STANDARD RESIDENTIAL MORTGAGE VALUATION REPORT

PRESENTED BY

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BENEFITS OF STANDARDISED REPORTING

1. The main benefit is that it will be easy for the loan officers and underwriters to find pertinent information regardless of which valuation firm does the report.

2. It is compliant with the Banks requirements & RICS standards.

3. Easy to compare and contrast valuation reports.

4. Ensures uniformity as all valuers collect the same information.

5. Easy to update/edit template if and when requirements or standards change.

2. Each valuation firm created its own report format that gave the information requested.

3. In the 1970’s a building and loan association and a commercial bank produced their own standard home mortgage valuation report format. Hard copies of their proforma were supplied to the valuers. This practice never caught on.

4. The publication of the valuation standards in 1976 RICS and 1985 (IVSC) gave valuers a common framework.
5. In 1987 the Home Mortgage Bank proposed a one page report format. It was never implemented.

6. The following years saw (a) the use of enhanced software (b) development of valuation standards in areas affecting house mortgage valuation and (c) expansion of the mortgage finance sector. A standard reporting format was a logical move that would benefit both provider and user.

7. In April 2013 the Institute of Surveyors of Trinidad and Tobago resolved to produce a standard house mortgage valuation report. This was completed in 2016 and will be under review.
Origins of the RICS Valuation Professional Standards “Red Book”

- The first set of valuation standards was produced by the RICS in 1976 following the secondary banking crisis of 1973-75 and subsequent property market crash in the UK. It was originally confined to valuations for use in company accounts or publicly available financial statements and colloquially known as the “Red Book”. Over the years its scope has broadened and has been updated 24 times.
THE ROLE OF THE VALUATION STANDARDS (M)

Overall purpose of the Red Book

- Consistency, objectivity and transparency.

- Supports and adopts the globally recognized high level valuation principles and definitions now embodied in the *International Valuation Standards* (IVS) published by the International Valuation Standards Council (IVSC). It also complements the IVS by providing detailed guidance and specific requirements concerning their practical implementation.

- Provides professional standards regarding ethics, skills and conduct.

- To engender confidence in a valuation provided by RICS-qualified valuer anywhere in the world.
The International Valuation Standards Council (IVSC) is an independent, not-for-profit, private sector organization that has a remit to serve the public interest. It was formed in London in 1981 and today has 50 Valuation Professional Organisations in 44 countries including the RICS.

The IVSC also promotes standards for the conduct and competency of professional valuers. These are the responsibility of the IVSC Professional Board and are produced and issued independently of the IVSs.
THE ROLE OF THE VALUATION STANDARDS

Objectives of the international valuation standards

The objective of the IVSs is to increase the confidence and trust of users of valuation services by establishing transparent and consistent valuation procedures. A standard will do one or more of the following:

1. identify or develop globally accepted principles and definitions.

2. identify and promulgate procedures for the undertaking of valuation assignments and the reporting of valuations.

3. identify specific matters that require consideration and methods commonly used for valuing different types of asset or liability.

4. identify appropriate valuation procedures for the major purpose for which valuations are required.
THE IMPORTANCE OF THE TERMS OF ENGAGEMENT (TOE)

PLEASE REFER TO THE ToE DOCUMENT HANDOUT

- The document is a practical necessity and is self-explanatory

- Why Terms of Engagement? Because everyone knows that all…

- So the RICS in their wisdom has issued a global valuation practice statement making it mandatory from 1st April 2015 that all valuations be subject to Terms of Engagement.

