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The Role of International and Local Valuation Standards in Influencing Valuation Practice in Emerging and Established Markets

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The Role of International and Local Valuation Standards in Influencing Valuation Practice in Emerging and Established Markets
Report for Royal Institution of Chartered Surveyors

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<td>CPPI</td>
<td>Commercial Property Price Index</td>
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<td>CPV</td>
<td>Certified Public Valuer</td>
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<td>CRE</td>
<td>Counselors of Real Estate</td>
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<td>CREA</td>
<td>Conselho Regional de Engenharia e Agronomia</td>
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<td>CRECI</td>
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<td>CREIS</td>
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<td>DCF</td>
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<td>FRICS</td>
<td>Fellow of the Royal Institution of Chartered Surveyors</td>
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<td>FTSE</td>
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<td>ITBI</td>
<td>Imposto sobre Transmissao de Bens Imoveis</td>
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<td>IVS</td>
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<td>RVS</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>SPV</td>
<td>Special Purchasing Vehicle</td>
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<td>ULI</td>
<td>Urban Land Institute</td>
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<td>US GAAP</td>
<td>US General Accepted Accounting Principles</td>
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<td>USPAP</td>
<td>Uniform Standards of Professional Appraisal and Practice</td>
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<td>VOA</td>
<td>Valuation Office Agency</td>
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<td>VS</td>
<td>Valuation Standard</td>
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<td>ZAP</td>
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Executive Summary

Valuation standards have a significant role to play in helping to regulate professional practice at national, regional and global levels, promote professional ethics, integrity, impartiality and trust in valuer activities. Many governments and professional bodies are responding to international pressure to regulate the valuation profession by reviewing the regulatory environment, valuer training and compliance with standards. At a global level the International Valuation Standards Council (IVSC) have become the recognised body that produce the International Valuation Standards (IVS). However, despite the existence of the IVSC’s International Valuation Standards there is considerable variation in how local standards engage and comply with the accepted principles laid out in the IVS. This is further compounded by diverging bases of value and methodologies that are being adopted to value property across the world. The different interpretation of concepts such as market value, differing valuation approaches adopted as well as the lack of qualified valuers continue to represent major challenges across both mature and emerging markets.

This research provides a strategic overview to international valuation standards in terms of identifying who sets and regulates the property valuation profession within four case study countries, namely Brazil, China, the US and the UK. In particular the research investigates the role of international and local valuation standards in influencing valuation practice within both emerging and established markets. The report presents the findings of four case studies, as well as a comparative overview of the underlying regulatory and practice based differences experienced. The case studies are utilised to demonstrate the cultural and operational issues facing the valuation profession, from both an emerging and established market perspective. The report is summarised within this executive summary under a series of thematic headings drawing on findings across all four case study countries.
Regulatory Environment

The US and the UK as two established real estate markets base their local valuation activities around one standard either the Uniform Standards of Professional Appraisal and Practice (USPAP) or the International Valuation Standards (IVS)/ RICS Valuation - Professional Standards (Red Book). While the UK has in recent years taken steps to fully adopt the IVS and incorporate it into the RICS Red Book, the US has been slower to engage with the IVS. However, a working group has been set up to help harmonise USPAP with the IVS to aid this transition. In contrast, the emerging markets of Brazil and China have a proliferation of local standards which might cause confusion for international investors and a normative disassociation at a local level. This bifurcation of standards can be further complicated by different professional bodies and different governmental departments each seeking to influence appraisal practice. Despite this there are suggestions that the IVS/Red Book standards are increasingly asked for by international investors. However, the understanding of these international standards outside of Europe is still relatively weak, thereby necessitating more training and awareness through local professional bodies.

