markets react much later to an economic recovery than other commercial sectors.

## 3. Valuation

### 3.1 Regulatory Framework

The German regulatory framework for property valuations consists of acts, directives and guidelines focusing on residential and commercial properties. Rules for the determination of the market value are laid down in the property valuation directive (Wertermittlungsverordnung (WertV)) and its amendments that became effective in 1988 / 1997. It bases on the regulations of the German federal building code (Baugesetzbuch (BauGB)) that regulates property valuation in Art. 192 – 199. Besides the definition of the market value (Art. 194), the code refers in Art. 199 to the property valuation directive that regulates the application of identical principles and approaches for the determination of market values and the derivation of necessary valuation data. Currently an amendment of the property valuation directive (its new title will be Immobilienwertermittlungsverordnung (ImmoWertV)) is in preparation.

The property valuation directive is supplemented by the property valuation guidelines (Wertermittlungsrichtlinien (WertR)); a substantially revised version was published in 2006.

In Germany, rules on the valuation of property for lending purposes are laid down in Article 16 of the Pfandbrief Act (PfandBG), which replaced the Mortgage Bank Act on 19 July 2005.

The Pfandbrief Act provides directives to stipulate in greater detail demands made on the Pfandbrief banks. One of these is the directive on the determination of the mortgage lending value of properties pursuant Art. 16 of the Pfandbrief Act.

### 3.2 Valuation Bases

In Germany, the following two valuation bases are typically used for the valuation of property for lending purposes:

- *Market Value (Verkehrswert)*

Art. 194 of the German Federal Building Code defines the Verkehrswert (Market Value) as the price, which would be achieved in an ordinary transaction at the time when the assessment is made, taking into account the existing legal circumstances and the actual characteristics, general condition and location of the property or other object of assessment, without consideration being given to any extraordinary or personal circumstances.

- *Mortgage Lending Value*

Art. 16 of the Pfandbrief Act provides a definition of the mortgage lending value and authorises the Federal Ministry of Finance in cooperation with the Federal Ministry of Justice, to issue secondary legislation providing details of the valuation methodology and the form of the assessment of the mortgage lending value as well as minimum requirements regarding qualification and independence the valuer has to meet. This regulation (Beleihungswertermittlungsverordnung (BelWertV)) was published during the first half of 2006.

The mortgage lending value is an independent value and is conceived as a safe top limit for long-term mortgage credits. Since it is only based on the sustainable aspects of the property, its careful calculation is in line with the safety requirements of mortgage bonds (Pfandbriefe), thus protecting the mortgage bondholders against defaults and market volatilities. In addition, a definition of the market value is also provided.

Article 16 of the Pfandbrief Act stipulates the main requirements for the assessment of the mortgage lending value. It explicitly states, for example, that the mortgage lending value may not exceed the market value, that the valuation has to be carried out by an independent and approved valuer and that speculative elements may not be taken into account. The definition reads as follows:

*"The mortgage lending value must not exceed the value resulting from a prudent valuation of the future saleability of a property and taking into consideration the long-term, permanent features of the property, the normal regional market situation as well as the present and possible alternative uses."*

- ***Other valuation bases***

***Insurance value (Versicherungswert):***

The insurance value is regulated in the German Insurance Contract Act (Versicherungsvertragsgesetz (VVG)). The value is determined according to the scope of indemnity of the insurance, e.g. replacement value or depreciated costs.

***Value for taxation (gemeiner Wert/ Einheitswert):***

The assessment of value for taxation purposes is laid down in the German Tax Valuation Act (Bewertungsgesetz (BewG)). The definition is similar to the market value, there are some variations concerning date of valuation and methodology. A revised regulation has been elaborated in 2008 and has to be applied to valuation dates after 31 December 2008.

**3.3 Valuation Methodology**

For market value purposes the following approaches are applied:

- *Comparative Method:* To be applied to value land and units where there are comparable properties such as freehold apartments, single-family houses, town houses etc.
- *Depreciated Reconstruction Cost Method:* Total of land value and construction value, taking into consideration depreciation and outstanding repairs, used to value single-family houses that are difficult to compare or other buildings that are specialised. The calculated value has to be adjusted to the market situation.
- *Income Method:* Capitalisation of the net income of the property. The net income is reduced by the proportionate land value, the remaining value being assigned to the building. The capitalisation rate is reflected by the interest rate derived from actual sales of comparable properties and applies to the present land value as well as to the building. The land value is capitalised indefinitely, the building value over the remaining economic life of the property.
- *Other non-regulatory methods, like Discounted Cash Flow approach and residual method:* To be applied to special purpose valuations (i.e. management properties or undeveloped land).

For mortgage lending value purposes the following approaches are applied:

Comparative, depreciated reconstruction value and income methods also apply to the assessment of the mortgage lending value.

- *Sustainable net rental income:* The income stream of the property is limited to its sustainable net rental income, excluding any over-renting and additional extraordinary cash flows.
- *Discount of property management and administration costs:* Property administration and management costs to be paid by the owner reduce the net rental income. There is a minimum rate for these costs that has to be considered.
- *Minimum capitalisation rate:* The capitalisation rate must reflect the long term market developments, the sustainable income producing capacity of the property, alternative uses as well as its future marketability. The banking supervisory authority fixes capitalisation rate floors for commercial and residential property according to market developments.

Art. 24 of the Directive on the Determination of the Mortgage Lending Value permits a simplification of the valuation process when the loan amount to be secured by the property (land charge) including all previous encumbrances does not exceed 400.000 Euro.

### 3.4 Valuation Report: Form & Content

For the property valuation on market value basis there are no detailed rules in the above mentioned regulations regarding form and content of the valuation report. Market and location surveys, which are conducted professionally by research companies within the banks, specific departments of agents' organisations, some academic institutes at universities and some independent enterprises, often provide important information for an expert's property valuation.

Regulations for mortgage lending valuation reports are laid down in Art. 5 of the directive on the determination of the mortgage lending value. The mortgage lending value must be determined by way of a report that mainly comments on:

- The quality of the property and location,
- The regional property market,
- The legal and actual attributes of the property,
- Its usability and marketability.

The report must also deal with the question of whether a sufficiently large circle of potential buyers and users exists for the surveyed property and, consequently, the sustainable profitability of the property is assured on account of its capability to be used for various purposes and its adequate usability by third parties. The most important valuation parameters and assumptions made must be stated and explained in a readily comprehensible manner.

### 3.5 Use of AVMs

In Germany, AVMs help to increase the quality of the valuation in the context of standardised credit business for private customers. AVMs are also used as a risk management tool for the monitoring and adjustment of property values in the context of Basel II.

However AVM must provide the option of a manual adjustment of individual valuation data and thus the final result; eventually it is the user of the program who is responsible for the result of the valuation and not the valuation program, which provides value suggestions, but does not replace an expert knowledge.

Valuation programs for Pfandbrief banks must comply with the specific requirements stipulated by the Regulation on the Determination of the Mortgage Lending Value.

## *4. The Valuer*

### 4.1 Regulatory Framework

The profession of valuer is not protected by law nor licensed, but different quality securing mechanisms exist such appointments of valuers by chambers of commerce, courts or certification bodies.

For lending purposes, Art 16 (1) of the Pfandbrief Act requires a valuer who must have the requisite professional experience and knowledge in order to make mortgage lending value assessments. The requirements are laid down in more detail in Art. 6 of the directive on the determination of the mortgage lending value.

### 4.2 Education/qualifications

Art 6 of the directive on the determination of the mortgage lending value regulates the necessary qualification of a valuer as follows:

“The valuer must, in respect of his vocational training and professional activity, possess special knowledge and experience in the field of property valuation; persons who have been appointed or certified by a government body, a state-approved body or a body accredited according to the standard DIN EN ISO/IEC 17024 as appraiser or valuer for the valuation of properties are assumed to possess such qualifications. When selecting the valuer the Pfandbrief bank must convince itself that, in addition to many years of professional experience in property valuation, the valuer has the knowledge that is needed specifically to prepare a mortgage lending value assessment, in particular of the respective property market and type of property.”

### 4.3 Use of valuer title

As mentioned above, there is no statutory regulation for the profession of valuers and of the use of valuer title. However, the public appointment of valuers (öffentlich bestellter und vereidigter Sachverständiger) and the appointment of the RICS as Chartered Surveyor are common approaches to secure quality of property valuations especially in the assessment of market values.


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In recent years, with the possibility of certification of experts on the basis of DIN EN45013/ISO 17024, certified experts have established themselves as an additional group of experts alongside publicly appointed and sworn experts and experts at courts. In 1996, the Association of German Mortgage Banks founded a certification company (Hyp Zert GmbH) for the special sector of determining mortgage lending values in which other associations in the banking industry have meanwhile participated. This certification is one possibility to assure full conformity with the requirements of Art. 16 (1) of the Pfandbrief Act and Art. 6 of the directive on the determination of the mortgage lending value.

**4.4 External v. Internal**

In Germany, Art. 20a par. 5 and 6 of the Banking Act (KWG) and Art. 16 par. 1 and 2 of the Pfandbrief Act both address independence of valuers. This legislation is complemented by the directive on the determination of the mortgage lending value, as laid down by the German Financial Services Authority (BaFin). Provisions of the new Minimum Requirements for Risk Management also include rules on the separation of conflicting activities within credit institutions. Furthermore, the professional principles of certifying bodies and professional associations include principles regarding the independence of valuers.

**4.5 Professional Indemnity Insurance**

In Germany, there is no legislation requiring valuers to have professional indemnity coverage or lenders to use only valuers covered by this type of insurance. However, orders e.g. “Sachverständigenordnung” from the Chamber of Commerce, highly recommend that valuers have insurance coverage. In the absence of legal or professional requirements, contractors can ask for a confirmation of adequate indemnity insurance as a condition for the assignment (provision of a copy of the certificate of insurance or contractual agreement). In practice, valuation applications are only accepted when the valuer can prove insurance covering the expected value of the property.

There are also no specific rules on the responsibility of valuers; the private valuer is liable according to §§ 633 ff. BGB (German Civil Code) (general rules for work and labour contracts).

## *5. Capital Requirements & Property Valuation:*

***Covered Bonds***

The German Pfandbrief Act dated 22nd of May 2005 is the legal basis for the issue of Pfandbriefe (Covered Bonds) covered by mortgage, ship, aircraft and public finance assets in Germany. In May 2006, the German regulator issued the Directive on the Determination of Mortgage Lending Values of Properties in accordance with the legal requirements stipulated under Art. 16 Pfandbrief Act (Beleihungswertermittlungsverordnung – BelWertV).

The law sets maximum LTV ratios for eligible residential and commercial mortgage assets. The LTV limit for both types of assets (residential and commercial) is 60% of the mortgage lending value of the property (Art. 16 Pfandbrief Act). This LTV is a relative limit, i.e. when the loan exceeds the 60% limit, the part of the loan up to 60% LTV remains eligible for the cover pool.

- Monitoring:

Art. 20a par. 6 of the Banking Act regulates the continuous monitoring of properties. In order to comply with these requirements, the entire German banking industry (ZKA-Zentraler Kreditausschuss) has developed a statistic based instrument allowing member institutions to measure market volatilities and to comply with the monitoring requirements (Marktschwankungskonzept).

According to Art. 20a par. 6 of the Banking act values of commercial properties have to be monitored every year and values of residential properties every three years. These requirements are supervised on an institution specific level and can be supported by the above mentioned "Marktschwankungskonzept" If this monitoring process results in any significant market changes the valuations of the affected properties have to be checked. If necessary the monitoring has to be intensified, e.g. due to economic or natural disasters.

The regulatory authority is expected to consider significant market changes for commercial property at a level of more than 10% (within one year) and for residential property of more than 20% (within a period of three years).

The valuations of properties of a value of 3 Mio Euro or more, have to be checked every three years irrespective of any market changes.

Art. 26 of the Directive on the Determination of the Mortgage Lending Value contains a review clause of mortgage lending values under certain conditions. This revaluation requirement is not the result of the CRD transposition in German law; rather it emerged from the high quality requirements, with which eligible mortgage cover assets have to comply.

- Insurance:

Adequate insurance of the property is required by law (Art. 20a par. 8 Banking Act). The insurance has to cover risks relevant to the location and type of the property at least of the amount of the value of the building.

The same requirement is stipulated under Art. 15 Pfandbrief Act for Pfandbrief funding purposes.

- Independence of valuers:

A valuer is considered independent if he is not involved in the loan decision and if he has the requisite professional experience and knowledge in order to carry out mortgage lending value valuations (Art. 16 par. 1 Pfandbrief Act). Further more detailed regulation about the organisational involvement of valuers/ unit of valuers within a credit institution is contained in Art. 7 BelWertV.

***Data Standards:***

According to Art. 20a par. 6 of the Banking Act (KWG) statistical methods may be used to monitor values and to identify properties that have to be revalued due to any significant changes in the respective property market, location etc.

In 2001 the Association bringing together the entire German banking industry (ZKA-Zentraler Kreditausschuss) established a tool allowing property market fluctuations to be measured for commercial properties on a yearly basis (Marktschwankungskonzept). With the coming into effect of Art. 20a of the Banking Act at the beginning of 2007, the Association extended this analysis to residential properties. The first results were published in 2008. With this concept, banks can specify regions, cities or types of property with significant changes in the property market and connect the results with further internal monitoring and/or revaluation activities.

There are no statutory or other regulatory requirements concerning data or approaches. In the case of the above mentioned analysis of property market fluctuation for commercial and residential properties, the concept was discussed with the German Financial Services Authority (BaFin), which approved it. Furthermore, there are statistical concepts, elaborated by associations or banks to support monitoring activities. One of them is the transaction database of the Association of German Pfandbrief Banks (vdp). On the basis of hedonic methods this database evaluates transactions of participating member institutes that result in an analysis of the fluctuation of prices in regional and sectoral markets.

# SPAIN

### 1. Macroeconomic Overview

The performance of the Spanish economy in 2008 showed a sharp deceleration which resulted from the combination of internal economic adjustments and the global financial turmoil.

Real GDP growth was 0.9%, compared to 3.6% in 2007. The domestic demand components that most contributed to GDP growth over the last years – consumption and private fixed investment- both recorded negative growth, and the only positive contribution to growth came from government spending and net external demand.

As regards inflation, the initial increase in the Harmonised Index of Consumer Pricesat slowed down during the year; at the end of 2008 it had increased year-on-year by a mere 1.4%, compared to 2.8% in 2007 (though the yearly average inflation was at 4.1%), mainly due to the behaviour of energy prices and the waning of both external and internal demand.

Against this new scenario characterised by a clear correction from record growth in previous years, the level of unemployment rose dramatically. At the end of 2008 the unemployment rate reached 14% (11.3% as a yearly average) and the data available for the first quarter of 2009 points to a further increase during the year.

### 2. Property Market Overview

#### 2.1 Residential Property Market Overview

As regards real estate activity, the volume of housing starts, which had been slightly decreasing over the the last few years, fell by 41.5%% in 2008 and remained far below the number of completions, showing a large adjustment in the production of new dwellings as a response to the current drop in housing demand. The annual growth rate of the amount of total transactions in 2008 fell by 32.6%, compared to the much lower decrease recorded in the previous year ( -12.4%).

Average house prices still recorded a year-on-year increase on the previous year (0.7%), but there was a clear slowdown in comparison with 2007 (5.8%) and it also should be pointed out that the slowdown in annual growth rates in house prices has continued since 2004. According to official statistics, during the first quarter of 2009 house prices decreased on a year-on-year basis by almost 7%.

Throughout 2008, the intensity of the correction in the real estate markets and the worsening of international economic conditions impacted the Spanish mortgage market.

Nevertheless, in 2008 the mortgage lending market recorded a higher growth rate than the whole economy, and it recorded positive monthly developments despite the large drops in both volumes and number of new mortgage loans subscribed.

At the end of December 2008, total mortgage volume outstanding (residential and commercial) was 1,088,946 million Euros, which represented 100.04% of GDP. In relative terms, the year-on-year increase was 4.0%. As regards residential lending alone, the increase at the end of the year was slightly higher (4.3%).

These positive growth rates were possible due to the significant volume of new lending, which compensated the negative effects of repayments on the mortgage portfolio.

Indeed, in 2008, around 971,000 mortgage loans were subscribed amounting to 188,000 million Euros (residential and commercial), so that new lending activity remained at similar volumes to those recorded in 2003-2004 when the housing boom started.

### 2.2 Commercial Property Market Overview[4]

At the end of June 2007, it is estimated that the volume of outstanding commercial loans amounted to €401,311 million (only refers to loans with mortgage collateral). A total of 283,128 commercial loans were granted up until June 2007. The volume of outstanding commercial loans represents approximately 38.8% of Spanish GDP.

## *3. The Valuation*

### 3.1 Regulatory Framework

In Spain, real estate valuation for mortgage purposes is carried out in accordance with **Act 2/1981** on Mortgage Market Regulation of March 25, subsequently modified and complemented by **Act 41/2007** of December 7th. In addition, there are several provisions for the development of such legislation, mainly the Ministerial **Order ECO/805/2003** of March 27 concerning real estate valuation, where the methods which must be used, and the values which must be calculated are clearly defined.

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[4] Source: Bank of Spain

Financial institutions can lend using valuations outside these regulations. However, only those mortgage loans which fulfill the requirements stated on these regulations can be used as collateral for the issue of securities. As a consequence, almost all mortgage loans granted in Spain have a valuation carried out according to the official regulation.

### 3.2 Valuation Bases

According to the **Order ECO/805/2003** valuation of properties for mortgage lending purposes will be determined by the 'mortgage lending value'.

### 3.3 Valuation Methodology

The valuation methodology is established on the Order ECO/805/2003. The technical methods used, depending on the type of the properties being valued and the information available, are:

- Cost method
- Comparison method
- Capitalization method
- Residual method

Moreover, the prudence principle stated on the Order requires the valuer to use, in case of doubt, the lowest value resulting from these methods as valuation base for lending purposes.

The use of valuation methods established in the Order and their application by authorized companies or services is compulsory if:

- The mortgage on the property is to be used for mortgage backed securities and/or covered bond issues;
- The property is to be used as an insurance company's technical reserve;
- The property is to be included as part of the net worth of property investment or pension funds;
- The valuation is to be accepted by the Bank of Spain for certain purposes.

### 3.4 Valuation Report: Form & Content

The Spanish legal valuation framework establishes clear requirements for both Valuation Reports and Certificates. Articles 61 through 78 of Ministerial Order ECO 805/2003 (Ministry of Economy) set out all the requirements that must be included in Valuation Reports and Certificates. Please refer to Ministerial Order ECO 805/2003 (Ministry of Economy) available on the EMF's website under Valuation Standards –Spain.

### 3.5 Use of AVMs

In Spain, AVMs for residential mortgage loans in the origination process can only be used as quality control tools, subject to the valuer having extensive and current market data bases. AVMs are also used for loan portfolio value monitoring.

## *4. The Valuer*

### 4.1 Regulatory Framework

Valuations for the mortgage market in Spain must be effected by valuation companies or lender's internal valuation services both of which must comply with the requirements that are established in **Law 41/2007** of December 7$^{th}$ and in the **Royal Decree 775/1997** of May 25 concerning the legal framework regulating the recognition of Valuation Services and Companies.

These two legal bodies lay down the rules under which frame valuers must work:

- In the **Royal Decree 775/1997** there are specific rules concerning the recognition of valuation services and companies, secrecy requirements, and the Supervision Legal framework.
- **Law 41/2007** establishes requirements with respect to independence between the valuer and the lender and a sanctioning regime for non compliance.

### 4.2 Education/qualifications

Professional valuers, irrespective of whether they belong to valuation companies or to the financial institutions' own valuation services, must hold a university degree in architecture and/or engineering and are typically specialised in the valuation of a certain property type.

### 4.3 Use of valuer title

Valuation companies and lenders own valuation services must be registered with the Bank of Spain and under their supervision (see Royal Decree 775/1997).

### 4.4 External v. Internal

Law 41/2007 and the Royal Decree 775/1997 lay down rules which frame valuation companies or lenders internal valuation companies work. The main criteria are prudence and truth in the valuation report. In this context, there are specific rules concerning technical organisation, internal control measures, market knowledge, fulfillment of the applicable legislation on valuation, experience and qualification of the director and individual valuers' (expertise) qualifications.

The Bank of Spain requires previous certification and registration of valuers. As such, valuers' professional activity is subject to the supervision of the Bank of Spain. Non-compliance with the regulation outlined above may be considered a breach of the applicable law, which may result in a penalty or sanction qualified as very serious, serious or not serious.

### 4.5 Professional Indemnity Insurance

In Spain, professional indemnity insurance is a legal requirement for valuation companies authorised to value for the mortgage market. Moreover, lenders are required to only use officially registered valuers. The mortgage market law for mortgage covering covered bonds and mortgage backed securities requires the underlying properties to be valued by officially registered valuers, who are required to have those insurance Policies contracted.

In Spain, there is also legislation, which determines exactly what the valuer is responsible for vis-à-vis his client. According to Royal Decree 775/1997 dated 30/V/1997 and Ministerial Order 27/III/2003, the valuer, on a civil basis, is directly responsible for the valuation vis-à-vis his clients, he/she responds in general for professional negligence and for negligence of its employees (in the case of a valuation company), without prejudice of the liability of the individual which has carried out the valuation. The professional indemnity insurance has to be higher than €600.000 plus 0.5/1000 of the properties valued limited to €2.400.000.

## *5. Capital Requirements & Property Valuation:*

### *Covered Bonds*

- Maximum eligible asset LTV ratios for different types of residential and commercial real estate:

The maximum LTV allowed in Spain, if the loans are to be covered by the Mortgage Law, is 60% as a general rule. For residential mortgages the maximum LTV allowed is 80%. The new Mortgage Regulation approved in December 2007 allows for LTVs for residential loans of between 80% and 95%, provided that the loans carry mortgage insurance cover for the excess over the 80% threshold.