- For the accounting profession it is also best practice to have a TOE which includes a contractual limitation on liability.
THE IMPORTANCE OF THE TERMS OF ENGAGEMENT (TOE)

- The Terms of Engagement sets out in plain English the specifics of the scope of works i.e. what the valuer is going to do so he can provide a Report for the specific purpose but more importantly what he is not going to do because of either a lack of competency or impossibility (either legal or factual) of finding information:

  - Not doing a land survey
  - Not doing a building or structural survey
  - Not doing a geological survey
  - No checks with TCP/ Regional Corporation / EMA/ Public Utilities/ other government agencies.
THE IMPORTANCE OF THE TERMS OF ENGAGEMENT (TOE)

- I mentioned earlier on, the purpose of the valuation, and for this gathering specifically the valuation for mortgage purposes normally has the highest degree of disclosure/qualifications and of course that dreaded statement - “NOT suitable collateral for a loan” e.g.

- Property prone to flooding.

- The construction of the building/infrastructure is substantially incomplete.

- Structural instability
TERMS OF ENGAGEMENT (TOE) - MORTGAGEE SALES

- I would like to take the opportunity here to mention that we are in the process of producing the Terms of Engagement for Mortgagee Sales as these types of requests are becoming more regular.

- This will be very similar to the Terms of Engagement for Residential Mortgage Valuations, however, you will notice some crucial differences.
WHAT IS INCLUDED AND WHAT IS NOT INCLUDED IN THE STANDARDISED MORTGAGE VALUATION RESIDENTIAL REPORT

- What is in the Standardised Residential Mortgage Valuation Report is self-explanatory.

- The copy of the standardization valuation report is in front of you.

The real question is what is out? and why?

- Cost approach (does not give a true reflection of market value, and is not supported by the RICS & IVS)

- Income approach for valuation of residential properties (does not give a reliable indication of market value)

- Sales of comparable properties (covered by other speaker)

- Economic Life (covered by other speaker)
WHAT IS INCLUDED AND WHAT IS NOT INCLUDED IN THE STANDARDISED MORTGAGE VALUATION RESIDENTIAL REPORT

- Various bits of data that you would get on a US or Canadian Multiple Listing Service

- Heating cost/rates/hydro/insurance (Not readily available)

- Info on listing. How long on market (Not readily available)

- Data on Water Heater/Cooling System for residential buildings not normally real property unless A/C is central

- Environmental considerations (No public data)

- Flood data is based on valuers local knowledge (No public data)

- Planning (No public data)
RECOMMENDED INSURANCE COVER

- Follow RICS guidelines on reinstatement cost.

- To be quite frank when someone is building a residence - is it not the practice of lending institutions to use a Quantity Surveyor to guide them? That is why the Insurance recommendation that the valuer gives is just a preliminary figure subject to the advice of a Quantity Surveyor.

- We have also excluded several items either because we have been so advised by the RICS or it is outside of our area of competence – namely:
  - VAT, Professional Fees and Site Clearance
  - Retaining Walls and boundary walls.
  - Water Features and swimming pools.
USE & OWNERSHIP OF DATA

PUBLIC  ➔ ➔  PRIVATE
Comparable Evidence

- This is the relevant transactional data from the sale of a property that shares similar characteristics of the subject property such as location, size and condition.

- It is used to support a valuation.
Comparable Evidence

Registrar General’s Record

and/or

Sale Agreement

Inspection

Comparable
Deed – Public Information

- **Date**: 30\textsuperscript{th} February 2010
- **Parties**: Kakashi Hatake (vendor) and Skiamaru Nara (purchaser)
- **Consideration**: $1,400,000
- **Tenure**: Leasehold
- **Deed Schedule**: All and singular a piece or parcel of land situated in the Ward of Manzanilla comprising 5,000 sq. ft. and bounded on the north by road reserve, on the south by lands of the vendor, on the east by lands of Uzumaki and on the west by lands of Hashirama. (Not always easy to identify since the legal and civic address may not correspond).
Inspection – Private Information