Some local valuation standards, namely USPAP and ABNT in the US and Brazil are mandated by local statute making them legally binding on practising appraisers or in the case of Brazil mandatory for the engineering and architecture professions. China, whilst not mandating the use of their local valuation standards in their statutes has strategically positioned these under the control of three distinct government ministries. In contrast, the UK operates a form of self-regulation through its professional body the RICS which seeks compliance for all members with the Red Book standard. All four countries operate some form of licence, certificate or registration programme for practising valuers to ensure compliance with local standards as well as regulating the technical competencies expected of the industry. However, the enforcement for non-compliance or fraudulent behaviour to some extent still relies on whistle blowers as the resources do not exist to implement regular checks and audits across all companies, with the exception of RICS members as the RICS operates a mandatory pro-active regulation scheme.

The focus of the local valuation standards falls into two distinct groups, namely the technical and methodology driven standards adopted by Brazil and China and the more principle based standards adopted by the US and the UK. The technically focused standards tend to be prescriptive reflecting the relative immaturity of the real estate markets in Brazil and China and the need to ensure uniformity across the profession. In contrast, the principle based approach places more emphasis on the skills and judgement of the valuer in determining what methods to apply and how to generate the value conclusion. Despite the differing focus of the standards there was broad support for the complementarity of local and international standards in terms of international standards governing valuer responsibilities and ethics versus local standards operationalizing the valuation approach or method.
**Education and Training**

The education background of practising valuers differed significantly between countries. In Brazil, engineers and architects specialise in property valuation and as a consequence have a limited number of dedicated real estate degree programmes. The UK and to a lesser extent the US have a longer established history in delivering dedicated real estate degrees at both undergraduate and post-graduate levels, whereas China tends to be serviced primarily by construction, economics, business or finance programmes. The differing standards and the educational background of valuers also influence the wider valuation philosophy practised. The emerging markets are more reliant on a ‘science based’ approach which tempers valuer opinions, compared to the ‘art based’ approach favoured by established markets which relies on valuer interpretation and knowledge. Despite these differing philosophies there was recognition for the need to better understand local valuation practice and culture and that this may need to be extended to reflect a common international valuation language. Support for the latter was widespread across all four countries in helping to temper any local nuances and interpretation differences that can result in local market distortions.

There was some evidence to suggest that valuers are seeking membership from more than one professional body to respond to demands from international clientele and the increasing influence of the IVS. In this regard, the RICS has played a dominant role in offering the opportunity to obtain membership of an internationally recognised professional body. The growth of RICS membership in China and Brazil is increasing and the presence of international property consultancies in the tier one cities is helping to grow this further. However, care is needed to ensure the quality and skills competencies of these international practising members as well as adequately enforcing compliance with the Red Book standard to uphold the professional integrity of the organisation. Furthermore, across all four countries there is evidence to suggest that there is a lack of young graduates opting for valuation or appraisal as a career destination. There needs to be a proactive approach by the local professional bodies as well as universities to increase the profile of the valuation profession.
Valuation Approaches and Practice

There was evidence of a two-tier valuation market in emerging markets with a clear separation between international and local appraisal services. International property consultancies almost exclusively deal with the international clientele whereas local appraisal companies concentrate on domestic investors or purchasers. This separation is in part linked to the greater understanding and knowledge of applying IVS/Red Book standards but also the reassurance that the international consultancy big brand name gives to international clients. To some extent the local markets are increasing their competitiveness through local initiatives such as the special status granted to engineering and architecture based professionals in Brazil and the complex ranking of local companies in China. Furthermore, in more obscure markets where international companies do not have a local presence there is evidence of sub-contracting local companies to undertake valuation services on behalf of the international companies. This can enhance the quality of output produced by some local companies which can be comparable to that produced by the international consultancies.

The consensus of opinion is for valuation consistency within countries thereby ensuring that the same principles and methods are being applied and reducing market distortions. Achieving consistency in the methodology applied across countries did not receive support, little appetite was displayed to standardise valuation methodologies or enforce methodology changes through the local standards. Instead the cultivation of greater awareness of other countries’ methods and local valuation culture were viewed as a means of improving understanding without the need to alter established methodologies.