- Monitoring

All lenders have in their loan contracts, provisions, according to which the lender may require from the borrower additional guarantees to cover the lost value if the value of the underlying asset, as showed by a new individual valuation, has fallen more than 20%.

- Insurance

All properties that are part of the Mortgage Market (i.e. eligible for mortgage bond or security issuance) need to have damage insurance.

- Independence of the Valuer

As noted above, Law 41/2007 has a whole section regarding "independence of the valuer". It establishes limits to control relationships between lenders and valuers and penalties when those controls are not adopted.

- Market Value & Mortgage Lending Value

Both Market value & Mortgage Lending Value are defined in ORDER ECO/805/2003. According to this *Order*, valuation of properties for mortgage lending purposes will be determined by the "mortgage lending value".

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***Data Standards***

As far as the provision in the CRD regarding “monitoring using statistical methods” is concerned, the transposition of the Directive into the Spanish legislation has been identical to the CRD. A further development has not been effected by the regulator up until now.

## *France*

### *1. Macroeconomic Overview*

For the first three quarters of 2008, the French economy was largely unaffected by the international financial crisis, in part due to an underestimation of its seriousness and of its ability to affect the real economy. But after the Lehman Brothers' crash (September 2008) the French economy plummeted: at the end of 2008 real GDP grew by a mere 0.4% against 2.3% in 2007.

This disappointing result in 2008 was a consequence of the weakness of domestic demand, resulting from the fall of household investment (-1.4%, against 5.5% in 2007), the weakness in household consumption (0.9%, 2.4% in 2007) and in private fixed investment (2.4% against 8.6%). Foreign trade performed weakly due to a decrease in exports (-0.5% against 2.5% in 2007) while imports remained stable (0.6%, 5.4% in 2007).

French employment decreased with unemployment rate rising to 8.2% at end 2008, against 7.9% at end 2007, while the average annual rate was 7.8%). Nominal households`income was still growing (3.4%, against 5.2% in 2007), but the increase in net income was much lower (0.6% against 3.1% in 2007). Average annual HICP inflation was 3.2%, but year-on- year inflation fell considerably in the second half of the year (in June it was 3.6% and in December it was 1.0%).

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

After 11 years of continued growth, housing and mortgage markets showed a visible slowdown in 2008. Yet, housing activity indicators remained at historically high levels. This could be observed as regards housing starts, new, mortgage loans, and house prices.

Housing starts decreased by 15.3%. The drop was heavier for apartments (-17%) than for single-family houses (-14%), but 368,600 units started still represented a high level.

Gross residential lending fell by 16.9% (amounting to 122 billion Euros, the decrease being stronger in Q4 2008. Total sales of new properties (79,000 units) fell by 34%, however in 2007 they had reached a peak in in absolute terms, recording the highest level of sales since 1985. The stock of unsold dwellings reached a peak of 110,900 residential properties (with an average duration of 21 months of sale, against 11 months recorded at the end of 2007). The price of new apartments per square metre remained stable (3,300 Euros ), but at the end of 2008 the prices of new houses decreased by 6.6% compared with the same period in 2007 and by 10% compared with the same period in 2006. The number of transactions in the second-hand market dropped by 14% (amounting to a total of 667,000 units) with a decrease in prices of 2.9%.

## *3. The Valuation*

### 3.1 Regulatory Framework

To lessen the impact of non-regulation of the organisation of the profession, valuation business is organised under the "Institut Français de l'Expertise Immobilière" (IFEI), which groups together approximately one hundred experts from all the professional sectors. This institution, whose members include the most important valuation companies, has drawn up a charter which consists of 4 chapters concerning:

- the general conditions of property valuation practices;
- a guide to the methods for property valuation;
- a guide on how valuations should be carried out;
- a professional code of ethics for property valuers.

This charter is very similar to the British concepts of valuation.

The second professional association is AFREXIM, which specifically groups Property Valuation Companies. In January 1998, AFREXIM published a quality charter for property valuation. Each adhering institution is obliged to respect this charter, which lays down a certain number of rules relating to the handling of information, the verification of work carried out, the homogeneity of the methods applied and in some cases the objectivity of the conclusions drawn.

### 3.2 Valuation Bases & Methodology

The value used for mortgage lending purposes is generally the market value, which uses a careful approach avoiding the highest values. The mortgage lending value may be used under certain circumstances e.g. in the context of a transfer of claims between Crédit Foncier and its subsidiary, which issues covered bonds. The mortgage lending value was defined by the Law on Savings and Financial Security of 25 June 1999.

For single-family houses, the comparative procedure and the real value procedure, based on the cost price of the elements, are the preferred methods. For rental dwellings, the value of yield procedure, or "by capitalisation" procedure is used.

In the case of industrial or commercial premises, it must be first ascertained whether they are rented out or occupied by the company which owns the premises. If the premises are rented out, they are generally purchased by institutional or other investors who have first conducted a calculation of the profitability. In this case, the capitalisation procedure is applied. In the case that the industrial or commercial premises are owned by the company which occupies them, the question is more complex and difficult to disassociate from a valuation of the company itself. The Discounted Cash Flow method is also often used for this type of property, since it considers the net income of the property.

**3.3 Valuation Report: Form & Content**

Information not available.

**3.4 Use of AVMs**

Information not available.

## *4. The Valuer*

**4.1 Regulatory Framework**

The Institut Français de l'Expertise Immobilière's charter consists of 4 chapters, one of which contanis a professional code of ethics for property valuers.

**4.2 Education/qualifications**

See 4.1. Additionally, both IFEI and AFREXIM also intend to adhere to the "Recognised European Valuer" standard, which TEGoVA is currently working on.

**4.3 Use of valuer title**

The title of expert is not subject to any legal protection. The valuer can be a real estate agent, a notary or a valuation company.

**4.4 External v. Internal**

Banks active both in commercial and residential mortgage lending resort to either employed staff or external experts for their valuations. Each bank can independently choose any expert according to experience, location or field of expertise. The valuation of assets is not compulsory, so most of the banks have independent valuers working for them when needed.

#### 4.5 Professional Indemnity Insurance

There is a legal requirement in France for valuers to have professional indemnity insurance.

### *5. Capital Requirements & Property Valuation:*

***Covered Bonds:***

Legislation exists in France on real estate covered bonds, and in the context of the CRD, the national regulator has made the following interpretations:

- *Maximum eligible asset LTV ratios for different types of residential and commercial real estate:*

80% LTV for residential real estate, 60% LTV for commercial real estate.

### *Data Standards*

Information not available.

## Greece

### *1. Macroeconomic Overview*

The Greek economy grew at a healthy rate of 2.9% in 2008 and 0.3% (year-on-year) in Q1 2009, however negative GDP growth of -1.0% is expected in 2009, due to the expected decline in both consumption and investment as the recession in Europe and the world economy deepens. Economic activity in Greece has been slowing down since the beginning of 2008 on the back of rising oil prices and the deterioration of global financial conditions. Nevertheless, growth in Q3 and Q4 2008 has been a solid 2.7% and 2.4% respectively, compared with the 0.5% and -1.5% year-on-year GDP growth rates recorded in Q3 and Q4 2008 in the euro area.

Inflation was at 0.5% in June 2009 and the average inflation for 2009 is expected to be 1.2%, significantly lower than the average annual level of 4.2% in 2008. Economic uncertainty and the substantial fall in international economic activity and trade in Q4 2008 and Q1 2009, has also rocked consumer and business confidence in the Greek economy, undermining economic activity especially in the housing, tourism, manufacturing and retail trade sectors. This has set the stage for a slowdown in consumption and a substantial fall in investment, exports and imports, and in GDP growth.

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

The main characteristic of the housing market in Greece over the last three years has been the deceleration in prices (since the beginning of 2006), which nevertheless kept registering positive annual changes (in nominal terms) in 2008. According to Bank of Greece estimates, residential property prices in all urban areas increased by 2.6% in 2008 from 4.6% in 2007, 12.2% in 2006 and 10.9% in 2005. More specifically, residential property prices in Athens grew by 2.7% in year-on-year terms in 2008, as against 5.2% in 2007 and 11.3% in 2006, while growth in residential property prices for urban areas excluding Athens further decelerated to 2.6% in 2008, from 3.8% in 2007 and 13% in 2006. Following the deceleration in residential property prices in 2008, the annual growth rate in residential property prices is estimated to have turned negative in the first three months of 2009. On the basis of data aggregated by banks, it is estimated that residential property prices fell by 1.4% (in nominal terms) in the first quarter of 2009 on the same quarter of the previous year.

The supply of new houses remained at high levels in 2007 and 2008 (even if the volume of private building activity in terms of residential construction permits issued recorded a decline of 5.3% and a fall of 15.8% in 2007 and in 2008 respectively). On the other hand, the more cautious attitude of banks in granting new housing loans is estimated to have contributed to the falling demand. The fall in demand is also depicted in the continuous deceleration in the outstanding balances of housing loans (11.5% at the end of 2008, from 21.9% in December 2007 and 25.8% in December 2006), still registering high growth rates despite the increase in the cost of financing up to October 2008 and the tighter lending criteria imposed by banks for housing loans. On the supply side, there is a substantial stock of new houses gradually being absorbed. The effect of these housing market developments on consumption as a wealth variable is estimated to be rather limited.

### 2.2 Commercial Property Market Overview

In 2006, the total volume of outstanding commercial mortgage loans amounted to €4.190 million, which represents approximately 2% of Greek GDP.

## *3. The Valuation*

### 3.1 Regulatory Framework

Currently there is no specific legislation in Greece explicitly covering property valuation.

However, there is a professional body, the Body of Sworn-In Valuers (BSV), which has a self-regulatory status and is supervised by the State (Ministries of Economics & Justice).

Regulations concerning property valuation are also determined by banks themselves. Financial institutions involved in mortgage lending have on the whole adopted a clearly defined set of criteria and requirements covering in detail the valuation process.

### 3.2 Valuation Bases

The main method used is the market value approach.

### 3.3 Valuation Methodology

The following valuation methods are in use in Greece:

- Comparative method
- Capitalisation method
- Residual method
- Profits method/Discounted Cash Flows

- Replacement method (depreciated replacement cost)
- The ‘antiparochi’ method

The antiparochi method is a local method based on the assumption that the owner is giving out his land to a construction firm for which he receives as payment a certain percentage of the completed building. This percentage can precisely define the value of the land. This method should however be used with care for building ratios below 0.8, as well as in cases of high marketability coeffiecients. In these cases, it is better to use the residual value method.

### 3.4 Valuation Report: Form & Content

Information not available.

### 3.5 Use of AVMs

Given the nature of the property market and the absence of a national land registry, it is considered unlikely that AVMs will be introduced in Greece in the near future. That said, the long-standing Greek “Objective Valuation” system, according to which each property is assigned a price based on a series of formulae, could form a basis for AVMs in the future if developed properly.

## *4. The Valuer*

### 4.1 Regulatory Framework

Currently there is no specific legislation in Greece explicitly relative to property valuers. However, as indicated above, there is a professional body, the Body of Sworn-In Valuers (BSV), which lays down rules specific to property valuers.

### 4.2 Education/qualifications

The BSV is staffed by specially qualified professionals, who have detailed knowledge and extensive experience in their particular fields (civil engineers, mechanical engineers, architects, economists, land surveyors etc.). These professionals are capable of undertaking and executing any type of appraisal task. Internal education courses are also provided by the BSV.

### 4.3 Use of valuer title

Only the members of the BSV have the right to be called ‘Sworn-In Valuers’ in Greece.

#### 4.4 External v. Internal

The independence of valuers, whether internal or external, is safeguarded by the fact that they are not involved in the credit decision process and in turn the loan origination departments of Greek banks have no involvement in the valuation process.

Apart from the stringent regulations governing property valuation established by the pertinent departments of the banks, property valuations are supervised and regularly reviewed by the internal audit departments of banks that undertake frequent random checks in order to ensure valuations standards have been upheld. Besides the general supervisory activities exercised by the Bank of Greece in this regard, external auditors are also used by mortgage lenders to ensure that the valuation process is carried out according to set specifications.

#### 4.5 Professional Indemnity Insurance

Information not available.

### *5. Capital Requirements & Property Valuation*

Information not available.

## *Hungary*

### *1. Macroeconomic Overview*

Hungary's adhesion to the European Union in 2004 bolstered the outlook for the economy. The residential debt to GDP ratio increased after 2004 as residential mortgage finance was fueled by cheap international credit (foreign currency denominated loans were mainly in Swiss Francs and Japanese Yen). Foreign Direct Investments continued to flow to Hungary, which, also thanks to the increase in EU funds, contributed to growth in the economy.

Until September 2008 household consumption funded by loans had continued to increase, but at the same time industrial production, employment and exports were falling. The Hungarian economy was close to recession even before the credit crunch and this is why the global financial crisis hit Hungary the hardest among CEE economies. A 25 billion USD agreement was signed with the IMF in 2008, because the Hungarian financial sector suffered when credits began to dry up in the middle of 2008. The government successfully decreased the budget deficit from 9.2 % of GDP in 2006 to 3.3% of GDP, and kept inflation under control at 6.0 % in 2008 (to compare to 7.9% in 2007).

The Hungarian economy grew only by just 1.2 % in 2007 and 0.5 % in 2008, and is expected to contract by 6% in 2009.

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

According to latest available data (2003), Hungary has a 92% homeownership rate as a consequence of the wide privatistion process of the 1990s. By 2000, the housing output had decreased to 22,000 units from 52,000 in 1989, but the housing programme of the government which started in 2000 (in parallel with the economic recovery at the end of the 1990s) continued to impact the residential real estate market.

The generous mortgage subsidies (two interest rate subsidy programs, PIT tax allowance and construction capital grant) boosted the mortgage market, leading to a marked increase in the outstanding mortgage loan to GDP. Building permits and housing construction increased as well. Because of the effect of the housing program on public deficit, the government cut the size of the subsidy and the eligibility criteria. However, the banks introduced foreign currency-denominated loans based on cheap international credit, which sustained the development of the residential mortgage market. The non-subsidized foreign-currency denominated loans were cheaper than the subsidized Hungarian Florint (HUF) loans, However, the interest rate risk and exchange rate risk were borne by the borrowers. By 2008 the outstanding residential loan to GDP ratio increased to 14.0% and the share of foreign-denominated loans to rose to 60% of the total stock of loans.

Housing construction activity decreased in 2008, but less than expected (from 36,159 housing completions in 2007 to 36,075 in 2008). However, there are other signs of difficulty in the construction sector as well, such as the stocks of unfinished buildings. It is expected that real fixed housing investment will fall in 2009 (although the tightening of the housing subsidy scheme in 2009 has brought forward some housing investment).

House prices increased just before the new housing policy was implemented as a correction to the downward trend in 1990s. The mortgage boom had an effect on house prices but did not lead to a house price bubble. The data for 2008 do not demonstrate a house price decrease yet, but anecdotal information indicates a 10% house price decrease year-on-year. Foreign demand for real estate in Budapest has greatly weakened, the demand from foreign investors went down substantially, the amounts involved were greatly reduced and the bargaining process lengthened.

## *3. The Valuation*

### 3.1 Regulatory Framework

Since 1993, Hungary has been adopting legislation to help facilitate a fully functioning mortgage finance market. In 1997, the Act on Mortgage Banks and Mortgage Bonds regulated the activity of mortgage banks, as well as mortgage lending.

The mortgage banks operate under special state supervision. A property supervisor regularly monitors the value of the mortgaged properties and the underlying principles used by the mortgage bank in assessing the value of the property.

### 3.2 Valuation Bases & Methodology

The determination of a property value is achieved using the Market Value approach. The Mortgage Lending Value is determined from the Market Value of the real estate.

Market value is determined by a valuer making a prudent assessment of the property. Prudent assessment requires the following approaches:

- review of the future marketability of the property
- considering only the long term sustainable aspects of the property
- considering the normal and local market conditions

- highest and best use principal is not applicable (only the current use of the property could be considered)
- cost approach should be used as a control value only
- if possible all three valuation approaches should be applied (market, income and cost approach)

Property professionals do not have information about the financial arrangements or about the borrower. Consequently, the valuer does not take into account the risks such as borrower risks, financial risks.

In addition to the above, the valuer should take into account the following risk criteria when making the valuation for lending purposes:

- Market information reliability risk
- Other information reliability risk
- Risk of the long term sustainable aspects of the property
- Forced sales value

### 3.3 Valuation Report: Form & Content

Information not available.

### 3.4 Use of AVMs

AVMs are currently not used in Hungary.

## *4. The Valuer*

### 4.1 Regulatory Framework

There is no real estate chamber based on the individual membership of property professionals. This would enable the property industry to regulate itself according to the market instead of waiting for legislation to come through. This could also lead to the establishment of a qualification, accredited schools and a code of ethics. On the other hand, Hungary is more advanced than some of its Western neighbours with regards to valuation. For example RICS was established in Hungary in the early 1990s when it was not present in some Western European countries.

### 4.2 Education/qualifications

The valuer license (based on the decree issued by the Ministry of Internal Affairs in 1995) is not conditional on a diploma/university degree; however real estate postgraduate education has existed in

Hungary since 1994. The license confers the legal ability to undertake professional assignments, such as valuation and to sign the valuation report.

Banks normally appoint professionals (companies) holding university degree (degree of engineering, economy, agriculture, law), who are members of one of the recognised national or international professional bodies (TEGOVA, RICS, MAISZ, ÉMSZ etc.). There is no general certification body, therefore valuers normally follow the codes and guidelines of their professional institution.

**4.3 Use of valuer title**

There are no restrictions on the use of ‘valuer’ or ‘real estate expert’ titles in Hungary.

**4.4 External v. Internal**

Valuations are carried out by both internal and external valuers. Practically, external valuers are appointed by lenders and then controlled by the Mortgage Bank’s internal valuers (based on the contract between the Mortgage Bank and Commercial Banks entitled with the mortgage lending right). Internal valuations are generally considered to be of a higher quality than external valuations, therefore valuations of high value real estate are carried out by qualified internal staff.

**4.5 Professional Indemnity Insurance**

Information not available.

***5. Capital Requirements & Property Valuation***

Information not available.

## *Ireland*

### *1. Macroeconomic Overview*

After over a decade of strong economic growth, Ireland was impacted by the global downturn in 2008. Gross domestic product contracted by 2.3% in 2008, although this trend of declining GDP growth had been emerging since the second half of 2007. The initial easing of construction activity that began in 2007 continued and filtered into other economic sectors, resulting in an increase in the unemployment rate from 4.6% in late 2007 to 7.7% a year later. As a small, open and export-oriented economy, Ireland was also impacted significantly by global developments which weakened domestic sentiment. Ireland, like its main trading partners, the UK, the Euro Area and the US entered recession in the latter half of 2008.

Exchange rate movements and the depreciation of sterling in particular, also had adverse effects on the economy's competitiveness, especially for exporters. Inflation, fuelled by high energy prices, peaked in mid-2008 with the Consumer Price Index reaching 5%in June. Inflationary pressures dropped off sharply thereafter aided by the consecutive reduction in ECB interest rates. Overall, the Harmonised Index of Consumer Prices (HICP) was 3.1% in 2008, up from 2.9% in 2007.

### *2. Residential Property Market Overview*

The slowdown in the mortgage market that had begun in 2007 continued in 2008 and was exacerbated by both global economic events and domestic developments. The sustained decline in the construction sector was demonstrated by the 34% fall in completions to 51,724 units in 2008. Housing starts fell by 53.2% to 22,852 units indicating that the tightening of housing supply is likely to continue into 2009. The construction slowdown translated into increasing unemployment and falling tax revenues in the first instance, before impacting on the wider economy.

Demand for housing was suppressed by growing and pervasive labour market uncertainty, as well as falling personal income. In October, the Government increased taxation to ease the exchequer deficit, with a view to further tax increases in 2009. Thus, property purchasers and potential property purchasers were constrained by both falling and uncertainty over, income, which constrained mortgage lending compared to 2007. A total of 110,305 mortgage loans was issued in 2008 at a value of 23,049 million Euros which represented a decrease of 30% compared to the previous year. Of these, 40,390 loans at a value of 10,405 Euros million were for the purchase of a home in 2008, representing a decrease of 36% in the number of loans drawn down by First- and Second-Time Buyers compared to the previous year. Similarly, the number of buy-to-let loans issued fell 36% to 13,226.

While growth of new mortgage lending declined, net lending continued to increase, with the total value of outstanding mortgages reaching almost 148 billion Euros by the end of 2008, an increase of nearly 6% on the previous year. At the same time, the position of many existing mortgage-holders was improved by the favourable cuts in the ECB rates and the general easing of inflation which, by the end of 2008, was negative in monthly growth terms. The Government also increased mortgage interest relief in November 2008 for First-Time Buyers which was designed to assist those more exposed to falling property values. Similarly, the position of potential purchasers was also improved as property prices, which had been falling since early 2007, continued that trend decreasing 9% nationally to 261,573 Euros from 287,887 Euros a year previous.

A further decline in the volume of units completed is expected in 2009 which will move the housing market towards equilibrium. As a consequence of this and the changed funding environment, mortgage lending is likely to remain subdued at least in the short-term. The Irish economy is unlikely to return to growth until the global economy, in particular Europe and the United States, recovers. However, international investors have responded positively to the decisive actions taken by the Government and the widespread and significant wage cuts across the public and private sector that, together with falls in other costs, will go some way towards enhancing competitiveness.

## *3. The Valuation*

### 3.1 Regulatory Framework

Property valuations are not regulated by law in Ireland. However, the Central Bank reviews all lenders' procedures including those concerning the valuation of property for security purposes.

Financial Institutions apply their own procedures when obtaining valuation reports for mortgage purposes. As a general rule valuations will only be accepted from a suitably qualified individual who has an adequate level of professional indemnity insurance cover as laid down by the mortgage lender. Typically valuations are carried out by auctioneers and estate agents, most of whom belong to the Irish Auctioneers' and Valuers' Institute or the Institute of Professional Auctioneers and Valuers.  Valuation reports can also be accepted from Chartered Surveyors, Architects and Engineers.