- **Building Size:** 2,000 sq. ft.; 500 sq. ft. garage annexe
- **Accommodation:** 3 bed; 2 bath; living/dining room; kitchen; porch; balcony
- **Site Improvements:** blockwork walls, pool, landscaping
- **Finishes:** gypsum ceilings, porcelain-tiled floors, high-end kitchen
- **Location:** specific address - Lot 50 Karakura Drive, Rukon District, Ward of Manzanilla
- **Condition:** good
- **Age:** 5
- **Gradient:** sloping
- **Transaction type:** arms length
- **Material Considerations:** panoramic view of city from balcony.
- Other notes on the neighbourhood character etc are captured.
<table>
<thead>
<tr>
<th>Field Name</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date of Transaction</td>
<td>30 Feb 2010</td>
</tr>
<tr>
<td>Address</td>
<td>Lot 50 Karakura Drive, Rukon District, Ward of Manzanilla</td>
</tr>
<tr>
<td>Tenure</td>
<td>Leasehold – 199 years</td>
</tr>
<tr>
<td>Building Size</td>
<td>2,000 sq. ft.</td>
</tr>
<tr>
<td>Consideration</td>
<td>$1,400,000</td>
</tr>
<tr>
<td>Rate psf</td>
<td>$700</td>
</tr>
<tr>
<td>Accommodation</td>
<td>3 bed; 2 bath; living/dining; kitchen; porch; balcony</td>
</tr>
<tr>
<td>Finishes</td>
<td>High-end</td>
</tr>
<tr>
<td>Condition</td>
<td>Good</td>
</tr>
<tr>
<td>Site Improvements</td>
<td>Blockwork walls, garage annexe, pool, landscaping</td>
</tr>
<tr>
<td>Gradient</td>
<td>Sloping</td>
</tr>
<tr>
<td>Age</td>
<td>5</td>
</tr>
<tr>
<td>Transaction Type</td>
<td>Arm’s length</td>
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</tbody>
</table>
The valuer’s job involves the collating of all the data, public and private, relating to the sale of a property and turning that data into a comparable.

<table>
<thead>
<tr>
<th>1.0 Sources of Real Estate Transaction Data in Trinidad and Tobago</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public &amp; open</strong></td>
</tr>
<tr>
<td>Media</td>
</tr>
<tr>
<td>Registry</td>
</tr>
<tr>
<td><strong>Private &amp; confidential</strong></td>
</tr>
<tr>
<td>Agent</td>
</tr>
<tr>
<td>Vendor/purchaser</td>
</tr>
<tr>
<td>Valuation work/colleagues</td>
</tr>
</tbody>
</table>
Why is it not included?

- Comparables are generated from a combination of public and **private** data.

- Gathered under confidentiality and would be unethical to disclose in reports; and

- Protected under the Data Protection Act 22.04 partially proclaimed via Legal Notice No. 2 of 2012.
Why is it not included?

- When a client allows you to inspect and reference their property it is with the understanding that the information is for that specific purpose and not to be released, partly or wholly in any report not affiliated with the purpose of the inspection.

- Note: In other more developed countries, there is a substantial amount of transactional data that is available in the public domain, therefore it can be shared. This is not the case in Trinidad and Tobago, consequently, it cannot be included in valuation report.
USING COMPARABLE EVIDENCE IN VALUATION

Analysis

- Square Footage Analysis
- Site Improvement Analysis
- Location Analysis
- Component Analysis (Beds, Baths)
- Etc.
USING COMPARABLE EVIDENCE IN VALUATION

Application

RICS Hierarchy

Weighing
USING COMPARABLES EVIDENCE IN VALUATION

Application

The RICS has recommended a hierarchy of the weight that should be given to ‘comps’

- Subject or similar property has been marketed with offers (full data available)
- Recently completed transactions (full data available)
- Recently completed transactions (sufficient data available)
- Historic evidence
- Indirect evidence (property indices)
- Indirect evidence (non-property related)
- Asking prices

Batho et al., (2012). *Comparable evidence in property valuation*. RICS. Coventry
WEIGHING COMPARABLE EVIDENCE:

- Should be recent transactions
- Within the same age range
- Of similar tenure
- Similar size, finishes and/or accommodation
- Similar location
- Preferably within a price bracket.