Valuation reporting styles across the four countries differed, but the level of sophistication and reasoning provided in justifying the value conclusion is improving in line with data availability and market maturity. There is increasing commonality in the content covered and the way in which the material is presented. In this regard many valuation reports produced in both Brazil and China are technically proficient and capable of capturing the market position. This is likely to increase further with reports becoming more uniform and comprehensive in their style and content as data availability improves further. Some local nuances in the report approach exist with Brazil adopting a self-grading of valuation reports according to quality of comparables, depth of detail and impact, whereas Chinese valuation reports require a points scoring review to determine compliance with local standards. There was also support for a summary page to be included in valuation reports to capture the value and underpinning assumptions, the objective being to ensure that no important information used in formulating the value opinion would be lost in the wider report content.
Market Value Definitions and Interpretation

The role of the IVSC in acting as the authoritative voice on valuation at an international level is becoming better understood and accepted across all four countries. However, this has not translated into greater adoption of the IVS market value definition within local valuation standards, with only 2 of the 7 local valuation standards studied in this research adopting the full IVS market value definition. In this regard the specific definition of market value included in local standards is often vague or confusing to a valuer which reduces the ability for it to be properly interpreted and uniformly applied. This failure of local standards to be explicit in their definitions has further resulted in informal definitions being used by the valuation industry or improper use of the terms such as forced sale value to capture what is effectively the market value situation. There is a need for a renewed drive by local professional bodies to lobby for the inclusion of explicit formal definitions for all types of value opinion to ensure transparency and avoid loose interpretation.

Market value remains the most common and preferred valuation basis despite the increasing number of either formal or informal value definitions appearing within local valuation standards. However, the volatile nature of real estate markets post 2007 has seen some reinterpretation of market value and inconsistency in the speed at which market adjustments were made. Despite this there was no real appetite for adopting alternative value definitions, such as the mortgage lending value favoured by German banks, as participants agreed that the true market value was lost in an artificial smoothing of the market cycles.

Market Data and Transparency

Whilst disparity still exists between established and emerging real estate markets in terms of real estate market data there are some signs that this gap is narrowing as information becomes more readily available especially for tier 1 cities. The use of asking prices rather than transacted prices for valuation purposes is still prevalent within Brazil and to a lesser extent in China. However, the availability of market data is slowly increasing and gradually this is extending beyond tier 1 cities. There is also an increasing number of data providers beginning to emerge, capable of generating statistical evidence on both investment and transaction data. This will enable the gap to transparent real estate markets to be bridged further to reflect market maturity.
Conclusion

This report demonstrates that valuation practice and the local standards used in both established and emerging markets are becoming more consistent and sophisticated to deal with international investor demands. The regulatory environment is generally well established and the wider compliance with standards is becoming more of a focus for emerging markets in recognition of the need to demonstrate integrity, valuer ethics and independence in the valuation process. Furthermore the level of complexity in reports is increasing and despite some local differences in methodological approach there is confidence shown in reports and values derived by local valuers. The international standards should still be deferred to for the market value definition, ethics and valuer responsibilities but local valuation standards are increasingly capable of operationalizing the valuation process and acting as an effective mechanism to regulate the valuation profession. Emerging markets will continue to offer attractive real estate returns to foreign investors and provided an understanding is gained of the local standards, valuation culture and methodologies used, then investors should not be apprehensive about the valuation practice adopted in these markets.
1.0 Introduction

1.1 Contextual Research Background

In an increasingly global environment international valuation standards are central to real estate valuation practice and bring many benefits to property markets in terms of economic competitiveness, promoting excellence within the valuation profession and ensuring transparency across markets. The RICS vision on international standards is dedicated to promoting excellence in professional standards whilst ensuring this is underpinned by world class regulation. This global emphasis is reflected in the promotion of the International Valuation Standard (IVS) produced by the International Valuation Standards Council (IVSC) as the main valuation standard, with the aim of increasing the level of adoption internationally and in turn to eliminate market fragmentation and improve market transparency.