### 3.2 Valuation Bases & Methodology

Valuations in Ireland for both residential and commercial properties are normally based on the principle of market value and supported by comparable evidence of recent sales of similar properties in the area. Other valuations are carried out for specific purposes such as insurance reinstatement values.

In the case of commercial properties, including office, industrial and retail the market value is ascertained by reference to accepted professional standards such as the Red Book of the Institute of Chartered Surveyors (RICS).

However, even in the case of commercial property significant information on local conditions is required to prepare and to interpret a valuation. While a property may have a certain market value, this may depend on certain factors such as tax allowances which, if a purchaser cannot use these allowances, may significantly reduce the value of the property to them. In the case of residential valuations considerable local knowledge is required as these depend to a large extent on location, the type of property involved and recent transactions. All these valuations are based on current market value.

### 3.3 Valuation Report: Form & Content

RICS ensures that valuation reports prepared and completed by their members complies with their Red Book.

Residential Mortgage Valuations – most financial institutions have their own standard Mortgage Valuation template that they require the valuer to complete. The templates typically request details relating to the location, description of the house, measurements, title issues, requirement for works to the unit, present value, value on completion of works, re-instatement values and rental information details (where applicable). Some institutions require a photograph of the property to accompany the valuation report.

Commercial Mortgage Valuations – Valuation reports can be submitted in Bank template or free format from the valuer. Information that would be required would include location, description and use (current and alternative) of the property, construction, accommodation and measurements, title issues (to include planning, boundaries and essential services), existing lease details, general commentary on the local market and of the requirement for works to the unit, present values, value on completion of works and re-instatement values.

### 3.4 Use of AVMs

AVMs are currently used in Ireland for mortgage origination and re-mortgaging purposes, and also as a quality control tool in the mortgage origination process.

## *4. The Valuer*

### 4.1 Regulatory Framework

There are no legislative requirements regulating the training or competence of valuers. Valuers are self-regulated by the professional body to which they are members.

### 4.2 Education/qualifications

As a general rule valuations will only be accepted from a mortgage lenders own panel of valuers. These individuals are suitably qualified and are

- A member of one of the two auctioneering bodies in the country, Irish Auctioneers & Valuers Institute or Institute of Professional Auctioneers & Valuers;
- A member of the Royal Institute of Chartered Surveyors; or
- A suitably qualified architect or engineer; and
- who have an adequate level of professional indemnity insurance cover as laid down by the mortgage lender.

Some lenders are prepared to accept valuations arranged by the borrower, provided the valuation is carried out by a firm known to the bank.

### 4.3 Use of valuer title

The use of the title 'Valuer' is not protected in the country. Lenders protect themselves against the risk of 'unqualified' valuers by assessing the valuer and their associated firms educational qualifications, experience and reputation, both individually and collectively, together with the level of professional indemnity insurance cover that is maintained by the individual/firm.

### 4.4 External v. Internal

Property valuations are not subject to restrictive regulations in Ireland. Institutions active both in commercial and residential mortgage lending resort to either employed staff or external experts for their valuations. Each lender can independently choose any expert according to experience, location or field of expertise which they typically retain on their own 'Panel of Valuers'.

### 4.5 Professional Indemnity Insurance

There is no legal requirement for a 'valuer' to hold professional indemnity insurance cover however it is typically a requirement of their associated professional institute/body that an adequate level of cover is in place which is typically proportionate to the income generated in their firm.

As a general rule lenders require all valuers that they accept valuation reports from to have professional indemnity insurance cover in place and request evidence of the cover on an annual basis.

## *5. Capital Requirements & Property Valuation:*

### ***Covered Bonds***

In Ireland, the Asset Covered Securities Act 2001, the Asset Covered Securities (Amendment) Act 2007, as well as related secondary legislation relate to real estate backed covered bonds, and in the context of the CRD, the national regulator has made the following interpretations:

- Maximum eligible asset LTV ratios for different types of residential and commercial real estate:

The maximum LTV for residential properties is 75%, the maximum for commercial properties is 60%.

- Monitoring:

The Irish regulator has not interpreted the provision regarding "more frequent monitoring where the market is subject to significant changes" in the context of covered bond legislation. Covered Bond issuing institutions (Designated Credit Institutions) are required to comply with the CRD and are subject to the supervision of the Financial Regulator with respect to their CRD compliance generally.

- Revaluation:

The Financial Regulator has specified the method by which values can be updated, using a reference index. On top of that the Designated Credit Institution must comply with the requirements in the CRD, and in doing so is subject to the supervision of the Financial Regulator.

- Insurance:

Insurance is not required by the covered bond legislation - Covered Bond issuing institutions (Designated Credit Institutions) are required to comply with the CRD and are subject to the supervision of the Financial Regulator with respect to their CRD compliance generally.

- Independence of the Valuer:

The Irish regulator has not interpreted the provision regarding "independent valuer" in the legislation. Covered Bond issuing institutions (Designated Credit Institutions) are required to comply with the CRD and are subject to the supervision of the Financial Regulator with respect to their CRD compliance generally.

- Market Value & Mortgage Lending Value:

The Irish regulator has not issued executive orders or guidelines on "market value" and "mortgage lending value".

***Data Standards***

As a principles-based regulator, the Irish Financial Regulator has not to date provided specific guidance on either statistical methods or data requirements for monitoring property values. Arising from their Supervisory Review & Evaluation Process further clarity or guidance may evolve.

## *Italy*

### *1. Macroeconomic Overview*

In 2008, real GDP decreased by 1.0%. The economic downturn was felt most acutely during the fourth quarter of 2008 when GDP fell by 1.9% on a year-on-year basis, recording the worst drop since the 1974-75 economic recession. As the global economic crisis deepened, the demand for exports dropped by 7.4%, while at the same time a slowdown in private investment was recorded, particularly in machinery, equipment and transportation (-8.9%). Household consumption expenditure also fell by approximately 1.0%.

In 2008, both the high increase in the price of raw materials, as well as the gradual worsening of economic conditions in the major global markets negatively impacted the Italian foreign trade balance: indeed, terms of trade and the quantities exchanged decreased. All the manufacturing sectors, with the exception of the foodstuff products, suffered from a sharp reduction in exports. In particular, the so-called 'made-in-Italy' products (leather, furniture) and machinery products, which after the rise in exports of the previous two years, suffered from slackening global demand for investment goods. The decrease in the overall volume of imports exceeded the reduction in the volume of exports; this decrease was particularly marked in investment goods (-5.4% on 2007) which dramatically weakened during the last quarter of the year (-7.4% compared with the same quarter in the previous year).

During 2008, the unemployment rate continued to rise, reaching 6.8%, compared to 6.1% in 2007.
Consumer price inflation decreased from 4.1% in July and August to 2.2% in December. The rapid fall in inflation was entirely due to the gradual loosening in inflationary pressures from commodity prices and food products. On the whole in 2008, the consumer price index rose by 3.5% (2.0% in 2007).

### *2. Property Market Overview*

#### *2.1 Residential Property Market Overview*

In 2008, the housing market recorded 686,587 transactions signalling a drop of 15.1% compared with 2007 data when 806,225 sales were recorded. Despite the falling number of sales in 2008, house prices remained fairly stable, recording an increase of 1.3%.

The value of outstanding residential mortgages increased from 305,488 million Euros in 2007 to 311,788 million Euros in 2008, which represented an annual increase of 2.5%, which is remarkably lower than the 2007-2006 increase (10.2%). In 2008, net lending amounted to 7,565 million Euros, which represented an annual decrease of 73.1%; whereas gross lending amounted to approximately 85 billion Euros, which amounted to a 9.7% decline on the previous year.

### *2.2 Commercial Property Market Overview*

As of the second quarter of 2007, the total number of outstanding commercial loans amounted to €128.401 billion, which equals approximately 8.9% of Italian GDP.

## *3. The Valuation*

### 3.1 Regulatory Framework

There are no specific provisions in Italian legislation regarding property valuation. The supervisory authorities have however defined a set of rules on the basis of the Credit Requirement Directive.

In recent years, the number of Banks, who lay down their own internal standards, has increased. In doing so, banks refer to internationally accepted codes and to parallel legislation already in place, such as the Bank of Italy's supervisory rule "Property Valuation for REITs", as well as the UNI (National Body of Standardisation) standard N° 10750 for the regulation of Estate Agency Services.

TECNOBORSA (a public body where the Chambers of Commerce meet) has recently issued the 3rd edition of the "Italian Property Valuation Standard" which includes specific guidelines for valuations for bank security purposes, agreed by the Italian Banking Association.

Professional organisations of valuers do not exist in Italy.

### 3.2 Valuation Bases & Methodology

The value used for mortgage lending purposes is customarily the market value. Nevertheless the practical use of the concept of market value is so cautious that it would be more appropriate to speak of a mortgage lending value (valore cauzionale). For residential property, the market data approach is normally used. In the case of a commercial property, the market data approach is supplemented by the income approach, whereby deductions are made for tax on property, maintenance, lost rents etc.

In the case of properties that are rented at below the market rate, the valuation usually takes the actual cash flow generated as a basis, taking into account the automatic prolongation of the contract and possibility of rent reviews at the end of the current contract. Consideration is also given to several factors affecting the value of the property, such as location, connection to the necessary services (schools, means of transport etc.), type of building, characteristics of construction and of prevailing demand. Data for valuations is built up by valuers on a case by case basis: for this reason banks create an appropriate network of valuers, so as to ensure the necessary expertise within the special sub-market to which the property belongs. A distinction is made between mortgage credit operations (in Italian "credito fondiario") complying with the special rules set out in sections 38 through 41 of the banking law, and loans simply granted against a mortgage, regardless of the stricter rules thereby.

The special rules mentioned above include a conservative loan to value ratio (up to 80%, in the case of existing buildings), or a loan to cost ratio (up to 80%, in the case of development loans), the requirement of a first-ranking mortgage as collateral of the loan, a minimum maturity exceeding 18 months (although average maturity is 20 years) and a set of privileges and shortcuts regarding the legal proceedings for the execution of the collateral itself.

### 3.4 Valuation Report: Form & Content

There are no legal/professional requirements with regard to the form and content of the valuation report in Italy. Every lender has its own code of valuation in this respect.

### 3.5 Use of AVMs

In Italy, it is currently felt that AVMs are incompatible with the complexity of the banking structure and typology related to mortgage origination.

## *4. The Valuer*

### 4.1 Regulatory Framework

There is no specific provision in Italian legislation regarding the profession of property valuers. However, in December 2006, Tecnoborsa, a public entity, published a valuation code based on the IVS, together with the Italian Banking Association. Moreover, some banks have their own valuation code and almost all banks have a list of approved valuers.

### 4.2 Education/qualifications

There is a register of valuers in Italy. TECNOBORSA also promotes and organises activities which encourage the acquisition of expertise in line with the evolution of the real estate market.

### 4.3 Use of valuer title

The use of the title itself is not protected, so that any individual listed in a technically relevant Trade Roster can describe himself as "valuer", "property consultant" etc. Banks normally refer to professionals holding degree/diploma level education consistent with the type of property concerned (engineers, architects, etc.), both for external and internal valuers: in fact, universities and specialised high schools have real estate valuation as a subject on their curricula. The listing in a relevant Trade Roster confers upon members - among other things - the legal ability to undertake autonomous professional assignments, such as a valuation, and to sign the valuation report in their own name. The listing in the relevant Trade Roster is mandatory for the valuer, whenever the valuation has to be used in court for legal purposes.

### 4.4 External v. Internal

Banks active in residential and commercial mortgage lending resort to either employed staff or external experts for their valuations. In general, external valuers are called upon whenever smaller loan amounts are involved, while employed staff is preferred as the value increases. External experts are ranked independently by each bank according to experience, location, field of expertise and value range of the property for which the bank entrusts them. Classification into each of the above categories is made on an empirical basis and at the discretion of the bank's management: normally each valuer is progressively tested through assignments of growing relevance over the years.

### 4.5 Professional Indemnity Insurance

In Italy, professional indemnity insurance is not required by regulation nor by professional bodies. Some valuers indeed do have professional indemnity insurance cover but such Policies make almost no difference to the lender. Moreover, these insurance Policies come into play only after the bank has brought the valuer to court and the court has found him guilty. Several years can elapse between the time the bank has incurred a loss (because of an erroneous valuation) and the time it can be indemnified by the valuer himself (or by his insurance company). Valuers' liability for professional malpractice and errors exist pursuant to the provisions of the civil code, which provide for monetary indemnity in case the valuer is found guilty. However, litigation between banks and external valuers is rather rare, as it involves a lengthy procedure, the outcome of which is largely uncertain. Professionals such as architects, engineers, agronomists etc. hold a so-called professional insurance Policy, which however covers risks of a different nature.

## *5. Capital Requirements & Property Valuation:*

### *Covered Bonds*

Legislation exists in Italy on real estate backed covered bonds, and in the context of the CRD, the national regulator has made the following interpretations:

- Maximum eligible asset LTV ratios for different types of residential and commercial real estate:

80% residential; 60% commercial

- Monitoring:

The Italian FSA has not issued any guidelines on the provision regarding "frequent monitoring".

- Revaluation:

The Italian FSA has not issued any guidelines on the provision regarding "individual revaluation".

- Insurance:

There are no insurance requirements in Italian legislation.

- Independence of the Valuer:

Independence is guaranteed by the fact that the valuer is independent on the decision of loans granting.

- Market Value & Mortgage Lending Value:

The Italian FSA has not issued any guidelines on the provision regarding the definitions of "market value" and "mortgage lending value".

### *Data Standards*

The Italian regulator has not published any interpretation of the provision regarding "monitoring using statistical methods" in the minimum requirements for valuation. Equally, the regulator has not set out any data requirements specifically relating to property valuation.

## *Luxembourg*

### *1. Macroeconomic Overview*

Like most of the EU's advanced economies in 2008, Luxembourg fell into recession as a consequence of the deterioration in the international macroeconomic environment: real GDP growth rate on the previous year was negative (-0.9%), after a 5.2% increase recorded in 2007 and prior to that four years running when economic growth was above 4%.

The main driver for the negative performance of the economy was the decrease in domestic demand: gross fixed investment slowed down (1.7%) after the bullish 11.8% increase recorded in 2007, other sub-components of domestic demand also performed poorly, especially investment in equipment (0.3%) and households` consumption (0.8%). Exports fell markedly, by 2.0%, on the previous year, but the current account balance in 2008 was still in surplus (at 5.5% of GDP), albeit declining from 2007 (9.8%). The rise in the consumer price index accelerated in comparison to 2007 (4.1% vs. 2.7%), due to the inflationary pressures over the first half of 2008. Despite the general worsening macroeconomic conditions, the government deficit to GDP ratio was still positive (2.6%), while government gross debt doubled in comparison with 2007 but remained at very low levels (14.7% of GDP). The unemployment rate also increased, reaching 4.9% (it was 4.2% in 2007).

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

Housing activity slowed down sharply in 2008. The number of building permits issued decreased by 28.6% on 2007 (4,017 units in 2008 vs 4,934 in 2007). Contrary to what happened in many EU housing markets in 2008, in Luxembourg house prices did not fall from the level reached over the previous year, but rather continued to show signs of stabilisation: after the 9.6% average annual increase in house prices recorded between 2000 and 2006, in 2008 the housing market also recorded the same modest growth rate in house prices as in 2007 (1.6% versus 1.5%). Residential mortgage lending market in absolute values grew by 15.1% in 2008 on the previous year 2007 (amounting to 15.9 billion Euros) which was the highest year-on-year increase recorded among EU15 countries. In terms of percentage of GDP, mortgage lending also increased and went from 38.5% to 43.5%. Representative mortgage interest rates rose from 3.47% in 2007 to 4.75% in 2008, but they remained below the euro area level (5.5%).

### *3. The Valuation*

### 3.1 Regulatory Framework

There is no regulatory framework concerning general mortgage loans, and the valuation of the underlying properties. The banking supervisory authority (Commission de Surveillance du Secteur Financier, CSSF) does not carry out any detailed control of the valuations used for mortgage loans.

Circulaire CSSF 06/273, which translates the European Solvency Directive into national law, contains however certain stipulations concerning the valuation of properties for the risk weighting of mortgages. This text rules for instance that for the mortgage to be eligible for reduced risk weighting, the value of the mortgaged property has to be determined by an independent valuer. For loans above EUR 3.000.000,- or exceeding 5% of the banks capital a control of the value has to be undertaken every three years by an independent valuer. In the case of commercial properties a control of the value has to be effected at least every year, but not necessarily by an independent valuer. In the case of residential properties this interval is three years. An independent valuer is defined as a person possessing the necessary qualifications and being independent from the credit decision process. The text furthermore obliges the Banks to have a clear written lending Policy concerning the types of property and the lending conditions in place. The Banks also need to have an internal procedure in place that allows them to monitor whether the property serving as security is adequately insured.

The market is likely to see continued domination of the market by the domestic banks using their own in house valuers and external valuers. The procedures used by these valuers are likely to remain unchanged in the short term.

There are also no professional organisations regulating the valuation profession.

### 3.2 Valuation Bases & Methodology

In the absence of any particular definition provided by legislation, it seems most prudent to assume that a market value corresponding to International Accounting Standards (IAS) is more or less consciously employed. Market value is thus the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and willing seller in an arms length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Generally all valuation methods are used, with the cost approach predominating in the residential sector, and the income approach mostly used for commercial property.

### 3.3 Valuation Report: Form & Content

There is no standard form of valuation report. Each valuer has his own format which will generally cover the normal issues a prudent valuer would assess such as location, situation, building description, floor areas, planning, tenure, tenancy etc.

**3.4 Use of AVMs**

There is no legal or professional framework governing the use of AVMs. As far as can be ascertained, AVMs appear to be unknown in the mortgage lending business.

***4. The Valuer***

**4.1 Regulatory Framework**

In Luxembourg, there is no legal or professional framework specific to valuers.

**4.2 Education/qualifications**

There are no qualifications to be passed in order to act as a valuer. Most valuers tend to be architects or engineers by training.

**4.3 Use of valuer title**

There is no legal prohibition against anyone describing themselves as a valuer.

**4.4 External v. Internal**

Circulaire CSSF 06/273, which translates the European Solvency Directive into national law, and Circulaire CSSF 01/42, which defines the rules of property valuations for covered bond issuers both lay down rules relative to the independence of valuers (see paragraph3.1. above). Both texts are issued by the Financial Sector Supervisory Authority (CSSF).

Residential and commercial lenders operating in Luxembourg will use internal or external valuers. It tends to be only the larger domestic banks with sufficient volume eg. Banque & Caisse d'Epargne and Banque Générale de Luxembourg, who have their own in house valuers.  The remaining mortgage valuations are carried out by external valuers.

**4.5 Professional Indemnity Insurance**

In Luxembourg, there is no legal or professional framework specific to valuers. However, property valuations may be carried out by members of professions, which are regulated by law and who are obliged to have PII e.g. architects and engineering-consultants. The professional body of architects and engineering-consultants has issued a specimen insurance Policy. This is however very much adapted to the situation of an architect or engineering-consultant acting as contractor, and does not contain any stipulations that would specifically apply to activity in the field of property valuation. Nevertheless, the cover of this specimen contract appears to be very comprehensive and generally includes all damages resulting from the professional activity of the insured.

***5. Capital Requirements & Property Valuation:***

***Covered Bonds:***

In November 1997, the Luxembourg Parliament enacted a new law on mortgage bond issues which has many parallels to the German Mortgage Bank Act. This legislation applies exclusively to banks issuing "lettres de gage hypothécaires" (i.e. mortgage banks) and requires that valuation for mortgage purposes must be carried out with care and talks of a realisable value (valeur estimée de réalisation du bien immobilier). The estimation of the realisable value must take into account the long term characteristics of the property (caractéristiques durables) and the sustainable income (revenu durable). Up to 60% of the realisable value thus determined of a mortgaged property may serve as cover for the issuance of covered bonds.

In November 2001, the banking supervisory authority (CSSF) issued Circulaire CSSF 01/42, which is a supplementary note with regard to the valuation principles to be observed by mortgage banks. Content and method of property valuations are set out in some detail. Furthermore, the note specifies requirements about the independence of internal valuers of the banks, and about the formal control of the valuations to be undertaken by the trustee (Treuhaender) of the cover fund and about the internal audit and the accountants. The note also stipulates that in principle a revaluation has to take place yearly. The regulatory authority can however require more frequent revaluations. No details are given concerning the exact scope of a revaluation (e.g. site inspection, market research, etc.).

The supplementary note stipulates that valuations for covered bond issuance may be carried out either by external or internal valuers. External valuers are to be appointed exclusively by the bank which has to verify that no personal or economic ties exist between the valuer and the borrower. Internal valuers are to be appointed by and have to report directly to the board. The organisational structure of the bank must be such that the internal valuers are independent from the credit decision process.

On the basis of this note, every mortgage bank has had to establish more detailed valuation regulations to be approved by the CSSF.

Mortgage banks are thus subject to a strict regulatory framework with respect to property valuations.

With regard to the CRD & covered bonds, the CSSF has not at this stage set maximum LTVs for different types of real estate, nor has it interpreted provisions relating to frequent monitoring, revaluation, and independence of the valuer. As indicated above however, the CSSF has issued executive orders or guidelines on the mortgage lending value (though not on the market value).

- ***Data Standards***

No specific interpretation has been issued by the CSSF regarding "monitoring using statistical methods". Moreover, there are no data requirements specifically relating to property valuation

## *The Netherlands*

### *1. Macroeconomic Overview*

In 2008 the Dutch economy grew at a rate of 2.1%, a figure affected by the worldwide decline in economic growth, which was felt in the Netherlands particularly at the end of 2008 and thereafter. Compared to the 3.5% growth rate recorded in in 2007, this marked a considerable slowdown, but still put the Netherlands above the EU average (0.9%). The slowdown in economic growth was driven by a drop in exports, with the worldwide economic downswing causing a global decline in international trade .

