1.0 Introduction

1.1 The objective of International Valuation Application 2 (IVA 2) is to provide a framework for valuations of assets that are to be offered or taken as loan security.

1.2 It is important that Valuers consistently apply accepted valuation principles within the scope of these standards, providing clear, independent and objective opinions that are relevant to the needs of valuation users.

2.0 Scope

2.1 This Application applies in all circumstances where valuations are required of assets that are, or are proposed to be, held as security for lending. The lending may be done by different means, including mortgage or other forms of fixed or floating charge.

3.0 Definitions

International Valuation Standards Definitions

3.1 Market Value. The estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion (IVS 1, para. 3.1).

3.2 Mortgage. A pledge of an interest in property as security or collateral for repayment of a loan with provision for redemption on repayment. In the event the borrower (mortgagor) defaults, the lender (mortgagee) has the power to recover the property pledged.

3.3 Specialised Property. A property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location, or otherwise.

3.4 Trade Related Property. Certain classes of real property, which are designed for a specific type of business and that are normally bought and sold in the market, having regard to their trading potential.

European Union Legislation Definition

3.5 Mortgage Lending Value. The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property. Speculative elements shall not be taken into account in the assessment of the mortgage lending value. The mortgage lending value shall be documented in a clear and transparent manner. (This definition is from Directive 2006/48/EC of the European Parliament.)

4.0 Relationship to Accounting Standards

4.1 A valuation prepared for lending purposes will not necessarily be the same as one made for accounting purposes, particularly one made for financial reporting purposes. Although a similar base such as Market Value may be applicable, the assumptions on which the valuation is based may be different.

4.2 By way of example, the underlying principle of many valuations for financial reporting is the presumption that the entity will continue as a going concern. However, this would not usually be appropriate for valuations undertaken for lending purposes. Such a presumption has particular implications for specialised assets where the value and marketability of the secured property, separate from the business of which it forms part, may be limited.
5.0 Application

To perform valuations that comply with this Application and Generally Accepted Valuation Principles (GAVP), Valuers shall adhere to all sections of the IVS Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

5.1 In performing valuations of property for lending purposes, Valuers will normally provide the Market Value of such property in accordance with these International Valuation Standards.

5.2 If the circumstances are such that a departure from the Market Value basis is justified, the departure shall be clearly set out and explained in the Valuation Report along with the identification and definition of the alternative basis used and an explanation of the reasons for the departure. If there is a material difference between the Market Value of the property and the alternative value, this should be reported.

5.3 The valuation opinion shall be reported in accordance with IVS 3, Valuation Reporting.

5.4 In addition to fulfilling the requirements of IVS 3, Valuation Reports for secured lending of real property will normally include comment, where relevant, on the following items:

5.4.1 current activity and trends in the relevant market;
5.4.2 historic, current and anticipated future demand for the category of property in the locality;
5.4.3 the potential and likely demand for alternative uses;
5.4.4 both the current marketability of the property and if requested, the likelihood of its sustainability;
5.4.5 any impact of foreseeable events (at the date of valuation) on the value of the security;
5.4.6 the valuation approach adopted, and the extent of market-based evidence in support of the valuation.

5.5 Valuations for lending purposes may be required on an assumption there has been a change in the state or condition of the property, for example, the assumed development of a new building, or upgrade of a building. Such a valuation will normally be provided on the assumption that the change has occurred at the valuation date. It is not a projection of the value at the date in the future when the change will have actually occurred. The report must make it clear that the valuation is based on the assumption that the change specified had already been made at the valuation date. Use of the term Market Value without a modifier in these circumstances can be misleading. The term “Market Value as if complete” is an example of a suitable modification of Market Value that may be used in these circumstances.

5.6 A valuation of a property may also be required on the assumption that an estimated occupancy level had been achieved. This should also reflect the realistic expectations and perceptions of market participants as at the date of the report.

5.7 Corporate and individual loans from banks and other financial institutions are often secured by specific property assets. Valuers need to have a general understanding of the requirements of such institutions, and possibly the structure of loan terms and agreements. Lenders will usually require that the terms of a loan be kept confidential, but this does not relieve the Valuer of the obligation to have a general understanding of the lending process.

AUSNZ 5.7.1 Application

The extent of general understanding of requirements of financial institutions for valuers in Australia and New Zealand would normally be limited to:

- the requirements of professional indemnity insurance policies including prudent lender clauses
- the distinction between first and second mortgages
- loan to value ratios
- basic loan terms

General knowledge of requirements of financial institutions in Australia and New Zealand does not extend to knowledge of loan terms and conditions for a particular loan or loan application, which valuers are typically not privy to. Ultimately loan terms and conditions are the commercial prerogative of a mortgagee or financier, and will have no impact on the assessment of market value by a valuer.
6.0 Discussion

6.1 At the outset of an assignment, the Valuer needs to clearly identify the property that is to serve as the security. Particular care is required to distinguish between property types where real property and personal property are combined.