The internationalisation of property as a key investment sector in many global investor portfolios has heralded a new era in terms of the need for greater market transparency and consistent valuation practice. There is a growing recognition that cultural differences and local nuances are having an impact on the consistency of valuations globally. This was reflected upon within the Carsberg Report (2002) which pointed out that if each member provided services only within a country or an area, then cultural differences may cause little detriment. However, the growth of cross-border financial dealings brings with it the need for standards that apply, are understood and trusted worldwide (Brett, 2002). Hence, consistency in valuation relies on the production and utilisation of reliable valuation standards. But it also requires more uniform interpretation of underpinning principles and their subsequent application in practice. The former is more easily achieved than the latter but one may be a necessary stepping stone to the other.

A number of emerging economies are still in their infancy in terms of the development of their real estate market and therefore the regulation of the valuation process remains a big challenge as they move towards a market-based system. Valuation standards have a significant role to play in helping to regulate local practice and promote professional ethics, integrity, impartiality and trust in valuer activities. Many governments are responding to international pressure to provide better market information, transparency and efficiency in their valuation practice by reviewing the regulatory environment, valuer training and compliance with local standards.

Despite the existence of international valuation standards there is still considerable variation in how local standards engage with the accepted principles laid out in IVS. This is further compounded by diverging bases of value and methodologies being adopted to value property across the world. The different interpretation of concepts such as market value, differing valuation approaches adopted as well as the lack of qualified valuers continue to represent major challenges across both mature and emerging markets. Furthermore, the infrastructure in place to support the valuation profession differs greatly between countries and therefore causes a fragmentation of the real estate services.

In order to overcome diversity in standards and application in practice the strategic direction emerging from professional bodies, non-governmental organisations and governments is one of standards convergence (McParland et al, 2002). This trend has accelerated in the aftermath of the global financial crisis reflecting the need for enhanced transparency to ensure greater accuracy and consistency in investment decision making, to mitigate risk and instil investor confidence. In the foreword to the FSA Business Plan 2009/10, the Chairman Lord Turner accepted that the regulatory system in the UK, and globally, must adapt and change…“arising from publicly admitted weakness in the supervisory approach” (p.5). Lord Turner believes that there was a failure to conduct and act on macro-prudential analysis and interestingly also a wide ranging intellectual failure.

The promotion of best international practice, world class regulation and excellence in practice are dependent on effective standard setting at a global level. Sustainable implementation is achieved through joint cooperation of professional bodies working across legal, financial, land, property and construction disciplines and in partnership with non-governmental organisations and increasingly governments, to prevent market fragmentation in the form of two-tier global versus local markets.

This research provides a strategic overview to international valuation standards in terms of identifying who sets and regulates the property valuation profession within four case study areas, namely Brazil, China, the US and the UK. In particular the research investigates the role of international and local valuation standards in influencing valuation practice within both emerging and established markets. The report presents the findings of four case studies, as well as a comparative overview of the underlying regulatory and practice based differences experienced in each. The case studies are utilised to demonstrate the cultural and operational issues facing the valuation profession, from both an emerging and established market perspective.
1.2 Research Objectives and Methodology

The research fulfills three key objectives which are as follows:

- To evaluate the regulatory and professional practice framework governing valuation practice in the four case study countries.
- To investigate the interaction between international and local valuation standards and country specific property market practice.
- To determine the linkages between international and local valuation standards, market fragmentation and investor confidence.

This research adopts a case study approach to the investigation of international valuation standards with the countries selected to reflect valuation practice in both established and emerging economies. Brazil and China were targeted to represent two of the most important of the emerging economies (i.e. two of the four so-called BRIC countries along with Russia and India), whereas the UK and the US represent the two most mature real estate markets in the world. The case study approach enabled the exploration of issues such as valuation consistency, accuracy and confidence from both a country specific and comparative viewpoint.

Furthermore, this enabled an understanding of the regulatory environment within which the local valuation standards operate as well as the localised approaches to the valuation process including engagement with the client, valuation bases, methodology and reporting. This case study approach was supplemented by both round table discussions and structured interviews in each country. The interviews and round table discussions were held with senior partners and directors across three key sectors namely valuers/appraisers, bankers and investors. These experts were consulted based on either their knowledge of the local market or their experience in dealing with international property transactions to ensure a mix of both local and international companies were represented.