Note: Selecting ‘comps’ of this nature would minimize the amount of adjustments required. However, due to the market, ‘comps’ fulfilling all the requirements are not easily obtained for all valuations.
USING COMPARABLE EVIDENCE IN VALUATION

Adjustments

Size
Age
Location
Services
Accommodation
Site
Improvements
Condition
Finishes
## USING COMPARABLE EVIDENCE IN VALUATION

### The Valuation

<table>
<thead>
<tr>
<th>Date</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>Subject</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building Size</td>
<td>May-16 1900</td>
<td>May-16 1800</td>
<td>May-16 1200</td>
<td>May-16 1500</td>
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<tr>
<td>Price</td>
<td>TT$1500,000</td>
<td>TT$1425,000</td>
<td>TT$1025,000</td>
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</tr>
<tr>
<td>Rate</td>
<td>TT$789.47</td>
<td>TT$791.67</td>
<td>TT$854.17</td>
<td></td>
</tr>
<tr>
<td>Adjustment</td>
<td>5%</td>
<td>5%</td>
<td>-5%</td>
<td></td>
</tr>
<tr>
<td>Adjusted Rate</td>
<td>TT$828.95</td>
<td>TT$831.25</td>
<td>TT$811.46</td>
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</tr>
<tr>
<td>Average Rate</td>
<td></td>
<td></td>
<td></td>
<td>TT$824</td>
</tr>
<tr>
<td>Valuation</td>
<td></td>
<td></td>
<td></td>
<td>TT$1235,828</td>
</tr>
</tbody>
</table>
What is the market going to do in the future?
“Economic life is defined as the period over which improvements to real property contribute to property value. Remaining economic life is the estimated period over which improvements will continue to contribute to property value.” Derbes, M (1987).

No guidance is offered on how the valuer might derive specific market adjustments for functional and economic obsolescence either in the Red Book or in text books (Bally, 2011). European valuation guidance (TEGOVA, 2003, Standard 4, paragraph 4.43) suggests that, because of the difficulty in putting a precise life span on a building, bands of “less than 20” “20 to 50” and over 50 are used.
ECONOMIC LIFE

- Valuers use their experience with the current market and recent (past) sales to determine market value.
- We cannot predict the economic life of a building.
- We can only determine if the improvements contribute to property value upon inspection and subsequent analysis.
Recently sold for $12.5 M
Recently sold for $12.5 M

Economic Life? Building was demolished
Market Value-RICS definition

- The estimated amount for which an asset or liability should exchange on the *valuation date* between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

- When we determine the market value of a property, we determine the value as an entity.

- Single storey house on # 5 No Street, St. Augustine sold for $2,500,000 in August 2016

- Market Value of # 3 No Street, St. Augustine is $2,650,000
\textbf{APPORTIONMENT}

- When a property is sold….it’s ONE figure. There is no breakdown of Land Value and Building Value.

- Apportioning values give that impression that Market Values are \textbf{not} derived from comparing similar properties with the subject property …but rather …a formula “cost of land + cost of building = Market Value”

- This is very misleading.
Apportionment is attempting to split the Market Value of a property by attributing a value to the land component and attributing a value to building component.

Apportionment is very hypothetical. One cannot purchase/sell a building without land.

Several methodologies are used to apportion and they have proven to be inconsistent and contain many shortcomings.
Example of Apportioning Market Value

- Property A – MV is $1,500,000
- Apportionment - Land $500,000 & Building $1,000,000
- However, this does not mean someone will purchase a vacant parcel for $500,000

Example

- A building can actually be considered an encumbrance. This can mean that someone will pay more for a cleared vacant site rather than an old building on the same site.
- This was clearly illustrated with the building shown earlier which was sold for 12.5M and then totally demolished.
Unlike the fields of Accounting and Taxation, there are no statutory, institutional, international standards/requirements for apportionment as it relates to Mortgage Valuations.