6.2 The manner in which property would ordinarily trade in the market will determine the applicability of the various approaches to assessing Market Value. Based upon market information, each approach is a comparative method, and the use of more than one method may be required.

6.3 Each relevant valuation method will, if appropriately and correctly applied, lead to a similar result. All valuation methods should be based on market observations. Construction costs and depreciation, where they apply, should be determined by reference to an analysis of market-based estimates of costs and accumulated depreciation. The use of an income method, particularly discounted cash flow techniques, will also be based on market-determined cash flows and market-derived rates of return.

6.4 Occasionally a lender may request a valuation on a basis other than Market Value. IVS 2 addresses the types, use and reporting of some common alternative bases of valuation. The Valuer should ensure that an alternative basis is not confused with Market Value. Although there may be circumstances where an alternative basis is appropriate for secured lending, users of such valuations should be made aware that such value may not be realisable if the alternative assumptions made are no longer applicable.

6.5 Investment Properties

6.5.1 Income-producing properties are usually valued as individual properties. Lending institutions may also wish to have a property assessed as part of a portfolio of properties. In such instances, the distinction between the value of the individual property, assuming it is sold individually, and its value as part of the portfolio should be clearly expressed.

6.5.2 Although the Valuer should comment on the expected demand and marketability of the property over the life of the loan (see para. 5.4 above), it is normally outside the scope of the valuation exercise to advise on the ability of a tenant to meet future lease obligations beyond comment on the market's current perception of the tenant's quality.

6.6 Owner-Occupied Properties

6.6.1 Owner-occupied properties valued for lending purposes will normally be valued on the assumption that the property is transferred unencumbered by the owner's occupancy, i.e., that the buyer is entitled to full legal control and possession. This does not preclude consideration of the existing owner as part of the market, but it does require that any special advantage attributable to the owner's occupancy, which may be reflected in a valuation of the business, be excluded from the valuation.

6.7 Leases Between Related or Connected Parties

6.7.1 Caution is required where property offered as security is subject to a lease to a party connected to the borrower. If the valuer considers that the lease creates a more favourable income stream than would be obtainable on a letting to an unconnected third party in an arm's-length transaction, the lender should be alerted and it may be appropriate to disregard the existence of the lease in a valuation of the property as security.

AUSNZ 6.7.2 Leases Between Related or Connected Parties

In Australia and New Zealand if the valuer considers that the lease creates a more favourable income stream than would be obtainable on a letting to an unconnected third party in an arm's-length transaction, the lender should be alerted and it is appropriate to disregard the existence of the lease in a valuation of the property as security.

6.8 Sales Incentives

6.8.1 It is not uncommon for a seller of property, especially developers of real property, to offer incentives to buyers. Examples of such incentives include rental income guarantees, contributions to the buyer’s removal or fitting out costs, or the supply of personal property such as furnishings or equipment. Market Value ignores any price inflated by special considerations or concessions (IVS 1, para 3.2.1). It may also be appropriate to alert the lender as to the effect that any incentives being offered have on the actual selling prices achieved.

6.9 Specialised Properties

6.9.1 Specialised properties by definition may have limited marketability and significant value only
as part of a business (see Concepts Fundamental to Generally Accepted Valuation Principles, para. 8.2). For loan security purposes, such properties will normally be valued on a vacant possession basis (see para. 6.6.1 above) and a valuation based on the highest and best alternative use is usually applicable. This will involve consideration of the costs and risks that would be involved in achieving that use. Lenders may not consider specialised property to be suitable as a security for lending purposes.

6.9.2 A valuation may be required of a specialised property where the property is part of a going-concern business. The lender should be alerted to the valuation being dependent on the continuing profitability (or otherwise) of the going concern. If the value on a vacant possession basis is potentially lower, this should be drawn to the attention of the lender.

6.10 Trade Related Properties

6.10.1 Certain classes of property, including but not limited to hotels and other trading businesses, where the property is approved and purpose-designed for only that use, are usually valued based on profitability but excluding Personal Goodwill (see GN 12, para. 3.3.2). In such cases, the lender should be made aware of the significant difference in value that may exist between an operating concern and a non-operating concern where the business is closed, the inventory is removed, licences (and other intangible assets such as certificates, franchise agreements, or permits) are removed or are in jeopardy, and any other circumstances exist that may impair future profitability and value.

6.10.2 If the income from a property is critically dependent on a tenant or tenants from a single sector or industry or some other factor, which could cause future income instability, the Valuer should address these factors in the Valuation Report. In certain cases, an assessment of the value of the property based on an alternative use, assuming vacant possession, may be appropriate.