The broad structure of the report is based on a mix of country specific chapters and a comparison chapter to present both factual and opinion based information on local and international valuation practice. More specifically chapter’s two to five present a country specific overview of the regulatory environment, the use of valuation standards as well as local valuation practice and market data issues. Chapter six outlines a cross comparison of the key differences in the style, practice and standards used in each country, Chapter seven provides an overview of the key findings.

1 In the context on this research the term ‘local standards’ is used as a collective noun to describe standards at either a city or national level, thereby distinct from those operating at an international level. Similarly, ‘international valuation standards’ is used to denote those produced by the IVSC.
2.0 Brazil

2.1 Brazilian Economy and Real Estate Market

According to the 2010 Census the population of Brazil was 190.7 million (IBGE, 2010) making Brazil the 5th largest country in the world. The World Economic Outlook published by International Monetary Fund (2013) predicts that GDP growth in Brazil for 2013 will strengthen to 3% from 0.9% in 2012. This reflects the noticeable slowdown in the emerging markets and developing economies during 2012 (IMF, 2013b), and the general feeling that companies in Brazil are starting to reduce expansion. However the impact of hosting the forthcoming Football World Cup in 2014 and subsequently the Olympic Games in 2016 may well see GDP growth accelerate once more. Of more concern is the continued increase in the rate of inflation and bank interest rates. According to IBGE (2013) inflation was recorded at 6.7% in June 2013, and whilst this is not high by the hyperinflation standards experienced in Brazil in the 1980s and 1990s it does represent a 1.8% increase on July 2012. Similarly, interest rates reported by the Banco Central do Brasil in July 2013 hit a recent peak at 8.5% up from 8% in an attempt to curb the increasing inflation rate. While the yield on the 10-year government bond as of July 2013 was 11.01% (Trading Economics, 2013).

The residential property market in Brazil is still developing after emerging from a long period of hyperinflation and high interest rates where banks offered limited lending for real estate. To some extent the reluctance to finance loans can be linked to the collapse of the National Housing Bank (Banco Nacional da Habitação, BNH) in 1985 which had to withdraw from the mortgage market after home owners and investors alike could no longer repay loans due to the inflation indexation on mortgages. The inflation indexation coupled with the law whereby banks cannot foreclose on a loan even if the borrower defaults provided it is the owner’s primary residency (known as ‘bem de família’), saw banks during this hyperinflation period withdraw from the mortgage market. This led to a period of housing market stagnation between 1985 and 2004. As a result of the ‘bem de família’ rule, mortgage foreclosures in Brazil were less prevalent than those experienced in established markets. The current economic buoyancy, led by the housing market and increased availability of finance, is not speculative but rather to meet the repressed demand from the mid-1980s to mid-1990s when individuals could not gain mortgage finance. In this regard the housing market is also dominated by first time buyers who hold approximately over 85% of residential loan guarantees.
Under the Brazilian Civil Code, the rights related to immovable assets (such as real estate) are divided into the right of possession and the right of ownership. Any transfer of ownership deeds need to be registered with the Real Estate Registry Office and are subject to the payment of a Real Estate Transfer Tax (ITBI), a rate which varies by city. Commercial lease agreements are usually less than 5 years, and are considered tenant friendly as once a lease exceeds 5 years the tenant has the automatic right to apply for a lease renewal. Rent for the lease extension is negotiable but if the parties cannot agree it will be determined in court. Similarly, according to the price adjustment rules in Brazil, rent can be monetarily adjusted for inflation every 12 months in accordance with the General Prices Index (GPI). After 3 years either party may request in court for the rent to be revised to adjust this to market price. Both the rent at renewal and the price adjustments to rent form a key volume of local valuers’ work in terms of acting as expert witnesses in rent review settlements.