We are of the opinion that apportionment of the MV of a property serves no purpose for its intended use because it is highly hypothetical, not real and non-existing.
Current use of apportionment in financial institutions

- Bank’s Policy
- Risk assessment

What happens when the property is an apartment or townhouse? Apportionment cannot be done on such properties? How is risk assessed for these properties? What’s the Bank’s policy here?

Generally apportionment is not supported/recommended in the industry because it is highly hypothetical. We attempt to make a logical split of the Market Value, ONLY to facilitate clients and satisfy the bank’s requirement.
Apportionment is not mandatory because, again, there is no statutory or institutional requirement for apportionment for Mortgage valuations.

I wish to point out that many international financial institutions do not require apportionment of Market Values. An example, Fannie Mae, the largest Mortgagor in the world…

However, some of our local financial institutions have accepted and understood that apportionment may serve “more harm than good” and critical decisions should not be based on a highly hypothetical scenario and have agreed that it is not needed for a mortgage valuation.

Perhaps this may set a trend in moving forward and apportionment of Market Value will no longer be requested for Mortgage Valuations.
APPORTIONMENT

Recommendation

- Value of the land as if it’s a cleared site with vacant possession.

- At present this is in practice by one of our firms and is accepted by most financial institutions. Again, this may be the best practice which can serve the purposes of the bank and would be the more logical resolution.
EXCLUSION OF MARKET VALUE OF UNFINISHED BUILDINGS

Reasons

- 1. No accepted or recognised methodology for valuing unfinished buildings.

- 2. No guidance from the valuation standards. The valuation standards refer to valuation of existing complete building or proposed buildings valued as if completed.

- 3. Insufficient comparable sales evidence.
EXCLUSION OF MARKET VALUE OF UNFINISHED BUILDINGS

4. What sales evidence there is may reflect the overbid of desperate unsophisticated home buyers or underbids by savvy profit driven speculators.

5. Buildings may be subject to ongoing construction and demolition, weathering or vandalism or the level of completion of hidden structural elements and services is unknown.

6. The potential for overvaluation or under valuation is too great for valuation for mortgage purposes because of the above.
DETERMINING HIGHEST AND BEST USE

1. The valuation standards impose on the valuer the requirement to determine the highest and best use.

- Red Book VPS 19e) 3 Where the basis of value is market value, the basis will reflect the highest and best use of the asset
- IVS Framework.
- *The market value* of an asset will reflect its highest and best use.
2. Defining Highest and Best Use

- Tenets or parameters of Highest and Best Use
  1) physically possible
  2) legally permissible
  3) financially feasible
  4) most profitable

IVS Framework

- 32 The highest and best use is the use of an asset that maximizes its potential and that is possible, legally permissible and financially feasible.
DETERMINING HIGHEST AND BEST USE

Is The Use Physically Possible?  
Is The Use Maximally Productive?  
Is The Use Legally Permitted?  
Is The Use Financially Feasible?
Determining the Highest and Best Use IVS Framework

The determination of the highest and best use involves consideration of the following:

a) to establish whether a use is possible, regard will be given to what would be considered reasonable by the market participants.

b) to reflect the requirement to be legally permissible, any legal restrictions on the use of the asset, e.g. zoning designations and user clauses in leases need to be taken into account.

c) the requirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical market participant, after taking into account the costs of conversion to that use, over and above the return of the existing use.
Old Apartment Building Vs Office Complex
DETERMINING HIGHEST AND BEST USE

What is legally permissible?

The Problem

1. In Trinidad and Tobago, the planning system does not work in the manner intended.

2. Permitted uses are not readily known unless there is an actual application.

3. In the recent *Intercommercial Bank* case determining highest and best use was the main issue.
DETERMINING HIGHEST AND BEST USE

The Solutions

Either

1. the report user/client provides formal planning information (letter or planning approvals) or

2. the report user/client accepts the determination of highest and best use given by the valuer without the benefit of the formal planning information but otherwise according to IVS framework and a proviso that Town & Country Approvals along with any relevant consents will be granted.