The figures for the Dutch labour market in 2008 were quite positive compared to the EU average, and also as compared to the previous year. The unemployment rate dropped from 3.2% in 2007 to 2.8% in 2008, marking the lowest unemployment rate in the EU27 However, the situation is evolving, with the economic downturn seriously affecting the labour market in 2009.

In 2008, inflation in the Netherlands was higher than for the previous year, rising from 1.6% to 2.2%, but still remaining below the EU27 average (3.7%).

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

The number of building permits issued dropped slightly, from 87,900 in 2007 to 87,200 in 2008, while the number of housing completions also fell, from 80,200 to 78,900, representing a decrease of 1.6%. So far, these figures show only minor effects of the worldwide economic recession. It should be noted that in the Netherlands the lag between the issuance of a building permit and the building completion is traditionally long and has been on the increase over the past few years. Moreover, the housing market is dominated by professional building companies that only start building after selling approximately 70 percent of the dwellings involved in the project. Therefore additional information concerning the number of new and planned dwellings sold would be valuable in this context. In the same period, the number of owner-occupied dwellings that were sold decreased by 30%, as a serious drop in consumer confidence resulted in decreasing demand. In the Dutch context, this drop in the number of sales due to the economic downturn will also negatively impact the number of completions at a later stage.

Over the last decades, the share of owner-occupied dwellings in the housing stock has considerably increased, moving from 42.0% in 1983 to 57.0% in 2008. Nevertheless, the home-ownership rate is far below the EU27 average. The rental market is dominated by housing associations which provide affordable rental accommodation (accounting for 32% of the total housing stock). They also invest in owner-occupied dwellings. The private rental sector (which accounts for 11% of the total housing tenure) consists of institutional investors such as insurance companies and pension funds (6%) and private individuals letting one or more dwellings. In recent years, there has been a shift in demand away from owner-occupied to rental dwellings and the share of housing production has changed accordingly. In particular, housing associations which had planned to build owner-occupied dwellings are now turning the dwellings into rental accommodation, planning to sell these when market circumstances improve.

The Netherlands has experienced a sustained period of house price increases. Prices have risen, on average, from 60,000 Euros in 1985 to 248,000 Euros in the third quarter of 2008. Over the period 1996-2001, house prices increased by 10 to 20% per year on average. Since then, the increase has slowed to 4 to 5% per year. The annual average house price increase in 2008 was flat (-0.1%), after the 3.6% increase recorded in 2007. Quarterly figures reveal that house prices started to decrease in the fourth quarter of 2008[5]. The downturn in the housing market iwas also reflected in the figures for housing market transactions, which dropped from 202,401 in 2007 to 182,400 in 2008, a decrease of 10%[6] .

The Netherlands has the highest residential mortgage debt to GDP ratio in the EU (99.1% in 2008). Factors such as increasing house prices, a healthy labour market, increasing incomes and the fact that 100% of the mortgage interest rate can be deducted from income tax, have all contributed to enormous growth in mortgage lending in recent years. Since 2005, net residential lending has slowed down; this decline continued into 2008, from 36,539 loans approved in 2007 to 30,550 in 2008[7] . In 2008, the total value of outstanding mortgages taken out by households was 589,532 million Euros, which was an increase of 6.9% on 2007. The representative mortgage rate for new loans increased from 4.96% in 2007 to 5.34% in 2008 and during 2008 the fixed interest period shifted towards periods of 1 to ten years.

## *3. The Valuation*

### 3.1 Regulatory Framework

2004 saw a significant breakthrough on the Dutch institutional scene, as the two major certification organisations for valuers, the CRMT (Nederlands Instituut Certificatie en Registratie Makelaar-taxateurs in onroende zaken) and the SRT (Stichting Register Taxateurs O.Z.) decided to merge and form the Stichting VastgoedCert. Two further organisations, the NRVT (Nederlands Register van Vastgoed Taxateurs) and Stichting WOZ, will also join the new body and cease to exist.

[5] Monitor New Dwellings, Netherlands
[6] RICS Housing Review 2008
[7] WEW (Homeownership Guarantee Fund Foundation), Annual Report 2008

Stichting VastgoedCert will eventually administer one single register for certified valuers in real estate, and will thereby put an end to the confusing situation that has developed since the abolition in the late 1990es of the swearing-in of valuers by the chambers of commerce.

Certification takes place by Kema Quality B.V. which is accredited according to the European norm EN 45015 by the Stichting Raad voor Accreditatie. Certified valuers will be registered in one of four chambers (residential, commercial, agrarian, taxation) of VastgoedCert and will have the right to call themselves either Register Makelaar-Taxateur (RMT, for the residential chamber) or Register Taxateur (RT, for the other chambers). It is widely expected, that these titles will become largely accepted standards within the valuation profession.

**3.2 Valuation Bases & Methodology**

In Dutch valuation practice, the Market Value ("Onderhandse Verkoopwaarde") concept has a pre-eminent role and is the most used for mortgage lending purposes. A Forced Sale Value ("Executiewaarde") concept, which reflects the higher transaction costs and the limited marketing period attached to a forced sale situation, also exists in the Netherlands. This is therefore not a value concept which could be compared to the Mortgage Lending Value. The Forced Sale Value does play a certain role in residential mortgage lending and is often determined together with the Market Value. In commercial property lending, the Forced Sale Value is of subordinate importance, although some banks appear to rely on it for their risk assessment.

Mortgage Lending Values are not yet estimated by the Dutch valuers, but under the pressure of the German mortgage banks active on the Dutch market, some valuation firms appear to consider estimating Mortgage Lending Values in the near future.

Due to the great transparency of the Dutch residential market, information about past transactions is easily available and the sales comparison method is therefore universally applied for residential mortgage valuations. In special cases, where the property characteristics are too specific for the property to be directly compared to other buildings, valuers may also rely on the depreciated replacement cost method.
For commercial mortgage lending, banks either employ their own in-house valuers or use the services of the valuation departments of the large international property consultants. A number of the more important domestic property consultants have also succeeded in being short listed by the banks. The net capitalisation method is nearly always applied, and the use of discounted cash-flow calculations as additional approach is becoming ever more widespread.

**3.3 Valuation Report: Form & Content**

In 2001 the interest group of residential mortgage lenders, the Contactorgaan Hypothecair Financiers (CHF), together with a number of a professional organisations of the real estate sector developed a standard valuation report (and an accompanying norm-sheet) for the purpose of residential mortgage lending. The members of the CHF, which comprise nearly all the major residential mortgage lenders of the country, only accept valuation reports which are in accordance with this standard report.

### 3.4 Use of AVMs

AVMs are used to carry out mass appraisals for taxation purposes and also as a quality control tool in the mortgage origination process.

## *4. The Valuer*

### 4.1 Regulatory Framework

As indicated above, Stichting VastgoedCert administers one single register for certified valuers in real estate. Certification is handled by Kema Quality B.V. which is accredited according to the European norm EN 45015 by the Stichting Raad voor Accreditatie. Certified valuers are registered in one of four chambers (residential, commercial, agrarian, taxation) of VastgoedCert and have the right to call themselves either Register Makelaar-Taxateur (RMT, for the residential chamber) or Register Taxateur (RT, for the other chambers). These titles are largely accepted standards within the valuation profession.

### 4.2 Education/qualifications

See above.

### 4.3 Use of valuer title

Certified valuers are registered in one of four chambers (residential, commercial, agrarian, taxation) of VastgoedCert and have the right to call themselves either Register Makelaar-Taxateur (RMT, for the residential chamber) or Register Taxateur (RT, for the other chambers).

### 4.4 External v. Internal

There is/are no legislation/rules in the Netherlands governing lenders as to whom they may use to value properties.

As far as typical practice is concerned regarding the use of internal and external valuers, this varies. Some lenders have their own internal valuers, while others rely on external ones. In the latter case, valuations submitted by the borrower may even be accepted by the lender.

### 4.5 Professional Indemnity Insurance

There is no legal requirement in the Netherlands for valuers to have professional indemnity insurance. The professional bodies (RICS, NVM) do have however requirements for their members to have appropriate cover. In practice this means that the vast majority of valuers will have cover. There is/are no legislation/rules in the Netherlands determining the responsibility of the valuer vis-à-vis his client. This should fall under the common civil law statutes (burgerlijk wetboek).

## *5. Capital Requirements & Property Valuation:*

- ***Covered Bonds:***

Legislation in the Netherlands on real estate backed covered bonds is currently being planned.

- ***Data Standards***

The Dutch regulator has not set out any data requirements specifically relating to property valuation.

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## *Poland*

### *1. Macroeconomic Overview*

The macroeconomic environment in Poland in 2008 was still very positive. Real GDP growth on 2007 reached 5.0% –although the growth rate slowed down in the last quarter to 2.9%. GDP growth was mainly driven by domestic demand (which increased by 4.8%) – largely due to the high growth rate in investment (7.9%), as well as in consumer demand (5.4%). Nevertheless, it should be noted that growth rates in all these indicators decelerated in Q4 2008.

At the end of 2008, the unemployment rate rose to 9.5% (7.1% as a yearly average) whereas the active population increased by 2.2%. In 2008, the increase in the average gross wage and salary in the private sector amounted to 5.5%.

Inflationary pressures in 2008 were still considerable – in annual terms the inflation rate stood at 4.2% (in December it was 3.3%). In order to keep inflation under control, monetary policy remained restrictive: in June 2008 the reference interest rate was at 6%. However, by the end of the year interest rates were brought down. In December, the central interest rate was cut down to 5%.

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

In 2008, over 165,000 dwellings were completed (representing a 23.5% increase in comparison with 2007). The number of building permits issued in 2008 amounted to over 220,372, half of which were for individual investors. At the end of December 2008, about 687,400 dwellings were under construction.

In 2008 the trend in prices which was observed since the second half of 2007 continued. Prices – especially in big cities - started to fall, although this decrease remained moderate. Further decreases are expected even though the availability of housing remained very limited: in biggest cities, the number of square metres of housing available for an average monthly salary was about 0.4.

At the end of December 2008 there were around 1.3 million mortgage credit agreements outstanding. In 2008 about 286,000 new residential mortgage loans were granted (a decrease of 9% on 2007). At the end of December 2008 Polish households` residential debt amounted to 192 billion Zlotys (56.5 billion Euros), which constituted an increase of 57% in comparison with December 2007. It must be stressed however that growth in the outstanding portfolio was in part a result of the depreciation of the zloty, as about 50%

of the portfolio are CHF-denominated loans. The new mortgage lending in 2008 amounted to 57.1 billion zlotys (15.1 billion euros).

In the second half of 2008 the majority of banks tightened their credit policy. Firstly, the supply of foreign currency-denominated loans was constricted, then banks restricted their lending criteria also with regard to zloty-denominated loans. In the last quarter of 2008, 85% of Polish banks tightened their credit policy, and 90% of them lowered their maximum LTV ratios. All banks imposed higher margins on residential loans and 5% of them imposed additional requirements regarding collateral.

## *3. The Valuation*

### 3.1 Regulatory Framework

All specifics of the valuation of residential and commercial property are regulated by law. Key property valuation rules are defined by the Real Estate Act and secondary legislation has been developed on the basis of that Act.

There are also detailed instructions in the Professional Standards of Property Valuers adopted by the Polish Federation of Valuers Association.

### 3.2 Valuation Bases & Methodology

In Poland, the valuation base for residential and commercial property for lending purposes is the Market Value.

The definition of the market value is the same as that laid down by the IVSC and TEGoVA. The market value is the price most likely to be achieved on the market, assuming that the parties to the agreement are independent, are not acting under the influence of pressure, and the property was exposed on the market for an adequate length of time.

There are four different valuation methodologies:

- The Comparative Approach: the average price correction method, the statistical analysis of an estate market method, the comparative pairs method.
- The Income Approach: the investment and profits method, and both methods may be employed with the use of either direct capitalisation or using DCF.
- The Cost Approach: the replacement cost method, the reproduced cost method, the liquidation cost method.
- The Mixed Approach: the residual method, the land’s estimated index method.

Usually valuers use the comparative approach for both residential and commercial properties. The valuation of commercial properties is based on a tenancy rate and for the residential purpose – a market value of equal residential properties. The cost approach is also used, although its use is rare and limited to special cases.

### 3.3 Valuation Report: Form & Content

Valuers are obliged by law to submit the property valuation in written form. It is not possible to depart from the mandatory form.

Each valuation report should contain:

- the object and the scope of valuation;
- the purpose on the valuation;
- the formal basis of the valuation and sources of data of real estate;
- material dates;
- description of the real estate;
- purpose on the real estate;
- analysis and description of characteristic of real estate market;
- defined value, approach, method and valuation technique;
- calculations, result with the justifications.

There is no special distinction between requirements (concerning form and content) for residential and commercial valuation purposes.

### 3.4 Use of AVMs

Polish legislation does not provide rules or guidance on the use of AVMs. The law demands that every valuation report contains certain obligatory elements, which makes valuation by AVMs more difficult. Valuers do employ certain special applications to for valuation purposes, but mainly for calculations.

## *4. The Valuer*

### 4.1 Regulatory Framework

There is no legislation exclusively related to property valuers for lending purposes in Poland. However, all questions related to property valuers are governed by the Act on Real Estate Management. Additionally, according to professional standards, valuers must fulfil the following conditions:

- The valuer must not be personally or officially related to the owner of the real estate;
- The valuer must not be employed by the mortgage debtor;
- The valuer must not be the mortgage debtor, mortgage debtor's spouse or relative;
- The valuer must not be rewarded irrespective of the amount of the loan.

**4.2 Education/qualifications**

Property valuers must meet certain statutory conditions:

- The valuer must have a university degree (until 1 January 2008 from the law, economics or technical faculty);
- The valuer must not have any criminal offences under the Real Estate Act (article 177, section 1, point 2);
- The valuer must have post-graduate studies in real estate valuation (1 year);
- The valuer must have one year's experience in real estate valuation;
- The valuer must pass a state exam.

Valuers are obliged by law to improve their professional qualification constantly, through participation in trainings, courses, conferences, etc

**4.3 Use of valuer title**

The title of property valuer is granted by the Ministry of Construction and is subject to legal protection. Illegal use of this title is an offence and the individual in question is liable for arrest, restriction of liberty and a fine.

**4.4 External v. Internal**

In Poland, the professional impartiality of property valuer is governed by the act on real estate management. A property valuer is obliged to carry out property valuation activities in accordance with legislation and professional standards, with utmost diligence befitting the professional nature of these activities and in accordance with professional ethics, while observing impartiality in the process of valuing the property. The act stipulates the observance of the rules laid out in the Professional Standards of Property Valuers.

According to the Professional Standards of Property Valuers adopted by the National Board of the Polish Federation of Valuers Associations, a property valuer is obliged to: observe the fundamental principle of impartiality, cannot be bound by the illegal requests of the party ordering the valuation or persons interested in the results of his work, cannot value his own property or the property of his close relatives if there is a clear legislative ban or if doing so could raise doubts as to the objectiveness of the valuer, cannot accept any personal or financial gains from the contracting party related to his activities except for the remuneration stipulated in the agreement and cannot condition the extent of the remuneration on the objective expected by the client, nor on the degree to which the client's wish is fulfilled.

This being said, banks do have departments of technical analysis, which determine the value of the real estate. In some precisely determined instances, there may be a need for a valuation report. This report can be prepared only by the person, who holds the title of property valuer. If no individual in the bank holds this title, the bank has to commission an external property valuer to carry out the valuation report. In other cases, the technical analysis carried out by the bank's employee is sufficient.

### 4.5 Professional Indemnity Insurance

In Poland, in accordance with article 175, section 4 of the Act dated 21/08/1997 on the management of real estate, a property surveyor is subject to compulsory civil liability insurance for losses caused in connection with the performance of his activities, specified in article 174, section 3 and 3a.

In Poland, the responsibility of the valuer vis-à-vis his clients is regulated in accordance with article 175, section 4 of the Act dated 21/08/1997 on the management of real estate described above.

## *5. Capital Requirements & Property Valuation:*

### *Covered Bonds*

Legislation exists in Poland on real estate backed covered bonds. No information is available on the the national regulator's interpretations in the context of the CRD.

### *Data Standards*

In Poland, there is no special standard for "monitoring using statistical methods" issued by the banking supervisor. According to Recommendation S (best practice for mortgage loans), banks are allowed to use ‘some’ statistical methods to conduct valuations based on simplified procedures for non substantial exposures (i.e. over €3m or over 5% of equity).

## *Portugal*

### *1. Macroeconomic Overview*

The strong decline in investment and exports associated with the international financial and economic crisis were among the factors behind the stagnation of the Portuguese economy: real GDP growth rate in 2008 was flat.

The above-mentioned factors also explained relatively high unemployment levels, at 7.7%, although this represented a slight decrease from 8.1% in 2007.

The inflation rate has declined dramatically, reaching 0.8% at the end of 2008. This was due to the sharp contraction in economic activity, the reduction in the price of commodities and increased unemployment. Average inflation in 2008 was 2.7%.

Despite the ECB`s repeated cuts in its central interest rate, mortgage interest rates in Portugal showed marked declines only in the first quarter of 2009, due to the time lag in the transmission mechanism.

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

At the end of 2008, the total stock of mortgage lending was 105,210 million Euros, which represented an annual increase of 4.1%. This was a slowdown in comparison with the 10% increase recorded in 2007, driven by factors related to the international crisis, which severely impacted families and businesses and had a negative effect on unemployment.

This negative scenario is also reflected in other housing and mortgage market indicators which recorded a contraction in activity over the previous year. In 2008, gross residential lending decreased by 31.1% on 2007 and the residential house price index fell by 6% (according to the Bank Evaluation on Housing published by the Statistical Institute of Portugal, INE).

### *3. The Valuation*

#### 3.1 Regulatory Framework

There is no legal framework specific to the valuation of property. The supervisory authorities have however defined a set of rules on the basis of the credit requirement directive, (Notice 5/2007, Bank of Portugal), and the covered bond regulation, (Notice 5/2006, Bank of Portugal).

**3.2 Valuation Bases & Methodology**

The valuation of property for lending purposes should be effected according to the market value or less in Portugal. Banks use the market value or the mortgage lending value. Their definitions are those prescribed by TEGOVA and IVSC. An administration value is used for tax purposes.

In terms of methodology, the following approaches are applied:

- Comparative method – principal method if there is a significant number of comparable properties
- Depreciate reconstruction cost method
- Income method – when there is an effective rent or market with liquidity for rental. Most frequent in commercial properties and offices.
- Residual Method – undeveloped land, unfinished construction
- Discount cash flow approach – in some management properties

**3.3 Valuation Report: Form & Content**

There is no legal or professional framework specific to the valuation of residential and commercial property. Most banks have their own standards mortgage valuation templates that they require the valuer to complete.

Normally each valuation report should contain the identification and description of the property, including composition, importance of the location, quality of construction and state of conservation. The valuer should report on the characteristics of the local real estate market and should define the value on the basis of, at least, two valuation methods.

**3.4 Use of AVMs**

AVMs are used for taxation purposes. Some banks have been recently introduced AVM's in the mortgage valuation for quality control and monitoring values in the context of the CRD.

***4. The Valuer***

**4.1 Regulatory Framework**

There is no legal or professional framework relative to valuers for lending purposes. The Regulator lays down rules stating that the valuer should be independent, with the appropriate qualifications, competency and professional experience to perform the function. He is deemed not to be independent if he is in a situation in which his unbiased opinion could be affected, namely if he has any specific interest in the real estate being appraised or any relationship – commercial or personal – with the debtor, or if his compensation is dependent on the appraisal value of the property. There are some courses that certify the valuers that can be registered in the Portuguese Securities Commission (CMVM).

**4.2 Education/qualifications**

Post-graduate courses on real estate management have been introduced only recently at some universities. Most valuers have a degree in engineering or architecture.

**4.3 Use of valuer title**

The title of valuer is not protected. Banks protect themselves by only cooperating with experienced valuers and regularly verifying their valuations.

**4.4 External v. Internal**

The appraisal specialist may belong to the institution; however, he must have independence from the credit analysis and decision process. Most valuers are external.

**4.5 Professional Indemnity Insurance**

There is no legal obligation for valuers to have professional indemnity insurance cover for mortgage valuations. For securities valuations, valuers must be registered in the Portuguese Securities Commission (CMVM) and must have professional indemnity insurance cover.

***5. Capital Requirements & Property Valuation:***

- ***Covered Bonds***

The legislation in Poland on covered bonds is regulated by Decree-law nº 59/2006 and complemented by secondary legislation - notice 5/2006 of the Central Bank.

- *Maximum eligible asset LTV ratios for different types of residential and commercial real estate:*

For residential real estate there is a limit of 80% and for commercial real estate there is a limit of 60% of the mortgage lending value.

- *Monitoring & Revaluation:*

The value of the mortgaged property must be checked by the institution on a periodic basis, at least every three years for residential mortgages and at least once a year for commercial properties. More frequent checks must be carried out if market conditions are prone to significant changes.

For those checks the institution may use indices or accepted statistical methods that it considers appropriate. When indices or statistical methods are employed, the Bank must submit to the bank of Portugal a report detailing the foundations for that methodology.

For loans that exceed 5% of the institutions' own funds or exceed €500.000 for residential mortgages and €1.000.000 for commercial mortgages, the valuation must be reviewed at least every three years.

- *Insurance:*

Legislation requires an adequate insurance for the mortgaged property.

- *Independence of the Valuer:*

The valuer should be independent, with appropriate qualifications, competency and professional experience to perform the function. He is deemed not to be independent if he is in a situation in which his unbiased opinion could be affected, namely if he has any specific interest in the real estate being appraised or any relationship – commercial or personal – with the debtor, or if his compensation is dependent on the appraisal value of the property.

