Valuation Management Solutions

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We welcome your proposals, specifically regarding the imposition of LTV ratios.

In theory the Banks and the Valuers should be independent from influencing market values. Valuers should report on the market and be prudent and conservative when assessing collateral values.

Unfortunately an unintended consequence of the way bank valuations have evolved can lead to market distortion regarding market values. The nature of this asset class, i.e. houses, depends on opinions at a point in time and once a value is determined it sets the benchmark for all others in the area. If this value is over stated it provides an artificial boost to the local prices and the values effect spirals and a multiplier effect ensues.

Loan to Values for Banks and asset managers are very importance. It influences their tiered rates, the LTV impacts of provisioning and capital requirements and it is used as a competitive advantage between banks. So the LTV is a very important part of risk management.

The Central Bank's Macro Prudential proposals and the new Mortgage Credit Directive are clear in terms of defining valuations standards and the basis of valuations, i.e. Market Values. However the principles and the wording within these guidelines do not address the flaws within the current valuation practices between banks and Valuers which can create higher reported market values. The problem in Ireland is that once one house gets a value the market interprets this as the benchmark and all the others in the area follow suit.

Below is what happens now and unfortunately your proposals in their current form will not address this.

1) The Valuer's duty of care should be to the banks and the banks are relying on the Appraisal Report to underwrite the risk. It needs an independent report which reflects the purpose of the loan. However the current process sees Valuers being instructed and paid by borrowers, brokers and bank sales people. Valuers can be coerced and pressured into valuing properties that do not necessarily reflect the Market Value and this process compromises their independence.

2) Market Values can be influenced by local estate agents who, by their nature, tend to set values at levels where they hope best values and asking prices can be achieved. These are not necessarily suitable for market values for lending purposes. In some cases the Valuer appointed also happens to be the Estate Agent.

3) In cases where there is no contract price and a lender is assessing an existing asset they have no benchmark other than what the borrower thinks his/her house is worth. In these cases the Valuers rely on what the local bank branch or broker advises them of what the borrowing figure is to be and this acts as an influencer to the Valuer to make the LTV 'fit'.

4) These issues are not unique to Ireland, but given the fact that Ireland never had a reduction in residential values up to 2007, there has not been any serious attention given to valuation

processes particularly as an underwriting activity. The current processes have not changed since the 1970s. Other countries have tackled these issues such as in the UK, Canada, USA and Australia by implementing certain simple and basic rules, which are set out below.

Recommendations:

1) Make it clear that the valuation process is a function of underwriting and risk management. Remove the borrower, broker or bank sales person from engaging directly with the Valuer. Only the loan underwriter should receive or discuss the valuation report with the Valuer. This is the case in the USA and in the UK where borrowers or brokers are not allowed to engage with the Valuer. In some case they also do not allow the bank sales person instruct the Valuer. The Valuer must be appointed at arm's length by the underwriter (this is part of their underwriting process) and the only person to receive the Appraisal Report is the Loan underwriters.

2) Make it clear that the Appraisal Report and the instructing of a Valuer is clearly a contract between the Bank and the Valuer. That the duty of care is between these two parties and that the bank is responsible for its own assessment of the valuation of the property. This is the case in other countries where these measures have reduced claims around the duty of care and responsibilities and fraud.

3) When instructing the Valuer, the bank or instructing party should not include the amount of credit or mortgage being sought. This is not relevant to the market value and it only puts pressure on the Valuer to make his value fit. This is the practice in the USA.

4) The choice of professional Valuer should be considered. It is noted that Auctioneers are focused on selling houses for the highest price at a point in time. A professional Valuer should be concerned with conservative and long term valuations and be aware of the importance of getting the value right for lenders to support them with assessing the property as security for the long term. A way this could be improved is to insist that all valuers, including Estate Agents, must be experienced in collateral valuations for mortgage purposes. They should be two or three years practicing this (preceding the valuation instruction) and they must be registered with their professional bodies who are now introducing specific registration schemes for these standards (Red book and Blue Book). This would go some way to bringing more professional and independent Valuers into the process.

5) Lastly, the quality of the Appraisals differs between banks as each bank makes up their own templates. The risks of providing loans over 25 years or so are not always reflected in the various appraisal reports. The European Mortgage Council has suggested a mortgage type appraisal which looks at a number of factors that affects the value and this is built into the appraisal reports. These factors include environmental factors that could artificially influence values. It makes sense at least for all banks to use a broad standard appraisal template which covers the key mortgage risk and brings consistencies across the process.

As lending limits depend on professional opinions it is critical that independence and conflicts of interests are tightly managed. These steps are welcomed by the professional bodies but they need to be built into processes to ensure compliance. Unless you include some of these measures into your guidelines (expressly) these practices will continue and the objectives of your Macro Prudential polices will be undermined.

All the above suggestions are easily implemented by the banks and Valuers. They bring huge benefits to all the parties and help to keep prices to realistic market values. Finally I must declare my interest in that our company is an Irish company with the technology and people to provide valuations management solutions to support banks in their obligations and to ensure that they will be compliant for the MCD, the Guideline and Lessons Learnt (CB 2012) and any of the rules that will materialise under the proposed Macro Prudential policies. We have designed our technology to ensure that the issues stated above are catered for and that real conflicts of interest are negated and independence of the Valuer is assured. We have developed our business and risk model on comparable models in other countries. By using a company like us no bank can say that they are unable to be compliant with any of the regulations and in fact they will be adopting best practice exceeding those in Europe.

I am willing to elaborate on our company and benefits if suitable.

Regards

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