6.11 Development Properties

6.11.1 Properties held for redevelopment or sites intended for development of buildings should be valued taking into account existing and potential development entitlements and controls. Any assumptions as to planning issues and other material factors must be reasonable, validated by market behaviour and explicitly stated in the Valuation Report.

6.11.2 The approach to the valuation of development properties will depend on the state of development of the property at the date of valuation and may take into account the degree to which the development is pre-sold or pre-leased. The valuation approach may need to be discussed with the lender prior to undertaking the valuation. Care should be taken by the Valuer to:

6.11.2.1 make a reasoned estimate of the development period from the date of valuation. The effect of additional development requirements on costs and revenues, using present value discounting where appropriate, will be reflected in this analysis;

6.11.2.2 evaluate as far as is possible at the date of valuation, market behaviour during the period of the development;

6.11.2.3 consider and outline the risks associated with the development; and

6.11.2.4 consider and disclose any known special relationships between the parties involved in the development.

6.12 Wasting Assets

6.12.1 Specific lending issues arise in relation to the valuation of wasting assets such as mines or quarries. The lender’s attention needs to be drawn to the risk associated with this type of a wasting asset and the planned program for its extraction or use.

6.12.2 Property rental that exceeds the current market or economic rent may constitute a wasting asset because any value attributable to this factor diminishes as the term of the lease decreases.

6.13 The Valuer

6.13.1 The nature and scope of the Valuer’s engagement should be clear to the Valuer and the user of the valuation. Valuers should be aware of the risk associated with valuations for lending purposes where miscommunication, misunderstanding or error may lead to a dispute or litigation between the lender and the Valuer.

6.13.2 In some jurisdictions financial services legislation requires licensing or registration of advisers when advice is related not only to the value of property, but also to securities issues such as equity, participatory interests, collective investment
schemes, or syndicated loans. Valuers may be restricted in the advice they can provide in these jurisdictions.

6.13.3 In undertaking valuations for lending purposes, it is particularly important that the Valuer be independent of the borrower.

6.13.4 It is important that the Valuer possess appropriate experience in relation to the particular property type and locale for the property involved, or if not, seek expert assistance.

6.14 Forced Sales and Limited Marketing or Disposal Periods

6.14.1 Lending institutions may request valuations on a forced, or liquidation, sale basis or impose a time limit for disposal of the security. Because the impact of a constraint on the price obtainable will depend upon the specific circumstances under which the sale takes place, it is not realistic for the Valuer to speculate on a price that could be obtained without either knowledge of the reasons for the constraint, or the circumstances under which the property might be offered for sale. An alternative valuation may be provided based on defined assumptions, but the Valuer should draw the lender’s attention to the fact that this opinion is valid only at the valuation date, and may not be relied upon in the event of a future default, when both market conditions and the sale circumstances may be different.

6.15 Lenders’ Solvency Ratios

6.15.1 Major banks and other lenders are normally subject to regulations that limit the total amount they can lend as a proportion of the lenders’ assets, known as the solvency ratio. In the international context, the Basle II Accord sets out rules for the minimum solvency ratios to be maintained by lending institutions and how those ratios are to be calculated. The value of assets over which the lender holds security is used in calculating the solvency ratio.

6.15.2 In exceptional circumstances for well-developed and long-established markets, the Basle II Accord requires the estimation of the Market Value and Mortgage Lending Value of a security backed by commercial real estate. A preferential risk weight of 50% is assigned to the tranche of a secured loan that does not exceed the lower of 50% of the Market Value or 60% of the Mortgage Lending Value.

6.15.3 Mortgage Lending Value is a long-term, risk assessment technique. As such, it is not a basis of value. MLV is a technique that is primarily used by banks in a number of European countries. Further information on Mortgage Lending Value is available on the IVSC website.

NZ 6.16 Security Recommendation

In New Zealand where a Member is requested to complete a valuation for the purposes of the Trustee Act 1956 and amendments, the Solicitors Nominee Company Rules 1996, or the Securities Act (Contributory Mortgage) Regulations 1988, or for any lender whom the Member is aware is acting in the capacity as a trustee, a recommendation shall be provided as to the maximum amount which the member considers it would be prudent to lend on the security of the property.

In all other cases in New Zealand a mortgage recommendation should be provided.

7.0 Disclosure Requirements

7.1 In reporting Market Value for lending security purposes, the Valuer shall make all disclosures required under IVS 3, Valuation Reporting.

7.2 The basis of the Valuer’s engagement is to be clearly set out in any reports to be used by third parties. All reports should be presented in a way that would not be considered by a reasonable person to be misleading.

7.3 The Valuer shall disclose the regulatory framework and any departure required from these Standards to comply with local legislation, regulation, or custom.

8.0 Departure Provisions

8.1 In following this Application any departures must be in accordance with directions provided in IVS 3, Valuation Reporting.

9.0 Effective Date

9.1 This International Valuation Application became effective 31 July 2007.