- *Market Value & Mortgage Lending Value:*

The regulator defines market value and mortgage lending value according to the TEGOVA and IVSC definition.

- ***Data Standards***

A bank may use indices or accepted statistical methods that it considers appropriate. When indices or statistical methods are employed, the Bank must submit to the bank of Portugal a report detailing the foundations for that methodology.

# *Sweden*

### *1. Macroeconomic Overview*

The Swedish GDP has showed a sharp decrease from mid 2008 to mid 2009 and is minus 4 percent by 1 July 2009. However, the forecast for 2010 is optimistic and the National Institute of Economic Research believes that Sweden will reach 0 percent growth by 2010. Also the unemployment rate has shown very negative development since mid 2008. Sweden has a sharp increase in unemployment for the period from 6 percent to almost 10 percent. The National Institute of Economic Research believe that the unemployment rate will continue to increase further to around 12 percent in 2010.

The government budget balance has been developing very weakly for the last year. From a plus of some SEK 100 billion end 2008 to a negative budget balance of some SEK 200 billion by end 2009. Part of the explanation for the fast decline is that the unemployment benefits have increased dramatically over the past year. However, the National Institute of Economic Research expect the balance to recover somewhat in year 2010.

The Swedish Central Bank closely follows the development of the consumer price index. The objective of the Swedish Central Bank is to have an inflation of 2 percent on a yearly basis +/- 1 percent. However, by mid 2009 the inflation was down to 0 percent and we even had a period of deflation during this summer. For 2010 the Swedish Central Bank is expecting inflation to increase somewhat.

Concerning the three months, interest rates for treasury bills have had a sharp decrease for the past nine months from 4.5 percent to 0.25 percent in mid 2009. From a historic perspective this sharp decrease in interest rates for treasury bills has never been seen in the Swedish economy.

### *2. Property Market Overview*

### 2.1 Residential Property Market Overview

In 2008, the total number of dwellings in Sweden amounted to 4.503.000. In 2004, the total number of dwellings amounted to 4.380.000. In 2007 52% of the housing stock was owner-occupied, 30% were provided by private landlords and 17% were provided by alternative sources.

The first quarter in 2009 was the weakest in 10 years regarding construction according to the National Board of Housing. The demand on one-family homes and tenant owned apartments have however increased slightly during the spring in 2009. The construction costs have increased for several years, but in 2008 it started to come down slightly and increased by around 5%. The construction costs increase have come down further in 2009 and increased by around 1 per cent in the end of June 2009.

The demand for mortgages has only decreased slightly in 2009. Quickly sinking mortgage interest rates and tax eases for workers are explanations why the demand for mortgages has remained fairly high. The total value of outstanding residential mortgage loans increased by 9,1% during 2008 to €186.786 million. In the end of 2008 the volume of residential mortgage loans outstanding represented approximately 64% of Swedish GDP (61% in the end of 2007).

Finansinspektionen, the Swedish Supervisory Authority, published a study on the mortgage market in May 2009. According to the study the Loan-to-value (LTV) ratios have increased slightly for new mortgage lending during 2008 to 70 per cent on average. However the LTV-ratio for the total stock of outstanding mortgages has diminished during the year to 58 per cent. According to the same study the real amortization periods on mortgage loans have fallen considerably since the end of 2007.

### 2.2 Commercial Property Market Overview

In 2008, the total number of commercial properties including retail and multi family houses in Sweden amounted to about 376.000 units (374.000 in 2007), of which 8% (8%) were retail and office buildings and about 20% (20%) were industrial premises.

In 2008, the total value of outstanding commercial loans was €26.670 million, accounting for 9% of Swedish GDP (16% in the end of 2007). Average LTVs on commercial property are less than 60%.

## *3. The Valuation*

### 3.1 Regulatory Framework

The valuation of real estate is not regulated by law in Sweden. SFF (Samfundet För Fastighetsekonomi), the professional Swedish organisation of real estate valuation experts has, however, issued a code of conduct regarding the procedure for the valuation of real estate. The code of conduct is aimed at securing professional, reliable, ethical and independent behaviour of SFF members.

The Swedish Financial Supervisory Authority has also issued rules on the valuation of property in the annual accounts of banks and mortgage credit institutions, based on the present market value of the property.

Legislation on covered bonds and also the new Capital Requirements Directive has affected they way in which valuations for lending purposes are carried out. The financial institutions have to structure the valuation business in a different way than before. Different valuation models are demanded and will be included in the daily lending activities.

### 3.2 Valuation Bases & Methodology

The predominant approach to valuation for lending business is the market value, calculated using either the comparison or the cash flow method. The cash flow method usually takes into account the expected risks and revenues over a five to ten year forecast. The comparison method approximates the market value by comparing the property with other properties of a similar character and state of repair.

### 3.3 Valuation Report: Form & Content

SFF has produced a Code of Practice, which covers the following elements:

- Professional conduct
- Requirement of independent position in conjunction with external valuation engagements
- Requirement concerning reporting of any conflict of interest in conjunction with internal valuation
- services
- The valuer's possibility to act as an agent and representative in real estate sales, disputes concerning the value of properties, etc.
- Performance of valuation services
- Relationship to customers
- Charging of fees
- Relationship to colleagues
- Publicity, advertising, and canvassing
- Relationship to the Society

### 3.4 Use of AVMs

AVMs are used in Sweden for the valuation of single family houses for a variety of purposes, including mortgage origination, quality control in the origination process, non purchase mortgage loan underwriting and securitisation. No rules or guidance (legal or professional) currently exist in Sweden for the use of AVMs, however in Sweden, banks have their own internal guidelines or procedures related to their use.

## *4. The Valuer*

### 4.1 Regulatory Framework

In Sweden, valuers are self-regulated by the Professional Organisation of Real Estate Valuation Experts. A Code of Conduct regarding the procedure for the valuation of real estate aims, amongst other things, at guaranteeing the independent behavior of its members.

**4.2 Education/qualifications**

**Academic requirement**

Authorisation as an SFF real estate valuer requires a university education including at least 140 university points. Authorisation as an SFF agricultural valuer requires a university education with at least 80 university points, and 120 university points are required to become an SFF authorised residential property valuer. Dispensation from the academic requirement is granted during the first few years following the establishment of authorisation for valuers with a good service record who possess substantial experience. Currently, dispensation from the academic requirement is only granted in exceptional cases.

An SFF authorised valuer must undergo nine additional days of education every three years.

**Vocational experience**

Authorisation requires three years practical experience, with a good service record, of valuations of the types of properties to which the authorisation relates.

**Current knowledge requirement**

Authorisation requires that the valuer regularly works with valuation issues and that he keeps abreast of developments within the relevant areas. The current knowledge requirement is reassessed every third year.

**Independence requirement**

A valuer who is authorised by SFF must constantly maintain such a position in relation to the customers of the valuation services that the valuer's integrity or his objectivity cannot be called into question

**4.3 Use of valuer title**

The title of 'authorised valuer' is protected by the Swedish Society of Real Estate Economics.

**4.4 External v. Internal**

In Sweden, the SFF Code of Conduct regarding the procedure for the valuation of real estate aims, amongst other things, at guaranteeing the independent behavior of its members.

Mortgage banks in Sweden use internal or/and external valuers. The largest mortgage banks, such as Stadshypotek and SPINTAB, have their own valuers.

**4.5 Professional Indemnity Insurance**

There is no legal obligation for valuers to have professional indemnity insurance cover in Sweden.
All authorised valuers need an Indemnity Insurance.

***5. Capital Requirements & Property Valuation:***

- ***Covered Bonds***

Legislation exists in Sweden on real estate backed covered bonds, and in the context of the CRD, the national regulator has made the following interpretations:

- *Maximum eligible asset LTV ratios for different types of residential and commercial real estate:*

75% LTV for residential real estate, all other 60% LTV.

- *Monitoring:*

The Issuer shall regularly monitor the market value of the property which constitutes collateral for mortgage loans. The Issuer shall regularly monitor property price trends at the localities or in the regions in which it issues loans. In the event of declining price levels, the Issuer shall verify that a property which constitutes collateral for issued loans maintains the same value as at the time of the original or latest valuation. Where the market conditions at the locality or in the region have seriously declined, the valuation shall be reviewed.

- *Revaluation:*

A valuation may, however, be based on general price levels where the valuation refers to (i) real property which constitute residential property in a single-family or two-family building; (ii) site-leasehold rights which have been granted for residential purposes with respect to a single-family or two-family building; or (iii) tenant-owner rights which have been granted for residential purposes. For all types of properties (residential and commercial) "recognised and accepted" valuation methods shall be used. There is no explicit requirement for an internal inspection.

- *Insurance:*

There is no insurance requirement and the regulator has not interpreted the provision regarding "procedures to monitor that the property taken as protection is adequately insured against damage"?

- *Independence of the Valuer:*

An individual valuation shall be performed by a “competent” appraiser. An appraiser is “competent” when he possesses “sufficient theoretical and practical experience regarding the manner in which the valuation shall be carried out” and is “otherwise well acquainted with the general and local property market”.

The preparatory works to the Act state that real estate used as residential property for one and two-family houses may be valued by employees of the Issuer, trained internally, but that other properties should be valued by an authorised appraiser. However, there is no indication in the Act or its preparatory works that such a person could not be employed by the Issuer.

- *Market Value & Mortgage Lending Value:*

“Market value” means the price which would be achieved upon a commercial sale where reasonable time is allowed for negotiations. The market value shall be determined without taking into consideration speculative and temporary circumstances.

- ***Data Standards***

Statistical methods may be used to monitor valuations and to identify properties that need to be revalued.

As far as data requirements specifically relating to property valuation are concerned, the regulator has determined that the taxation status of the property is the guideline of deciding property type.

## *UK*

### *1. Marcroeconomic overview*

The UK has not been immune to the global financial crisis and associated economic implications. The UK economy shrank for three successive quarters from Q2 2008 onwards, confirming an expected period of recession. Alongside the economic contraction unemployment also rose, from 5.2% at the start of the year to 6.3% in December 2008. At the end of 2008 there were around 2 million unemployed, and this is forecast to rise to 3 million by the end of 2009.

Inflation also rose in 2008. Having fallen in the latter part of 2007, it then rose steadily through Q3 2008 to well above the target range of 1 to 3%, peaking at 5.2% in September. However, because this relatively high inflation was largely the result of the spike in energy prices it was temporary in nature. This allowed the Bank freedom to respond to the ongoing financial crisis, and its spread to the wider UK economy, by lowering interest rates progressively throughout 2008, from 5.5% in January to just 2% in December – a historic low. Since then rates have fallen further, to just 0.5%.

### 2. Property Market Overview

### 2.1 Residential Property Market Overview

Having reached a record high of £363 billion (533 billion Euros) in 2007, gross mortgage lending dropped sharply in 2008, down 29% to £253 billion (316 billion Euros). In the early part of the year this drop-off was primarily supply-driven. With the private securitisation market remaining closed for business, funding for mortgage lending was severely restricted. A large number of lenders either significantly cut back or ceased accepting new business entirely. And those still taking on material volumes of new lending tightened lending criteria, particularly with respect to maximum LTVs. But as the crisis continued and spread to the wider economy, consumer confidence in the housing market deteriorated leading to reduced demand for mortgages.

Whilst confidence in the housing market fell away, and with it house purchase transaction numbers, remortgaging activity proved relatively resilient for most of the year. By Q3 2008 remortgaging accounted for fully one half of total gross lending, supported by large numbers of borrowers coming off fixed rate deals which were taken out at comparatively low interest rates two and three years previously. However, later in the year remortgaging dropped sharply as many potential borrowers could not meet tighter lending criteria, with others finding that, following the bank rate cuts throughout the year, remaining on the reversion rate was in fact the most attractive option.

Buy-to-let lending held up relatively well in initial months of 2008. But with its greater reliance on wholesale markets, buy-to-let has since been disproportionately affected by the credit crisis, with many lenders exiting this market entirely, at least until funding lines return. By Q4 2008, buy-to-let gross lending had shrunk by two thirds.

House prices fell in 2008, for the first time since the early 1990s. The rate of decline accelerated throughout the year. The precise extent of house price falls varies according to the measure used. The DCLG Index (released by Department of Communities and Local Government) fell by 0.9% on an annual basis, but the more timely indicators (those from Nationwide and Halifax, both based on mortgage approvals data) estimate the annual rate of decline had fallen to nearly 20% by December 2008.

Affordability indicators – typical Loan-to-Value (LTV) and income multiples – fell significantly throughout 2008. But rather than an easing of borrower affordability this reflected a tightening of lending criteria, most notably on LTVs, in the face of falling house prices and the ongoing credit crisis. The number of mortgage deals available at higher LTVs – 90% and above – has fallen dramatically over the course of the year, and those that remain are relatively more expensive. As a result, only those with substantial deposits are able to enter the market. Even with rapidly falling house prices the typical first-time buyer had to put down almost £30,000 (equal to 35,714 Euros) deposit money in December 2008, double the amount needed at the beginning of the year.

***3. The Valuation***

**3.1 Regulatory Framework**

There is no legal framework specific to the valuation of residential and/or commercial property for lending purposes in the UK. Rules on valuation are instead laid down by the professional associations, the Royal Institute of Chartered Surveyors (RICS) in the Red Book. The Appraisal and Valuation Manual (Red Book) issued by the RICS in 1995 has been updated and reissued in 2003. Regular revisions are also published. It is mandatory for valuers to comply with the requirements of the Red Book. The Practice Statements in the Red Book set out and define the whole range of valuers' responsibilities.

Within residential valuation, a major recent change has been the introduction of Home Information Packs (HIPS) as proposed in the Housing Act 2004. HIPS are now live with effect from December 14th on all property within England and Wales. Sellers are compelled to compile an information pack upon the property including a mid-range survey. The pack does not include a valuation and it is the responsibility of individual lenders to determine their own valuation process.

**3.2 Valuation Bases & Methodology**

In the case of residential property, the majority of secured lending assessments are still currently based upon a valuation following the inspection of the property by a qualified valuer. In recent times, external inspections of the property, and the introduction of a valuation model have replaced full inspections in certain circumstances. In the UK, the comparison method is almost exclusively used to value residential properties. The income, depreciated cost replacement and residual methods are used at different times for commercial and industrial properties.

In August 2002, RICS amended the bases of valuation for commercial property. The internationally recognised Market Value (MV) replaced market value (OMV). Estimated Realisation Price (ERP) and Estimated Restricted Realisation Price (ERRP) were abolished. Any additional valuations required are to be based on Market Value (MV) with the addition of 'Special Assumptions'. These may relate to the time scale to sell the property, planning consent or condition of the property.

Further changes to the Red Book will require valuers to provide lenders with, amongst other things, a greater depth of information relating to the local property market, marketability of the property throughout the loan and the valuation methodology adopted.

**3.3 Valuation Report: Form & Content**

There are no formal requirements with regard to the form and content of the valuation report, but the form and content are governed by the requirement for the lenders to lend prudently. Building Societies are governed by the Act and must obtain valuations from a suitably qualified and experienced person.

The majority of valuation reports comprise a short written report detailing construction, accommodation, condition and value, a small percentage are now automated in which case the lender relies upon a figure produced by a computer program without any further information being available.

**3.4 Use of AVMs**

AVMs have been recently introduced in the UK and the two major providers, UK Valuation Ltd. and Hometrack Data Systems (HDS) have produced hedonic models, "which rely on a large database of extensive property valuation sand sales prices, and conduct an automated search for comparable properties with the target property"[8]. UK Valuation has also recently launched ValueFinder Portfolio, the first commercially available portfolio property valuation tool based on AVM technology in the UK.

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[8] "Guidelines for the Use of Automated Valuation Models for UK RMBS Transactions", Standard & Poor's, Feb. 2004.

Currently, there is no legislation or rules governing the use of AVMs, although some guidance has been issued which requires lenders to use them in a prudent manner supervised by a qualified surveyor.

In the UK, AVMs can play a role in mortgage origination, as a quality control tool in the mortgage origination process and in the monitoring and adjusting of values in the context of the CRD. AVMs are not used extensively at present although their use and application is increasing rapidly, currently for example less than 20% of loans would be made using an AVM.

***4. The Valuer***

**4.1 Regulatory Framework**

The valuer will almost always be a member of the Royal Institution of Chartered Surveyors (RICS). Relevant expertise and market knowledge is a prerequisite.

**4.2 Education/qualifications**

There are no formal requirements regarding valuers' qualifications, however in practice, most lenders require valuers to be members of the RICS.

**4.3 Use of valuer title**

The title of valuer is protected by the RICS.

**4.4 External v. Internal**

In the UK, rules concerning the independence of the valuers are laid down by the professional association, RICS. Rules can also be dictated by the lender or the client.

Lenders usually commission residential valuations directly from employed staff valuers or from panels of independent specialist firms who have satisfied the standards of competence and professional indemnity insurance. Valuation fees are based on the purchase price and in 2005 average fees are in the region of £175.

Valuations and reports for commercial property are prepared by independent valuers, from a variety of large and niche firms. Although often instructed by the lender, some valuations are commissioned by brokers with reports being readdressed to the lender. The customer pays valuation fees.

### 4.5 Professional Indemnity Insurance

In the UK, PII is a prerequisite for membership of RICS. Valuation companies must have a minimum cover, which is dictated depending on the type and volume of work that they undertake. The cover must be appropriate for the work carried out by the company. Incidentally, the majority of lenders in the UK would insist upon an insurance Policy being in place and regularly check that they are in existence.

## *5. Capital Requirements & Property Valuation:*

Legislation exists in the UK on real estate backed covered bonds, and in the context of the CRD, the FSA has made the following interpretations:

***Covered Bonds***

- Maximum eligible asset LTV ratios for different types of residential and commercial real estate:

80% for residential loans.

- Monitoring:

According to the FSA, monitoring property values is an inherent part of the risk management and tracking of the mortgage book. This should include: record keeping, systems that keep track of values and market surveillance to pick up market moves and/or events that would result in a fall in a property value. Statistical methods, such as house price indices, or AVMs can be used to monitor the value of a property and to identify properties that need revaluation. Monitoring must be carried out at least every three years although this test can be met by the ongoing use of house price indices. When monitoring indicates that the value of the property is likely to have risen, a lender has two options: it can either keep the value of the property as at origination or, if it wishes to revalue the property, it must carry out a review to establish the new value on a loan-by-loan basis.

- Revaluation:

A review of property valuations is required:

  - If monitoring indicates that the value of a property may have risen and the firm wishes to revalue the property; or
  - If monitoring indicates that the value of a property may have fallen relative to general market places; or
  - Every three years when the value of the loan exceeds €3 million or 5% of capital resources of the firm.

Reviewing a property value goes further than the monitoring requirement above and includes taking property values on a loan-by-loan level.

- Insurance:

Lenders must ensure that properties are adequately insured, if necessary by use of block policy to cover cases where the homeowner has failed to maintain cover.

- Independence of the Valuer:

The valuer must be independent of the credit granting decision but can be employed by the lender.

- Market Value & Mortgage Lending Value:

The FSA has not issued executive orders or guidelines on "market value" and "mortgage lending value".

***Data Standards***

The FSA has not ruled out the use of statistical indices for valuation purposes. The FSA has not set out any data requirements specifically relating to property valuation.

## *Independence of the Valuer*

Valuers can be employed by a bank or work as freelancers. Whatever the case, independence of the valuer is of paramount importance to the quality and integrity and, therefore, the credibility of the valuation and applies to both the internal and the external valuer. Against this background, in May 2002, the EMF's Valuation Committee decided to examine the question of the independence of valuers and the way in which the issue is addressed in EU Member States. In the meantime, the question has also been raised in the context of the Capital Requirements Directive and the Commission's assessment of the integration of Europe's mortgage markets. In light of this renewed focus, the EMF's Valuation Committee took the decision to reexamine this issue and subsequently produced the updated Note on Independence of the Valuer below.

Very often, the concepts of independence and external vs. internal valuers are confused, with independence being necessarily associated with external valuers, when in fact internal valuers can be equally independent, providing the necessary mechanisms are in place to separate them from lenders' commercial units. On the basis of this erroneous premise, the EMF's Valuation Committee took the decision to draft the set of Guidelines below, which explain clearly the difference between internal and external valuers, demonstrate how internal and external valuers can be equally independent and set out measures which can be taken to ensure valuers' (both internal and external) independence.

# EMF Note on Independence of the Valuer

## Summary of Findings

- Rules to ensure that valuations are unbiased and not subject to undue pressure exist in 8 Member States i.e. DK, DE, ES, IT, LUX, PL, SE and the UK.

- Depending on the Member State, independence of the valuer is either ensured via legislation (DK, DE, ES, LUX & PL) or self-regulation ((DE), IT, (PL), SE & the UK).

- Pressure on valuers to overvalue a property would typically originate from the vendor, the broker, the purchaser, or the lending institution.

- Depending on the Member State, compliance with rules, which are intended to ensure independence of the valuer, is ensured by:
    - National supervisory authority (DK, DE, ES, LUX, PL & SE)
    - Professional association (DE & PL)
    - Additionally, internal and external auditors ensure compliance (DK, IT, LUX & the UK).

- In the event of valuer bias, consequences depend on the way in which independence of the valuer is ensured at national level:
    - Disciplinary sanctions by the national banking supervisor if independence of the valuer is prescribed by legislation (ES, LUX & PL)
    - Expulsion from the professional association (DE & the UK) if compliance with rules on independence of the valuer are a membership requirement
    - Internal disciplinary measures if the valuer is employed by the bank, which can include warnings or termination of employment (DK, DE, IT & the UK).

- The rights of holders of covered bonds or mortgage backed securities are protected:
    - Directly through provisions in legislation (ES, LUX & PL)
    - Through inspections by the supervisory authority (DE & SE)
    - In the UK, bonds are sold with guarantees regarding the quality of the valuations that support the value of the security.

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## 1. *Current Regulatory Background*

Rules to ensure that valuations are unbiased and not subject to undue pressure exist in ***Denmark***, ***Germany***, ***Spain***, ***Italy***, ***Luxembourg***, ***Poland***, ***Sweden*** and the ***UK***. Depending on the Member State, independence of the valuer is either ensured via legislation or self-regulation.

### *Legislation*

- In ***Denmark***, the Financial Business Act stipulates that a credit institution shall have procedures to prevent conflicts of interest between the interest of the employee and the institution and that of the customer. The executive order on valuation of property as covered bond collateral stipulates that the valuer must be independent from the credit decision process. Furthermore the professional valuation bodies in Denmark have membership rules to avoid conflicts of interest.
- In ***Germany***, Art. 20a par. 5 and 6 of the Banking Act (KWG) and Art. 16 par. 1 and 2 of the Pfandbrief Act both address independence of valuers. This legislation is complemented by the 'Regulation on the Determination of the Mortgage Lending Value', as laid down by the German Financial Services Authority (BaFin). Provisions of the new Minimum Requirements for Risk Management also include rules on the separation of conflicting activities within credit institutions. Furthermore, the professional principles of certifying bodies and professional associations include principles regarding the independence of valuers.
- In ***Spain***, Act 3/1994 of April 14$^{th}$ and the Royal Decree 77/1997 lay down rules, which frame valuers' work. The main criteria are prudence and truth in the valuation report. In this context, there are specific rules concerning technical organisation, internal control measures, market knowledge, fulfillment of the applicable legislation on valuation, experience and qualification of the director and individual valuers' (expertise) qualifications.
- In ***Luxembourg***, Circulaire CSSF 06/273, which translates the European Solvency Directive into national law, and Circulaire CSSF 01/42, which defines the rules of property valuations for covered bond issuers both lay down rules relative to the independence of valuers. Both texts are issued by the Financial Sector Supervisory Authority (CSSF).
- In ***Poland***, the professional impartiality of the property valuers is governed by the act on real estate management. A property valuer is obliged to carry out property valuation activities in accordance with legislation and professional standards, with utmost diligence fitting the professional nature of these activities and in accordance with professional ethics, while observing impartiality in the process of valuing the property. The act stipulates the observance of the rules laid out in the Professional Standards of Property Valuers.

***Self-Regulation***

- In ***Italy***, Tecnoborsa, a public entity, published a valuation code based on the IVS in December 2006, together with the Italian Banking Association. Moreover, some banks have their own valuation code and almost all banks have a list of approved valuers.
- In ***Poland***, the Professional Standards of Property Valuers are an example of self-regulation. They were adopted by the National Board of the Polish Federation of Valuers Associations. Pursuant to the Standards, a property valuer: is obliged to observe the fundamental principle of impartiality, cannot be bound by the illegal requests of the party ordering the valuation or persons interested in the results of his work, cannot value his own property or the property of his close relatives if there is a clear legislative ban or if doing so could raise doubts as to the objectiveness of the valuer, cannot accept any personal or financial gains from the contracting party related to his activities except for the remuneration stipulated in the agreement, cannot condition the extent of the remuneration on the objective expected by the client, nor on the degree to which the client's wish is fulfilled.
- In ***Sweden***, valuers are self-regulated by the Professional Organisation of Real Estate Valuation Experts. A Code of Conduct regarding the procedure for the valuation of real estate aims, amongst other things, at guaranteeing the independent behavior of its members.
- Similarly, in the ***UK***, rules concerning the independence of the valuers are laid down by the professional association, the Royal Institute of Chartered Surveyors (RICS). Rules can also be dictated by the lender or the client.

***2. Sources of Undue Pressure on Valuers***

Pressure on valuers can orginate from the ***vendor***, the ***broker*** or the ***purchaser***. If a property is traded above the market value, both the borrower and the estate agent will have an interest in the purchase sum being used as the loan value. Pressure might also come from the ***lending institution*** and more specifically, trading units or the commercial department, who want to maximise business opportunities.

- In ***Germany***, separation of Trading and Back Office Processing and Control (where valuers work) is ensured by the Minimum Requirements for Risk Management described above. If the valuation is being carried out for refinancing purposes, then pressure will normally come from the broker.
- In the ***UK***, for example, brokers will be in receipt of substantial fees for completing mortgages, often working on a commission basis. Valuers can receive calls on a daily basis from brokers regarding valuation levels. A typical case of misconduct in the ***UK*** would be a sale ring where values are deliberately inflated, the vendor, the broker, the purchaser and a lawyer would collude to defraud the lender by overstating the value of the security; the lender releases more funds than the property is worth, no payments are made and the ring absconds with the funds.

### *3. Enforcement of Rules*

Compliance with rules, which are intended to ensure independence of the valuer, is typically ensured by the ***national supervisory authority*** in ***Denmark***, ***Germany***, ***Spain***, ***Luxembourg, Poland*** & ***Sweden***.

- In ***Spain***, the national bank requires previous certification and registration of valuers. As such, valuers' professional activity is subject to the supervision of the Bank of Spain.
- In ***Germany***, in addition to monitoring by the supervisory authority, compliance is also monitored via certification systems and Codes of Conduct.
- Similarly, in ***Poland***, the Committee for Professional Liability of Property Valuers, the scope and manner of activity of which is regulated by a Regulation of the Minister of Infrastructure and the Professional Ethics Committee established as part of the Polish Federation of Valuers Associations, ensures that the rules of impartiality are abided by.

In ***Denmark***, ***Luxembourg*** and the ***UK***, ***internal and external auditors*** also ensure compliance. Moreover, in the ***UK***, valuation work is allocated on a random basis making it difficult for a valuer to guarantee that he will be selected to value a particular property. In ***Italy***, banks' internal monitoring offices and auditing departments will ensure compliance with the rules.

### *4. Sanctions in the event of Valuer Bias*

***Supervisory Authority***

In ***Spain***, ***Luxembourg*** and ***Poland***, disciplinary measures can be taken by the supervisory authority against the valuer, who is found not to be independent.

- In ***Spain***, non-compliance with the regulation outlined above may be considered a breach of the applicable law, which may result in a penalty or sanction qualified as very serious, serious or not serious.
- In ***Luxembourg***, the full range of disciplinary sanctions at the disposal of the supervisory authority may be applied in the event of non-compliance with rules.
- In ***Poland***, the following disciplinary fines can be imposed on a property valuer who fails to fulfill his duties in accordance with the provisions of the act outlined under 1 (including observance of the rules of ethics and the principle of impartiality) as part of his professional liability: rebuke, reprimand with an entry in the central register of property valuers, suspension of the professional license for a period from 6 months to 1 year, suspension of the professional license until an exam is retaken with a

positive results, revocation of the professional license with a possibility to reapply for it 3 years after it was revoked. The revocation of the professional license also takes place in the event of a loss of legal capacity and conviction for offences referred to in article 177 par. 1 item 2. The professional license can also be suspended or revoked if the activities related to property valuation are not performed for more than 5 years from the moment the last valuation is performed.

- Although there are no legal requirements specific to independence of the valuer, in the ***UK***, if a valuer were found not to be independent, a charge of misconduct would most likely result, which could mean possible legal (fraud) charges.

***Expulsion from Professional Association***

- In the ***UK***, a charge of misconduct could also result in expulsion from RICS.
- Similarly, in ***Germany***, the certification body has a range of measures at its disposal in the event of non-compliance with professional principles. These include warnings, suspension of the certification and withdrawal of the certification.

***Internal Disciplinary measures***

- In ***Germany***, valuers, who are employed in a credit institution, will also incur disciplinary measures, as laid down by labour law, in the event of a breach of rules.
- Similarly, in ***Denmark***, depending on the damage inflicted on the credit institution, which will typically compensate the borrower, sanctions range from a warning to a termination of employment of an internal valuer or cooperation with an external valuer.
- In ***Italy***, the valuer will be taken from the bank's list of approved valuers. In the ***UK***, if the valuer is employed directly by the lender then dismissal would almost certainly result. The borrower would have to sue the lender if a loss arose, in which case the lender would probably transfer the liability for the claim to the valuer.

In ***Sweden***, the valuation will not be approved for lending purposes.

### ***5. Protection of Covered Bond or MBS Holders' Rights***

In addition to implications for the lender and potentially for the borrower, valuer bias can also impact upon the holders of covered bonds and mortgage backed securities.

- In ***Germany***, holders of covered bonds do not have direct rights in this respect. However, the cover pool monitor does act in the interest of covered bond holders and could take action in the event of an incorrect valuation. Valuations for lending purposes for the cover in the Pfandbrief market are subject to periodic audits of the cover by the German supervisory authority (BaFin) and by the trustee appointed by the BaFin.

- In ***Spain***, holders have access to the Registers of the Bank of Spain (Registries of Companies and Lenders' Valuation Services). They may request the relevant information from the Bank of Spain and sue for a breach of the applicable law, criteria and unusual acts. The Bank of Spain will start a file or report and may propose the penalties described under 4. It is also possible to lodge a complaint before the Comisión del Mercado de Valores (CNMV) and to bring formal legal action before the courts.
- In ***Luxembourg***, Art. 21 of Chapter IX of the Circulaire CSSF 06/273 and Chapter III of the Circulaire CSSF 01/42 both contain detailed stipulations regarding property valuation in the context of the eligibility of mortgage backed exposures and the inclusion of properties backing mortgages in the cover pool.
- In ***Poland***, the rules for valuing properties are regulated by the act on mortgage bonds and mortgage banks. The act obliges the mortgage bank to abide by the valuation regulations approved by the Banking Supervision Commission and prepared on the basis of the Commission's recommendation concerning the basic criteria to be applied by the Banking Supervision Commission when approving the regulations governing determination of the bank and mortgage value of the property issued by the mortgage banks.
- In ***Sweden***, regular inspections by the Swedish supervisory authority and internal and external auditors monitor valuations in this respect.

- In ***Denmark***, the risk of over-inflated valuations is part of the operational risk disclosed according to the Capital Requirements Directive (CRD). In the event that over-inflated valuations are revealed by the credit institution, an adjustment will be made to the credit risk, which is also disclosed according to the CRD.
- In the ***UK***, the sale of such bonds will involve guarantees regarding the quality of the valuations that support the value of the security.

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**EMF GUIDELINES ON THE INDEPENDENCE OF VALUERS, drafted by José Ramón Ormazabal, the Chairman of the EMF's Valuation Committee**

***Defining Terms***

An 'independent valuer' might be defined as follows: A valuer is independent when he/she is and appears to be free of any undue influence from any person or entity, which has an interest in the final value and the content of the valuation report.

***Introduction***

Valuers can be individual professionals working on their own, or they may belong to valuation entities:

- **Valuation entities** can be external to their main customers, the mortgage lenders or be part of a lending institution. External valuation entities may have a close relationship with particular lending entities, which generate a substantial share of their revenues. Conversely, they may have a well diversified customer base. Valuation entities may be single purpose companies or belong to broader organisations engaged in related activities such as real estate agencies or intermediation.
- An **individual valuer** may be part of a credit institution, in which case he/she exercises valuation activities exclusively for his/her employer.

Many different possibilities and business approaches therefore exist in the market for valuers, all of them perfectly acceptable. However, in order for valuers to be acceptable in a modern mortgage market they must be **independent**. A very common error is being made by a number of constituencies, which are equating the concept of independence with being external to the lender. All of the actors and possibilities in the business approaches mentioned above, whether internal or external, allow for independent professional behaviour.

Internal valuers can act independently if proper internal rules are adequately established and monitored. Conversely, it is also very possible to find cases in which external valuers do not act independently: the commercial employee of a bank branch, who commissions a valuation from an external valuer, could eventually put pressure on him to inflate the value if proper internal rules and adequate supervision are not in place. Furthermore, not only must a valuer act independently, he/she must also be free of any circumstances which might affect his neutrality. A real estate agent, who is professionally well equipped to effect a valuation, could in theory be asked to value a property for which he/she is intermediating. These are but a few instances in which external valuers are or may not be considered independent.

There are Member States in the European Union with stringent regulations that ensure a strict enforcement of independent behaviour by valuers. The approach of other Member States is one of self-regulation. In principle, it is not necessary to have a regulatory environment to ensure professional and independent performance.

***External vs. Internal Valuers***

*External valuers:* An individual valuer can be considered external to one particular lender when his/her professional activity as a valuer cannot be influenced by the lender due to another business and/or personal relationship, or when the valuation business generated by that particular lender is a substantial portion of his/her total business.

A valuation company is considered external to a particular lender when the lender has no substantial economic interest in the valuation company, which would enable the lender to have an influence on this company. The economic interest may be in the form of a substantial portion of the company's shares, a significant proportion of its business and so on.

*Internal valuers:* All other valuers, for the sake of control measures, should be considered as being internal to the lender.

***Measures to Ensure Valuers' Independence***

It is in the best interest of both lenders and investors to ensure that valuations of mortgaged properties are carried out in a highly professional way. Different measures however should be implemented depending on whether the valuer is internal or external.

1. *External Valuers:*

- Conflicts of Interest:
  It is highly advisable that external valuers are members of professional bodies with clearly established membership rules with respect to conflicts of interest between their valuation activities and other occupations (e.g. real estate intermediation, relation with buyer or seller etc.). These professional valuation bodies should be able to supervise and, if necessary, impose penalties in the event of non-compliance with rules. In countries where there are such bodies, lenders, in principle, should only use the services of external valuers that are members of these bodies. In those countries where no such bodies exist, lenders should ensure that external valuers, who carry out valuations for them, have strict internal rules to avoid conflicts of interest; it should be possible to supervise compliance. One

clear rule that should exist in all cases is that the professional who carries out valuations, should have no real estate intermediation responsibilities nor should he/she directly or indirectly benefit economically or otherwise from this business. In principle, there should be well established "Chinese Walls" between both activities and professional transfers from one activity to the other should be handled with great care.

- Commercial Influence:
  Lenders should establish internal rules so that valuers are protected from influence from lenders' internal commercial units or from units that have an interest in the real estate transaction. Ideally, lenders should have a certification procedure authorising external valuers to work with the lender. This procedure should be managed exclusively within the risk management units of the lender. These units should also be responsible for supervising the abnormal use of single valuers (excessive or too little). Lenders' internal audit units should be responsible for uncovering eventual undue influence on valuers. For a number of lenders, the responsibility for validating all valuations lays with their risk management units.

2. *Internal valuers:*

Valuation companies, which are part of a lending group or which, as a result of shareholding or revenue dependence, have a link with a lending entity should establish internal guidance rules to be applied when performing valuations for that lending entity. These guidance rules should, at least, consist of internal codes of conduct, which establish incompatibility rules when necessary. Supervisory authorities should ensure that the lending entity frequently monitors the existence of and compliance with the code of conduct. These rules/codes of conduct should be in place both for valuations performed by internal valuation companies or by valuation services of the lending entity (individual valuers).

As a general rule, lenders' internal valuation activity (carried out by companies or individual valuers) should be the responsibility of their risk management units. It is of paramount importance that lenders, which use the internal valuation approach, ensure that internal valuers are protected from influence from the commercial units/officers. For instance, lenders may use a central validation system of valuation figures and reports. Frequent corrections to the valuations of individual valuers would be centrally monitored and then investigated.

Selection and supervision of individual internal valuers (companies or individuals) should be the responsibility of risk management units.

Internal valuation professionals' remuneration and promotion should not be linked to the commercial objectives of the mortgage business.

The existence of and compliance with these internal rules and internal reporting lines should be monitored by the supervisory authorities.

***Conclusion***

Quality valuations are of paramount importance for sound mortgage lending activity and, as a result, for the confidence of covered bond and MBS investors.

Ensuring an independent performance by the valuer is essential to achieve a quality valuation.

Independent valuers can be either internal or external to the lender.

It is the responsibility of lenders to have adequate mechanisms in place to ensure that valuers are well protected from undue influence from commercial units and from the participants in the transaction. Supervisory authorities must ensure that lenders do have these adequate mechanisms.

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## *Automated Valuation Models*

The use of Automated Valuation Models (AVMs), which are statistic-based computer programmes that use property information (e.g. comparable sales and property characteristics etc.) to provide a value or a proposal for a value for a targeted property, is particularly well established in North America, where they are used in approximately 10% of all mortgage originations. To date, their use in the EU for the valuation of property has been relatively limited. However, pressures to increase competitiveness by maximising cost and time efficiencies combined with the introduction of new legislation at EU level will almost definitely drive their use in the future. This will be stimulated by constant improvements to AVM technology.

Against this background, it was felt that it would be of interest for the EMF's Valuation Committee to assess and consider the current extent and nature of AVM use in the EU, AVM methodology and modeling, the regulatory environment and the scope for providing guidance on minimum standards and the future of AVMs. The result of this assessment is the Note on the Use of AVMs in the EU below, which is complemented by an article, entitled "Valuation Technology: A New Approach", written by the EMF's UK delegate to the Valuation Committee, Paul Trott.

In light of the expected growth outlined above and with a view to framing this evolution, the EMF's Valuation Committee also took the decision to issue a set of guidelines, focusing in particular on AVM quality criteria. In doing so, the EMF also identified certain issues, which could be of relevance to the 'prudent' use of AVMs by lenders across the EU, and certain other issues, which could be of relevance to supervisory authorities possibly considering intervention in this particular area now or in the future. On a broader level, these guidelines, which can also be found below, could also be of interest to a broader spectrum of stakeholders, including rating agencies and auditors.

# "Valuation Technology: A New Approach"

## Introduction

An AVM is a mathematically based computer software programme that produces an estimate of value based on market analysis and information that has been collected and collated and input into the system. The credibility of the result must be based upon the quality of the data and the skill of the modeller who produced the AVM.

In its most simple form an AVM is an index. A given value is increased or decreased to produce an estimate of the current value. The results can be relatively accurate as long as the data is reliable and the values follow a recognisable pattern. The quality of the data and the data input is a key to the quality of the results. Purely random activity cannot be modelled accurately, and incomplete or inaccurate data will lead to poor results.

Models that take into account different property characteristics and location tend to produce better results; they also require the modeller to demonstrate more skill. The quality of the result is directly related to the quality of the data and the modeller used to produce it.

Much depends on what the AVM is trying to produce, is it the market value, the mortgage lending value, or some other value? Most, if not all models, use historic data to forecast the current market value. It is essential to establish what value is being produced before using a particular model, and to understand what the result is actually telling the user. For example is it saying this is the current open market value, the distressed value or the mortgage value?

Automated, implies an absence of human intervention, this has been a stumbling block in some countries, including the USA where the use of AVMs was first pioneered. The need to provide a "sense check" has formed part of the basis for introducing standards in their use and implementation. The degree and type of intervention varies depending on the quality of the model and the risk levels the users wish to adopt. With some models, trained staff verifies and inputs the raw data, with others the models are constantly being refined and updated. The results can be measured against locally or nationally developed standards, or may be evaluated by an outside agency. The key is that some form of independent assessment is necessary to ensure that the results are consistent and are keeping pace with the market. If the model fails there is unlikely to be any form of redress that can be taken against the provider, Lenders must be certain that they have made adequate provision to guard against what would effectively be uninsured losses.

**AVM use in Europe**

There is a patchy and complex picture of AVM use within the EU, influenced by a range of issues including data availability, regulation, housing, lending market conditions and commercial sensitivity. However, one message is heard clearly through all these differences: AVMs are increasingly and ever more widely used and this trend will continue.

The two main drivers of growth of AVMs in the EU is competition in the lending industry, with pressure to cut the cost and time taken for valuation, and the increasing need to assess the value of the RMBS portfolio for Lenders. In other parts of the World and especially in the USA where the models were first developed they are used more for book revaluations and audit rather than for loan origination purposes. Expensive and slow traditional valuation processes are being replaced by instantaneous and cheap AVMs, moderated by both regulatory and other pressures to maintain prudent loan decisions.

In the UK the key area of FSA compliance is the requirement that 'the use of AVM outputs for loan origination purposes must always fall within a process leading to a valuation that can be ascribed to an independent Valuer. This is equally relevant where a property is being revalued when it has been identified that its value has not moved in line with the market generally.

With the intention of making much wider use of AVMs in the future Lenders need to ensure governance, Policies and procedures must be put in place so that a suitable level of approval and an appropriate level of confidence in the accuracy of the AVMs can be achieved. Responsibility for the valuation Policy and approval of the use of AVMs is assigned to the Credit Risk Area so that it is remote from the Sales Channels to ensure that an adequate level of governance is in place.

Completing these actions will allow Lenders to be confident that their use of AVMs is appropriate, to allow them to make the best use of AVMs and satisfy the regulator that their use is compliant and outputs accurate.

**Key Observations**

The main factor identified as an impediment to further AVM use is caution over inaccuracy. Where accuracy is less critical, for instance when LTV is low or credit and capacity are good, and where the physical features of the property have already been checked, as in the case of second mortgages, AVMs may be judged acceptable despite this concern.

Where an AVM is undeniably weak is with regard to the condition of the property as there is no way of confirming its actual state of repair. Thus using an AVM on older property which is being purchased at a high LTV is a high risk approach. In most countries the mortgage deed places a responsibility on the mortgagee to keep the security in good repair; there is a danger that by constantly using an AVM to revalue the property that the results will not reflect the true value where this obligation is ignored.

Another potential are of weakness surrounds the use of AVMs in a falling housing market. Although values have fallen in the last two years in some locations in the USA no evidence was found to date that AVMs have been found wanting in these circumstances. As we face uncertain times in some areas of the EU where prices are falling it remains to be seen how the use of AVMs will impact. There is inevitably a short "time-lag" period between the data updates being input into the system and the effect of this upon the outcomes, typically this might lead to a delay of up to one month in output. In a volatile market this may have an impact upon mortgage offers as prices can rise and fall very quickly. Lenders need to be very vigilant to ensure that these volatile market conditions are being reflected in the AVM results in real time.

In some parts of Europe financial regulation aimed at maintaining prudent lending standards have acted to delay the growth in AVM use. However, this does not seem to be a particular barrier in the UK, and overall there is a trend for regulation to be relaxed as experience and understanding of AVMs increases.

In some early stage markets, Valuers professional bodies have made attempts to resist using AVMs, motivated by concerns over their accuracy and erosion of Valuers' jobs. Whilst in some more established markets these concerns seem to reduce and are replaced by a trend towards developing best practice guidance, there is still some resistance in the UK, and in other parts of the EU. There is a need to develop guidance on when and how to use AVMs and the degree to which Lenders need to understand the operation of the individual models.

The attitudes of the Rating Agencies to AVMs do not constitute regulation; they are nonetheless very influential in determining AVM use by lenders. Whilst the Agencies do have a view with regard to the acceptance of AVMs they will not accept any liability for the accuracy of the results that any given provider may produce. The agencies' approach in less established markets has been to periodically test AVM accuracy and haircut AVM assessed values accordingly. As AVM experience has become established in the USA they have abandoned haircuts in favour of placing responsibility on lenders to demonstrate that they have regularly justified, tested and audited their Policies for AVM use. The primary use of AVMs in USA remains securitisation rather than origination. It seems likely that as AVM accuracy develops in other markets the agencies' Policy there will evolve in the same way, where it evolves in this way.

**Developments and innovations**

The main areas of innovation involve the integration of valuation, credit and capacity data and decision rules in electronic loan decision-making platforms. AVMs will be increasingly integrated into these platforms in an attempt to create a unified risk management solution. This will also ultimately lead to the development of AVM cascades, AVM testing, fraud detection systems and hybrid AVMs involving rules based selection of valuation services. Increased frequency, sophistication and standardization of AVM testing and audit may well be the most important of these developments, since it affects the longer term credibility of AVMs themselves and hence the degree to which they are trusted and used in the future.

It is clear from the US experience, and from the limited experience in Europe that although some valuations will be carried out electronically, the need to carry out physical inspections by qualified Valuers will not become obsolete. They are required to interpret, check and evaluate AVM outputs and where they choose to add AVMs to their toolkit they can add value and speed to the professional service offered. There is no doubt that the use and range of ways that AVMs are used is likely to continue expanding. Their use for low-cost low risk revaluations is already accelerating, due to concerns over falling housing markets in the USA and some parts of Europe and the potential of portfolio revaluations to reduce regulatory capital under the Basel II framework this trend will continue.

The proliferation of different models and the differences in the way they present results has made it difficult to compare them. Some standardisation or regulation of the suppliers would enable users to compare features such as confidence scores, the cycle on which databases and models are refreshed, accuracy testing and AVM audit. Standardization is likely to require the collaboration of many stakeholders and may be difficult to achieve but would enable AVMs to be more widely used. Some form of regulation or the introduction of a voluntary code would also instil more confidence with users.

**Conclusions**

An AVM is a useful and efficient tool when used appropriately by an experienced operator. Lenders must be certain that the model used has been developed after rigorous testing using good quality data by experienced modellers. There is no doubt that there is an appetite to expand their use and application for not only portfolio valuations but also for loan origination purposes, indeed there is evidence that there is a growing acceptance of their usefulness from not only the regulatory bodies that oversee the provision of financial services but also from the Rating agencies who comment on their appropriateness. More work needs to be done to ensure that an AVM provider has some responsibility for the accuracy of the results that they produce and for Lenders to understand exactly what it is that they provide. There needs to be some exposure to different housing markets, in areas perhaps where prices do not always rise, but where they fall and fluctuate to test the validity of the results in each scenario. Lenders must make sure that they understand exactly what they are being provided with and make adequate provision for losses that might arise where the AVM has not accurately reflected the value of a security. An AVM is not a tool for the inexperienced, it must be used with financial intelligence as part of a credit strategy where the risks of their use are fully understood.

Paul Trott
Valuation Panel Member Council of Mortgage Lenders UK
May 2008

## EMF Note on AVM Use in Europe

**DEFINING TERMS**

*Automated Valuation Models (AVMs):* AVMs are statistic-based computer programmes, which use property information (e.g. comparable sales and property characteristics etc.) to provide a value or a proposal for a value for the targeted property.

**SUMMARY OF FINDINGS**

**I. Current Market Position**

- AVMs are currently used in DK, DE, ES, IT, IRL, NL, SE & the UK to determine a property value for a variety of purposes according to the MS:
    - *Mortgage Origination:* DK, IRL, SE & the UK
    - *Quality control tool in the mortgage origination process:* DK, ES, IRL, NL, SE & the UK
    - *Underwriting of non-purchase mortgage loan products:* DK (presumed), IRL, SE & the UK
    - *Monitoring and adjusting of values in the context of the CRD:* DK, DE, ES (likely in the future), IT, SE & the UK
    - *Securitisation:* IT, SE & the UK
    - *Others:* NL (for taxation purposes) and the UK (for auditing purposes).

- In DE, AVMs are used to determine market values and mortgage lending values for standardised residential properties under the prerequisite that those models produce automated values but no automatic values.

- They are not used in GR, where they are unlikely to be employed in the future, FR, or PL. Polish legislation does not provide rules or guidance on the use of AVMs. The law demands that every valuation report contains certain obligatory elements, which makes valuation by AVMs more difficult. Valuers do employ certain special applications to for valuation purposes, but mainly for calculations.

- Reductions in cost and time are viewed as the key advantages of the use of AVMs but the quality of the result needs to be ensured.

- Limitations of AVMs can be placed in 3 categories: quality, quantity & timeliness of data, reliability and accuracy of the result and inadequate methodology.

**II. Current Practice Methodology**

- Depending on the MS, AVMs can be based on comparables analysis (DK, DE, ES, IT, SE & the UK), repeat sales analysis (DK, IT, SE & the UK) and hedonic methods (DK, DE, IT & the UK):

- Depending on the MS, data for use in AVMs is collected from the Land Registry (DK, IT, SE & the UK), and real estate companies (IT, SE & the UK). In DE, sources are usually lenders in combination with information from the land valuation board. In ES, the 6 Valuation Companies use their own data.

- In Member States where they are employed, restrictions on AVM use exist in DK and SE, where AVMs are only used for single family properties and owner occupied residential properties, respectively.

- Adjustments are made to automated valuations in DE & SE. In ES, automated valuations are used to adjust physical valuations.

**III. Rules, Guidance, Standards**

- Rules or guidance currently only exist in DK (only for mortgage origination), DE (valuations produced by AVMs must comply with specific regulations) and the UK (guidance urging lenders to use AVMs with appropriate controls in place).

- In DE, SE & the UK banks have internal guidelines or procedures related to the use of AVMs. In ES, the 6 Valuation Companies have their own internal rules, which are approved by the supervisor.

**IV. Future Use of AVMs**

- *Usage:* It is expected that the use of AVMS will expand (DE, DK, SE & the UK) and that generally they will become very important tools in the context of the frequent re-monitoring requirements of the CRD.

- *Technology:* AVMs are expected to improve with the use of Geographical Information Systems

(DK) and become more integrated (SE). Advances in technology are also expected to improve the accuracy of results and coverage (UK).

- *In light of recent Credit Crisis:* It is now even less likely in ES that AVMs will be used in origination. In SE, the manual verification of automated valuation is likely to be reinforced, while in the UK, the credit crisis is not expected to have any long-term effects on AVM use.

- *In light of the secondary market tensions resulting from the US Subprime Crisis:* In ES, the use of AVMs in originations will remain unlikely, while their use as a quality control tool will increase. No direct consequences of the secondary market tensions on AVM use are expected in DK & SE.

## I. Current Market Position

### *1. AVM use to determine a property value*

AVM are currently used in ***Denmark***, ***Germany***, ***Spain***, ***Ireland***, ***Italy*** *(rarely)****, the Netherlands***, ***Sweden*** *(only for single-family houses)* and ***the UK*** to determine a property value for a variety of purposes according to the Member State:

- ***Mortgage Origination***

AVMs are currently used in **Ireland, Sweden** and ***the UK*** for mortgage origination. In ***the UK***, however, AVMs are employed for only 5% of originations. In ***Denmark***, according to the executive order on valuation for mortgage lending an on-site valuation is prescribed but the Danish FSA can grant an exemption if the mortgage bank has a documented AVM. Mortgage banks can only get an exemption for owner occupied residential properties. In 2005, the Danish FSA authorised a mortgage bank to carry out automatic valuations. Neither the precise basis of the mortgage banks application, nor those of the Danish FSA's authorisation, have been published. In its application, the mortgage bank put forward a number of calculation models and models for collection data on property values on the market. Other mortgage banks have presumably also applied for approval.

AVMs may not be used for mortgage origination in ***Spain***.

- ***Quality control tool in the mortgage origination process***

AVMs are used as a quality control tool in the mortgage origination process in ***Denmark***, ***Spain*** (*limited to 6 Valuation Companies*), ***Ireland, the Netherlands, Sweden*** and ***the UK*** *(not extensively)*. In

***Germany***, there is potential, albeit it on a limited scale, for AVMs to be used for quality control in the origination process in the future.

- ***Underwriting of non-purchase mortgage loan products e.g. equity withdrawal products and remortgaging***

In ***Ireland, Sweden*** and ***the UK***, AVMs are used in the underwriting of non-purchase mortgage loan products. In the UK, however, this use is limited to only 5 to 10% of cases. In ***Denmark***, as noted above, the precise basis of the mortgage banks application and the given authorisation has not been published but it is presumed that the authorisation applies to other loan purposes than purchase mortgage loans.

There is no record of AVMs being used in the underwriting of non-purchase mortgage loan products in ***Germany***.

- ***Monitoring and adjusting of values in the context of the CRD***

AVMs are employed as a risk management tool for the monitoring and adjustment of property values in the context of the CRD in ***Denmark***, ***Germany***, ***Sweden*** and ***the UK***. In ***Spain***, the specific transposition as to how the frequent monitoring will be done has not yet been established, although it has already been accepted that statistical techniques will be allowed.

- ***Securitisation***

AVMs are used in securitisation transactions in ***Sweden*** and ***the UK*** (although to a limited extent).

- ***Other Uses***

In ***Germany***, AVMs are used to support the valuation process, especially for standardised residential properties.

In ***the Netherlands***, AVMs are used to carry out mass appraisals for taxation purposes.

In **the UK**, AVMs are also used for audit purposes when checking other valuation types e.g. indexed linked valuations, desk top valuations and drive-bys.

## 2. Reasons for non-AVM Use

In ***Germany***, AVMs are used to produce proposals of values for market and mortgage lending value valuations. The use of AVMs is based on the assumption that such systems are only applied with the purpose to enable an educated user to transpose the produced proposals of values after appropriate assessment into market and mortgage lending values.

In ***Greece***, given the nature of the property market and especially the absence of a national land registry, the use of AVMs is unlikely in the near future. However, the "Objective Valuation" system, which has been in effect for the past 15 years, whereby each property in Greece is assigned, through a series of formulae, a price, which is then used for taxation purposes, if developed properly, could form a basis for AVMs in the future.

### *3. Key advantages of AVM Use*

Reductions in cost and time are viewed as the key advantages of the use of AVMs. In ***the UK***, in particular, lenders are working towards point of sale offers using an AVM linked to a credit-scoring system. An additional advantage is deemed to be the use of AVMs as a tool to offer a second opinion on market values. Moreover, in the future, it is suggested that sophisticated AVMs might also be able to increase the quality of valuations.

Regardless of the advantages, clearly the quality of the result needs to be ensured.

### *4. Key limitations of AVMs*

A number of limitations of AVMs can be identified:

- *Nature of data:* The quantity, quality and timeliness of data can be further limitations to the use of AVMs. In Sweden, for example, there are too few transactions in some geographical areas for an AVM to function correctly.

- *Reliability or accuracy of the result:* In the absence of a physical inspection of the property, an AVM has to make a key assumption, namely that the property is in a mortgageable condition. What is more, depending on the strength of the model, there is a risk of over/under valuation for non-standardised property and property in certain geographical locations. Clearly, an automated system that does not apply some intelligence will produce some very poor results.

- *AVM Methodology:* On occasion, AVM methodology does not fully meet the requirements of valuers.

## II. Current Practice Methodology

### *1. AVM Modelling Components*

In ***Denmark, Italy*** and ***the UK***, all three models are used as the basis for AVMs i.e. comparables analysis, repeat sales analysis and hedonic methods. In ***Denmark***, however, the precise basis of the models has not been published. In ***Germany and Spain***, an analysis of comparables is common. In ***Germany***, hedonic methods can also be used as the basis for the AVM. In ***Sweden***, comparables analysis and repeat sales analysis are most commonly used as the basis for AVMs.

### *2. Sources of data collected for use in AVMs*

Data is collected from a variety of sources for use in AVMs:

In ***Denmark***, the precise sources of the data have not been disclosed but it is assumed that all models will at least be based on official sales and property data from the Land Registry. The Land Registry also acts as the source for data in ***Italy, Sweden*** and ***the UK***, as do real estate agent companies. In ***Germany***, the source of the data depends on the developer of the AVM. In the case of AVMs used in bank data, sources are usually the lenders in combination with information from the land valuation board (Gutachterausschuss) as well as socioeconomic databases. In ***Spain***, AVMs are used only by 6 Valuation Companies, which use their own internal data.

### *3. Restrictions on AVM Use in those MS where they are employed*

In ***Denmark***, AVM use for mortgage origination is only allowed for owner occupied residential properties. In ***Sweden***, AVMs are only used for the valuation of single family properties. A model for owner-occupied apartments is currently under construction.

In ***Germany*** and ***the UK***, there are no restrictions on the type of property or LTV limit, for which an AVM may be used. In ***Germany***, however, they are more often used for standardised properties, especially in the retail residential sector. In ***the UK***, some lenders use AVMs for all properties. Cases may then be physically valued if they do not meet certain set criteria.

### *4. Automated Valuation Adjustments*

Adjustments are made to automated valuations in ***Germany*** and ***Sweden***. In ***Germany***, the AVM must provide the option of a manual adjustment of individual valuation data and thus the final result. In

***Sweden***, if the branch office manager or similar finds for some reason that it is necessary to make an adjustment, the automated valuation will be examined manually.

In ***Spain***, the situation is rather reversed i.e. values obtained using AVMs are used to adjust the final value further to a physical inspection, if necessary.

Adjustments are not made to automated valuations in ***the UK***.

## III. Rules, guidance, standards

### 1. Rules & Guidance on AVM Use

There are currently no rules or guidance on the use of AVMs in ***Spain, Italy*** and ***Sweden***.

In ***Denmark***, the Danish FSA has only published rules or standards regarding the use of AVMs for mortgage origination. AVMs can only replace a conventional on-site valuation for owner-occupied residential properties (not for summer houses, buy-to-let or commercial properties).

In ***Germany***, there are ongoing discussions with the regulatory body (German banking supervision) to determine minimum requirements for AVM approval. To obtain approval the AVM must be able to guarantee a valuation pursuant to the German Pfandbrief Act. Valuation programs for Pfandbrief banks must comply with the specific requirements stipulated by the Regulation on the Determination of the MLV (BelWertV).

In ***the UK***, the main regulatory bodies have looked into the use and application of AVMs at a superficial level. No rules have been published, but guidance has been issued urging lenders to use AVMs with the appropriate controls in place. Their use must be supervised by a qualified surveyor who is independent of the sales process.

### 2. Internal Guidelines/Procedures on AVM Use

In ***Germany***, ***Sweden*** and ***the UK*** banks have internal guidelines or procedures related to the use of AVMs. In ***Spain***, the Valuation Companies that use AVMs have their own internal rules, which are known and individually checked by the supervisor, the Bank of Spain.

## IV. Future of AVMs

- ***Usage***

In Germany, ***Denmark***, ***Sweden*** and ***the UK***, expanded use of AVMs is expected. In ***the UK***, it is predicted that within the next 5 years, AVM use will vary between 25% and 80%. It is also suggested that AVMs will become very important tools for the frequent monitoring requirements established in the CRD. In ***Spain***, given the legal restrictions, it is felt that with regard to originations, AVMs will only be used as a quality control tool and nothing more.

- ***Technology***

In ***Denmark***, it is anticipated that the use of Geographical Information Systems will improve AVMs. In ***Sweden***, it is expected that AVM systems will become more integrated. In ***the UK***, the key developments involve improving the accuracy of the results and the coverage; in some parts of the UK there is insufficient data to allow production of acceptable results. The expansion of the use of confidence factors is also progressing.

- ***In light of the recent Credit Crisis***

In ***Spain***, it is likely that the recent credit crisis will render any already remote possibility for AVMs to be used in origination even more remote. In ***Sweden***, the recent crisis is likely to reinforce the manual verification of automated valuations. In ***the UK***, the current crisis is seen as a temporary blip that will not affect the long term growth of the use of AVMs. AVM providers have been working very hard to promote the use of their systems. The pressure is on lenders to appease the ever increasing demands of the mortgage brokers who currently control the vast majority of originations in the UK, hence, there is an inevitable rush towards any system that speeds up the process. This response often forgets the need to make sure that the new process is robust and to properly assess the risks taken, and thus the consequences of the adoption of quicker processes where the risk reward values are not fully understood in the long term.

- ***In light of the current secondary market tensions resulting from the US subprime crisis***

From a ***Spanish*** perspective, it is clear that the recent credit crisis has introduced a substantial level of mistrust regarding the origination process in general and the value of the underlying asset in particular. Insofar as the valuations obtained using AVMs cannot be as reliable since there is no physical inspection of the property, their use in origination will most probably slow down. However, their use as quality control tool may reinforce the quality of the final result, and therefore, the use of AVMs in this form will increase.

In ***Denmark*** and ***Sweden***, it is felt that there will be no direct consequences of the current secondary market tensions.



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# EMF Guidelines for AVM Quality Criteria and the Use of AVMs in the EU

## *AVM Quality Criteria*

With regard to the criteria specific to the intrinsic quality of AVMs, the EMF's guidelines focus on those elements, which will directly impact the accuracy and reliability of the resulting valuations, i.e. the quality of the model, the quality of data and sources and also property characteristics.

### 1. Quality of Model

- The valuation programme must contain the valuation methods that are applicable in the Member State in question for the determination of market and/or mortgage lending values as appropriate, i.e. the cost method, comparative method, and income method.
- For the determination of market values, the valuation programme must take into account the appropriate national legal regulations. In addition, it would be useful for efficiency reasons if the data recorded in the valuation programme allowed for a value review/monitoring and if the data provided the basis for an LGD determination (such as market value adjustment/forecast), if necessary.
- For the determination of mortgage lending values, the programme must be able to guarantee valuation pursuant to the appropriate national legislation.
- The valuation programme must make sure when market values and mortgage lending values are being determined at the same time, that they can be calculated by separate methods to fulfil their different purposes.
- When deducting the necessary valuation data, the valuation programme must be in a position to reflect the market situation, the location, and the actual characteristics of the property to be assessed. When programmes are used that supply complete valuations, the individual features of a property need to be documented in text form or as a rating assessment based on measuring standards.
- In order to allow for some control over the valuation process, the AVM should allow for the manual selection of the comparable properties to be used and the manual adjustment of individual valuation data, and therefore the final result.
- In addition to being able to provide a valuation for the subject property, the valuation programme should also provide an indication of confidence in the accuracy of the valuation.
- The valuation programme should be designed in such a way that it can also be applied to perform the legally required valuations by sales unit staff in connection with a lending decision, providing this type of operation is allowed under national legislation. However, sales staff should only be allowed to input data into the program and should have no possibility to adjust or manipulate that data.

### 2. Quality of Data & Sources

The quality of the data in the underlying database in terms of credible source, number of (comparable) properties and scope of coverage is vital to the accuracy of the resulting valuation. As such, it is vital that the following criteria are respected:

- The data used in the underlying database should be reliable and accurate. Reliability of the data depends greatly on liquid and transparent markets.
- The underlying database should contain adequate percentage coverage of properties.
- The value of the target property should be estimated from an adequate number of good comparables.
- Data should be refreshed on a regular basis using information from reliable sources.

**3. Property Characteristics**

At least until database sizes increase and new approaches are developed to estimate values in heterogeneous areas, accurate AVM valuations are dependent on homogeneity in properties in the area in which the property to be valued is located. Against this background and according to the specificities of the market, care should be taken to limit the risk associated with AVM-generated valuations of, for example, the following types of properties:

- Properties that have unique features
- Properties located in sparsely populated areas
- Properties located in areas with little property turnover

## *Guidelines for the Use of AVMs in the EU*

In identifying the key criteria intrinsic to the quality of the AVM, the EMF has also identified:

- Certain issues, which a lender may want to take into consideration as part of its lending Policy when using AVMs to generate a property value; and
- Certain issues, which could be of relevance to supervisory authorities, which might be considering intervention in this particular area.

*Guidelines for the Use of AVMs in the EU by Lenders*

**1. Use of models**

- If the intrinsic quality criteria are satisfied and caution has been exercised where necessary, AVMs could be used for the following purposes:
  - Mortgage origination
  - Quality control tool in mortgage origination process
  - Underwriting of non-purchase mortgage loan products e.g. equity withdrawal and remortgaging
  - Monitoring and adjusting of values in the context of the CRD

- Securitisation

**2. Loan to Value (LTV)**

- Lenders may wish to limit potential risk associated with AVM-generated valuations if a loan has a high LTV ratio.

**3. Property Type**

- Lenders may wish to limit potential risk associated with AVM-generated valuations of properties in markets segments where liquidity may be low or data limited. The type of property will depend largely on the specificities of different Member States' markets but might include:
    - Buy-to-let properties
    - Past or current auction properties
    - Property in multiple occupation
    - Shared (equity) ownership property

**4. Monitoring**

- Lenders might wish to satisfy themselves that adequate and regular tests of the results and data are completed by an *internal* assessor, who is not connected to the sales process, or by an appointed *external* third party.

*Issues of Relevance to Supervisory Authorities*

**1. Supervision & Audit**

- The relevant supervisory authority should ensure that lenders use AVMs in a prudent way.
- The relevant supervisory authority should audit the results of lenders' back tests to ensure that the AVMs are being used appropriately and the resulting valuations are accurate.

**2. Insurance**

- In those countries, where valuers are required to hold professional indemnity insurance, providers of AVMs should also be required to hold the same level of insurance to protect against liability in the event of damages resulting from the use of the AVM.

## *Annex I: EMF Profile on Risk Related Criteria for Valuations*

### *Introduction*

The European Mortgage Federation recommends that certain risk related criteria (see attached risk profile) should be used when preparing and interpreting property valuations for lending purposes. These criteria relate to valuations using mortgage lending value or market value and can be considered independently of the valuation approach. In addition, there are other criteria that can be considered by professionals in assessing risks such as partnership risks and financial risks.

The risk profile can be used by lenders to obtain additional information that would improve their recognition and management of risk. The profile is intended to enhance the quality of valuations by covering what could be of interest to mortgage lenders.

### *Rationale for a risk profile*

The risk profile builds on the findings of the EMF Comparative Study on the Valuation of Property for Lending Purposes in the European Union, now in its 6th edition, especially with respect to the use of valuations nationally and cross-border together with the relevant regulation and/or self regulation. Property valuation is increasingly recognised as a core criterion for the optimal measurement and management of credit risk by mortgage lenders especially with respect to the risk sensitive approach of Basel II and the Capital Requirements Directive.

In this respect, the risk profile can be seen as a tool to manage and reduce risk. It should prove useful in improving the quality of valuations and increasing the credibility of valuation with supervisors.

### *Valuation and lending practices*

In a number of Member States, the valuation of property is a different, albeit complementary, act from risk assessment in the granting of a loan. For instance, an independent valuation company may undertake the former while the latter is done internally within the lender. This reflects the different valuation traditions in the European Union. In some Member States valuation is internal to the lender and is an integral part of the risk management process. In others the valuation profession operates independently from the lender.

In the latter case, valuers do not have information about the financial arrangements or about the borrower. For example, the loan to value ratio comes under the heading 'financial risks'. The valuer should not take into account loan to value when determining the value. However, credit officers do have such information which they can use along with the valuation report. Therefore, the valuer when making a valuation for lending purposes should take into account market and location risks, construction related property risks, the quality of tenants and leases as well as fiscal and legal risks. The credit officer, when considering a mortgage loan application, should also take into account other risks such as financial risks.

***Different valuation approaches***

The profile is not linked to a specific valuation approach (e.g. comparative, income etc). This enables users of valuations from another valuation tradition to use the profile to assist the interpretation of any kind of valuation report. Where a valuation is carried out using the market value one could signal that the valuation has been carried out at the top of the cycle and may not be sustainable. It may not be possible to purchase/sell a property at this price. Where a valuation is carried out using the mortgage lending value one could signal that this is the sustainable value.

***Profile of Risk Related Criteria for Valuations***

***All Types of Property***

A valuation of property for lending purposes should reflect the following risk criteria:

**1. Market Risks**

- Timing (present market conditions)
- Market cycles
- Market volatility / stability / liquidity
- Demand and supply
- Economic stability of the market
- Market structures
- Attractiveness of regional markets
- Investor or owner occupier driven market
- Behaviour of the market participants
- Demographic trends
- Labour supply
- Other investment opportunities

**2. Location Risks**

- Planning and development of the immediate neighbourhood and the greater surroundings (micro & macro)
- Development of the region, the city and the district
- Competition: micro-trends of the local economy / other alternative investment opportunities at local level
- Suitability of the location for investment, revenues and increases in values
- Infrastructure
- Public utilities / local supply
- Attractiveness of the location for companies

**3. Construction related property risks**

- Physical / architectural issues / quality of the property (fitting out, age etc.)
- Maintenance requirements
- Economic efficiency
- Environmental efficiency
- Marketability and appropriateness for third party users
- Flexibility for other types of use

- Contamination / polluted land
- Reconstruction cost

**4. Tenants / Leases**

- Strength of tenants
- Reputation of tenants
- Cash flow risks
- Strength of investor

**5. Fiscal risks**

- Current tax situation
- Potential positive / negative changes
- Local tax regime
- Regional incentives

**6. Legal risks**

- Ownership
- Planning permission
- Country specific lease structures
- Subsidies
- Efficiency of enforcement (repossession) and forced sale
- Liability for contamination

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## *Annex II: EMF Response to the Commission on Mutual Recognition dated 21 November 2006*

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**EMF RESPONSE TO THE COMMISSION FURTHER TO ITS REQUEST FOR ADDITIONAL INPUT ON PROPERTY VALUATION**

### 1. Country Specific Examples of 'Mutual Recognition' Scenarios

In the context of the Commission's decision to further investigate certain issues, of which valuation is one, on a bilateral basis with interested stakeholders, the EMF welcomes the opportunity to provide the Commission with more detailed information on its position relating to the mutual recognition of national valuation methodologies, complemented by the application of European or internationally-recognised standards or internationally-recognised national standards.

In this context, the EMF would like to point out that problems relating to differences in national valuation methodologies on a cross-border basis essentially arise in the case of two regulated countries. In these cases, the EMF gives concrete examples of the problems and recommends specific action as outlined below. For those cases where the home country of the lender or the property is regulated, or in the case of two unregulated countries, the EMF simply provides guidance on how these scenarios could be handled in practice.

The EMF would also like to emphasise that the mutual recognition proposal does not imply any changes to existing legislation at national level on property valuation. Instead and more realistically, it requires flexibility on the part of national supervisory authorities as outlined below.

**SCENARIO 1: REGULATION IN HOME COUNTRY OF LENDER AND PROPERTY**

**Example 1: Germany & the UK**

**Problem**

In Germany, the national supervisory authority requires that, for the valuation of owner-occupied single houses, both the land and the building are valued. In the UK however, the valuer will only deliver a valuation where the land value is not separately disclosed. In the absence of a land value from the UK valuer, the German lender wishing to finance the purchase of a property in the UK will be unable to meet the requirements of his supervisory authority.

**Recommended Action**

In this context and in light of the importance of local knowledge, the market valuation report should first be prepared by a UK valuer according to UK valuation standards. However, the German lender should ensure that the UK valuer is instructed to assess the value of the land in order to be able to adapt the UK valuation report to meet the requirements of the German supervisory authority for the mortgage lending value.

In other words, the EMF proposal requires an addition to the UK valuation in order to ascertain the land value and to comply with German requirements and an acceptance (mutual recognition) of the underlying UK market value methodology used to carry out the valuation by the German supervisory authority.

**Example 2: Denmark & Poland**

**Problem**

In Poland, only "Licensed Appraisers", as designated by the authorities according to special legislation, may carry out valuations and only on the basis of Polish valuation standards. Polish rules as to market valuation are very strict compared to Danish rules. According to Polish rules, the market value is derived from a mathematical average of comparable properties (which might be from old sales if the number of local sales is low). However, in Denmark the market value is based on sales between independent parties, which makes it difficult for a Danish bank to grant a loan in Poland based on the actual trade price.

**Recommended Action**

In this context, the valuation report will be carried out by the Polish lender on the basis of Polish valuation standards. However, the Danish lender wishing to finance the purchase of a property in Poland should instruct the Polish valuer to collect sufficient information - and the valuer should have the possibility to do this - on sales between independent parties to enable the Danish lender to adapt the Polish valuation report to meet the requirements his supervisory authority.

As indicated above, this proposal implies an adaptation of the Polish valuation and an acceptance (mutual recognition) of the underlying Polish market value methodology used to carry out the valuation by the Danish supervisory authority. This proposal would potentially also imply an acceptance (mutual recognition) by the Polish supervisory authority of the collection of additional information by the Polish valuer further to the request by the Danish lender.

### Scenario 2: Regulation in home country of lender but not in Home country of property – Germany & France

As indicated above, the German supervisory authority requires that property is valued according to the mortgage lending value. Against this background, it is vital in the case of a German lender wishing to finance the purchase of a property in France that the results of the valuation by a French valuer (importance of local knowledge) satisfy the fundamental criteria of the MLV.

Given that there is no regulatory framework in France governing the valuation of property (trade associations have outlined general rules but valuers are not bound to these) the German lender can either instruct the French valuer to carry out the valuation on the basis of German valuation standards or European or internationally-recognised standards, providing the latter appropriately cover the specificities and risks present in the local market and ensure that the MLV criteria are satisfied.

### Scenario 3: Regulation in home country of property but not in home country of lender: Italy & Spain

As outlined in the EMF's position dated 7 June 2006, in the case of regulation in the property's home country but not in the lender's, the regulations of the property's home country may be applied or where appropriate and providing they are at least equivalent, European or internationally-recognised or internationally-recognised national standards may be used:

**Use of property's home country regulation**

In Spain, there is specific legislation relating to subsidised housing, which places price (and time) limits on the sale value. Given the Spanish legal requirements for this type of property, it would be highly recommendable for an Italian lender wishing to finance subsidised housing in Spain to employ a Spanish valuer to value the property according to Spanish valuation methodology. Use of international standards would be inappropriate in this context because of the special requirements of the Spanish legislator.

**Use of international standards**

If, however, an Italian lender were to finance the purchase of an owner-occupied residential property in Spain, for which there were no specific legal requirements, the Italian lender could also choose to instruct a Spanish valuer to use European or Internationally-recognised standards to value the property, providing they were at least equivalent to the Spanish regulation on valuation. In this case, the Italian lender could instruct the Spanish valuer to carry out the valuation on the basis of a European or Internationally-recognised standard.

No specific action is required from the Commission in this particular case, since there is no legal requirement in Italy, which prevents the Italian lender from choosing the valuation or standard he wants i.e. property's home country regulation or international standard.

#### SCENARIO 4: NO REGULATION IN HOME COUNTRY OF LENDER OR PROPERTY – GREECE & HUNGARY

There is no regulation on the valuation of property for lending purposes in Greece or Hungary. If a Greek lender were to lend on a property in Hungary, he could use a European or internationally-recognised standard or an internationally-recognised national standard. A dialogue between the Greek lender and the Hungarian valuer would be vital in order to adopt the most appropriate methodology, taking into account local specificities and the lender's needs. In this case, Hungarian valuers typically use the standards laid down by TEGOVA. Against this background, the Greek lender could request that a valuer in Hungary carries out the valuation according to the Blue Book.

In all of the scenarios outlined above, it would be highly recommendable for all valuation reports to consider the core risk related criteria[9] as proposed by the EMF and endorsed by the Forum Group on Mortgage Credit in its Report[10], with a view to securing high standards of valuation.

### 2. Treatment of Valuation in Capital Requirements Directive as a model for the treatment of Valuation in the context of Mortgage Lending

The Commission requested feedback from the EMF on whether or not the treatment of valuation in the Capital Requirements Directive could potentially serve as a model for the treatment of valuation in the context of the valuation of property for lending purposes. The EMF is of the opinion that the rules in the CRD regarding definitions of values, independence of valuers and monitoring of values could provide a valuable orientation of best practice principles in this respect.

The EMF would however like to reiterate that it is opposed to regulation of any kind for property valuation. Against this background, the EMF is reluctant to recommend cross-reading with the CRD in case this may be interpreted, either now or in a later stage, as an endorsement of regulation.

### 3. Intervention at EU level

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[9] See Annex I.
[10] Report by the Forum Group on Mortgage Credit, December 2004, Recommendation 27, page. 31.

- ***Valuation Principles & Professional Qualifications***

In line with the position of the Commission's Mortgage Funding Expert Group, the EMF would support the convergence of valuation principles i.e. definitions and reporting requirements, and of professional qualifications through an EU recommendation, rather than binding EU regulation.

- ***Valuation Methodology***

Valuation methodologies always reflect national, regional or even local market specificities and consequently vary throughout Europe. In order to ensure that the valuation of a property reflects the local real-estate market i.e. that it complies with local legal and tax systems and market participants' behaviour, the EMF would support Commission action in this area in the form of an EU recommendation to encourage the mutual recognition of national valuation methodologies, complemented by the use of European or international standards (IVS (IVSC), EVS (TEGOVA)) or internationally recognised national standards (The RICS Red Book) where appropriate, as outlined above.

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***Annex III: EMF Proposal for a new IVSC Valuation Application for Mortgage Lending Valuation***

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## EUROPEAN MORTGAGE FEDERATION PROPOSAL FOR A NEW IVSC VALUATION APPLICATION FOR MORTGAGE LENDING VALUATION

(1) In many countries, Mortgage Lending Value is used by the financial services industry in the activity of lending secured by real estate. The Mortgage Lending Value provides a long-term sustainable value limit, which guides internal banking decisions in the credit decisioning process (e.g. loan-to-value, amortization structure, loan duration) or in risk management.

Mortgage Lending Value facilitates the assessment of whether a mortgaged property provides sufficient collateral to secure a loan over a long period. Given that Mortgage Lending Value considers property value for a long period of time, it cannot be grouped together with other valuation approaches based on market value which are taken on a fixed date (spot market values).

(2) Additionally, Mortgage Lending Value can be used as a risk management instrument in a number of ways in the context of:

- capital requirements for credit institutions as detailed in Basel I and II
- funding of mortgage loans through covered bonds secured by real estate as the cover assets
- the development of capital market products converting real estate and real estate collateral into tradable assets (e.g. mortgage backed securities)

The concept of Mortgage Lending Value is defined in detail by legislation, Directives and additional country specific regulation.

(3) 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 the long term sustainable aspects of the property, the normal and local market conditions, as well as the current use and alternative possible uses of the property. Speculative elements should not be taken into account in the assessment of Mortgage Lending Value. Mortgage Lending Value should be documented in a clear and transparent way.

All internationally recognised valuation methods also apply to the Mortgage Lending Value, subject to the type of property and the market specificities (historic, legal etc.) where the property is located. These are:

- income method
- comparison method

- depreciated replacement cost method

(4) Regarding the technical transposition of the definition mentioned above, the long term validity of Mortgage Lending Value requires compliance with a certain number of steps aimed at eliminating short term market volatility or temporary market trends.

The valuer must address the following key issues when determining the Mortgage Lending Value of a property:

- The future marketability and saleability of the property has to be assessed carefully and prudently. The underlying time perspective goes beyond the short term market and covers a long term period.
- As a principle, the long term sustainable aspects of the property such as the quality of the location, construction and allocation of surfaces must be taken into account.
- As far as the sustainable yield to be applied is concerned, the rental income must be calculated based on past and current long term market trends. Any uncertain elements of possible future yield increases should not be taken into account.
- The application of capitalisation rates is also based on long term market trends and excludes all short term expectations regarding the return on investment
- The valuer must apply minimum depreciation rates for administration costs and capitalisation of rents.
- If the mortgage lending value is derived using comparison values or depreciated replacement costs, the sustainability of the comparative values needs to be taken into account through the application of appropriate discounts where necessary.
- The mortgage lending value is generally based on the current use of the property. The Mortgage Lending Value shall only be calculated on the basis of a better alternative use, under certain circumstances i.e. if there is a proven intention to renovate or change the use of the property.
- Further requirements, for example with respect to compliance with national standards, transparency, content and comprehensibility of the valuation, complement the legal framework for the calculation of Mortgage Lending Value.

(5) Although Mortgage Lending Value is similar to Market Value in many respects, there are a number of clear differences; Market Value is internationally recognised for the assessment of the value of a property at a given moment in time. It describes the price which could be obtained for a property within a very short time frame. Notwithstanding that this value could alter very rapidly and no longer be up-to-date.

In contrast, the purpose of Mortgage Lending Value is to provide a long term sustainable value, which evaluates the suitability of a property as a security for a mortgage loan independently from future market fluctuations and on a more stable basis. It provides a figure, usually below Market Value and therefore able to absorb short term market fluctuations whilst at the same time accurately reflecting the underlying long term trend in the market.

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## Questionnaire for 2009 Study on the Valuation of Property for Lending Purposes

### *1. Macroeconomic Overview*

### *2. Property Market Overview*

#### 2.1 Residential Property Market Overview

a) Stock & Tenure:
- Total number of dwellings
- % Owner Occupied
- % Rented
- % State-owned
- % Other

b) Lending activity:
- Total national outstanding residential loans
- Total number of new loans
- Outstanding residential loans as % of GDP

c) Valuation activity:
- Volume of valuations carried out
- Average LTVs

#### 2.2 Commercial Property Market Overview

a) Stock & Tenure
- Total number of commercial properties
- % Office
- % Retail
- % Industrial
- % Other

b) Lending activity:
- Total number of outstanding commercial loans
- Total number of new commercial loans
- Outstanding commercial loans as % of GDP

c) Valuation activity:
- Volume of valuations carried out
- Average LTVs

### *3. The Valuation*

#### 3.1 Regulatory Framework

a) Is there a legal framework in your Member State specific to the valuation of residential and/or commercial property for lending purposes? If yes, please provide references.
b) If there is no specific legal framework, is the valuation of residential and commercial property for lending purposes covered by another legal framework or is the sector self-regulated/self-certified? If yes, please explain.
c) If there is no specific legal or professional framework, does the covered bond/MBS legislation in your Member State include legal provisions for property valuation?

#### 3.2 Valuation Bases

a) What valuation bases (Market Value, Mortgage Lending Value, etc.) are typically used in your Member State for the valuation of property for lending purposes:
   - Residential
   - Commercial
b) Based on what definition? Please provide the definition if different from the IVSC and TEGOVA definitions.
c) Depending on the requirements of different users, what other valuation bases are used in your Member State for the valuation of property?

#### 3.3 Valuation Methodology

Depending on the valuation base used, which valuation methods (comparison, capitalization, cost, etc.) are typically applied in your Member State to value properties for lending purposes in each category?

#### 3.4 Valuation Report: Form & Content

a) If there is a legal or professional framework in your Member State specific to the valuation of residential and commercial property, does/do the legislation/rules provide minimum requirements in terms of the form and content of the valuation report?
b) If yes, please indicate what these minimum requirements are.
c) If there is no legal or professional framework in your Member State, what form does the valuation report typically take?

d) Please provide an example of a pro-forma valuation report delivered in your Member State for the valuation of both a residential and commercial property.

### 3.5 Use of AVMs

a) If there is a legal or professional framework in your Member State specific to the valuation for lending purposes, does/do the legislation/rules provide guidance on the use of AVMs? If yes, what does this consist of?

b) For what purpose are AVMs employed in your Member State?
   - Mortgage origination?
   - Quality control tool in mortgage origination process?
   - Monitoring and adjusting of values in the context of the CRD?

c) To what extent are AVMs used for these purposes?

d) Is the use of AVMs in your Member State restricted to a particular type of property?

## *4. The Valuer*

### 4.1 Regulatory Framework

a) Is there a legal framework in your Member State relative to property valuers for lending purposes? If yes, please provide a short explanation plus references.

b) If there is no specific legal framework, are valuers covered by another legal framework or is the profession self-regulated/self-certified? If yes, please explain.

c) If there is no legal or professional framework relative to valuers for lending purposes in your Member State, please indicate for each of the sections below, what is typical practice.

### 4.2 Education/qualifications

a) If there is a legal or professional framework in your Member State regulating the valuer, are their minimum requirements regarding valuers' qualifications? If yes, what do these consist of?

b) If there is no legal or professional framework in your Member State regulating the valuer, what is general practice with regard to professional qualifications?

### 4.3 Use of valuer title

a) Is the use of the title of valuer protected in your Member State?

b) If yes, by whom?

c) If the title of valuer is not protected in your Member State, how do lenders protect themselves against the risk of 'unqualified' valuers?

**4.4 External v. Internal**

a) If there is a legal or professional framework in your Member State specific to the valuation for lending purposes, is/are there legislation/rules governing banks and lenders as to whom they may use to value properties?
   - If yes, do credit institutions have the possibility to employ both internal and external valuers?
   - Is one type of valuer typically employed more frequently than the other?

b) Is/are there legislation/rules that valuers have to comply with in order to guarantee that the valuations are unbiased and are not subject to undue pressure?

c) If there is/are no legislation/rules regarding the use of external and internal valuers, what is typical practice?

**4.5 Professional Indemnity Insurance**

a) If there is a legal or professional framework in your Member State specific to the valuation for lending purposes, is/are there legislation/rules requiring:
   - Valuers to have professional indemnity insurance cover?
   - Lenders to use only valuers covered by professional indemnity insurance?

b) If there is no legal requirement or no requirement by a professional valuation body, how are lenders/valuers covered for the risk?
   - Is/are there legislation/rules in your Member State determining the responsibility of the valuer vis-à-vis his client? If yes, please describe the legislation/rules and the responsibility of the valuer.

***5. Capital Requirements & Property Valuation:***

***Covered Bonds:***

a) Is there legislation in your Member State on real estate backed covered bonds or is such legislation planned?

b) If yes:
   - What are the maximum eligible asset LTV ratios for different types of residential and commercial real estate?
   - Has the regulator in your Member State interpreted the provision regarding "more frequent monitoring where the market is subject to significant changes"? If yes, how?

- Has the regulator in your Member State interpreted the provision regarding individual revaluation, i.e. is up-to-date data (actual rent and costs) required? Is an on-site valuation required?
- Is adequate insurance required by legislation?
- If not, has the regulator in your Member State interpreted the provision regarding "procedures to monitor that the property taken as protection is adequately insured against damage"? If yes, how?
- Has the regulator in your MS interpreted the provision regarding "independent valuer"? If yes, how?
- Has the regulator in your Member State issued executive orders or guidelines on "market value" and "mortgage lending value"? If yes, what do they consist of?

***Data Standards***

a) How has your regulator interpreted the provision regarding “monitoring using statistical methods” in the minimum requirements for valuation?

b) Does your regulator set out any data requirements specifically relating to property valuation?