The Banking system is well developed to encourage real estate investment as under a regulation of the National Monetary Council, banks have to lend up to 65% of their saving deposits to the construction industry, either through construction finance or as mortgages for home buyers. However, banks in Brazil tend to be very conservative on their Loan to Value (LTV) ratios given historic problems with hyperinflation and the collapse of the National Housing Bank. Typical LTV ratios for development would average 58% with a maximum ratio of 80%. This conservative nature can result in some banks offering to lend lower than market value and buyers then struggling to get loans secured. The conservative banking culture reflects the local market situation which avoids high levels of debt. Developers often must complete one project thereby releasing the equity from one development to help part finance the next one. There is also an increasingly sophisticated real estate investment market in Brazil with the existence of both Real Estate Investment Trusts (REITs) and various Special Purchase Vehicles (SPVs).

The larger cities (Sao Paulo and Rio de Janeiro) have the presence of a number of international property consultancies including Colliers International, Cushman and Wakefield, Jones Lang La Salle and CBRE. These cities also have the presence of some international banks including Citibank, HSBC and Santander which are starting to rival national banks such as Banco do Brasil, Itau Unibanco, Bradesco and Caixa Economica Federal. Furthermore, there is also an increasing presence from large international multi-national companies (Walmart, Carrefour, Zara, Mango, McDonalds and Starbucks) reflecting the appeal of Brazil’s high urban population, high consumption rate and growing middle class.
2.2 Valuation Regulatory Environment in Brazil

The Brazilian economy and property market are classified as emerging but this status is changing fast both in perception but also in reality as it becomes a key investment and development opportunity for both local and overseas investors. There is also evidence to suggest that the broad regulatory framework within which valuation operates is maturing with both real estate legislation and standards in place from the 1970s to help govern the valuation process. The current legislation governing real estate is the Brazilian Civil Code (Federal Law 10.406/2002) which covers the ownership and transfer of real estate and the Lease Law (Federal Law 8.245/1991) for urban commercial and residential real estate lease agreements. Furthermore, there is an established local professional body (IBAPE) which offers membership and provides training courses to practising valuers to ensure the public have confidence in the ability of valuers to fulfil their role whilst ensuring the valuation output conforms to a recognised standard. The following sections outline the regulatory environment by highlighting the key valuation standards operating in Brazil as well as the wider monitoring process, education background of valuers and the focus of the local standards.

2.2.1 Valuation Standards Operating in Brazil

The main valuation standard in Brazil is ABNT (Associação Brasileira de Normas Técnicas or the Association of Brazilian Technical Standards) which is enforced by Consumer Law and is legally binding for all architects and engineers carrying out real estate appraisals. ABNT standards for evaluating urban properties date back to 1950s and are well developed in terms of their acceptance in the local market and more importantly their use by local valuers. The ABNT standard has 7 parts relating to the valuation of all asset classes and reflects more than just real estate valuation. The first 4 parts are most closely associated with real estate, although in practice Parts 1 and 2 are those most commonly referred to for typical commercial appraisals –

- **Part 1** – general procedures [NBR 14653-1]
- **Part 2** – appraisal of urban real estate [NBR 14653-2]
- **Part 3** – appraisal of rural real estate [NBR 14653-3]
- **Part 4** – developments [NBR 14653-4]
- **Part 5** – appraisal of machinery, equipment and other industrial assets [NBR 14653-5]
- **Part 6** – valuation of natural and environmental resources [NBR 14653-6]
- **Part 7** – assets that embody historic and artistic heritage [NBR 14653-7].
The ABNT standard is supplemented by a voluntary standard produced by the local valuation professional body IBAPE (Instituto Brasileiro de Avaliações e Perícias de Engenharia or the Brazilian Institute of Engineering and Expert Reviews). IBAPE not only produces a national valuation standard but also publishes separate valuation standards at a state level (e.g., IBAPE Sao Paulo). Hence it reflects both state and central specific issues. Practising valuers who are normally engineers and architects are not mandated by law to become members of IBAPE and therefore do not have to follow the IBAPE standards, unlike ABNT which is enforced through legislation. However, in practice many architects and engineers are members of IBAPE and therefore utilise both sets of standards when carrying out a real estate appraisal. In this regard the use of ABNT and IBAPE is considered complementary with the broad content being very similar.

The ABNT standards must be used for valuations conducted for Brazilian banks. However, there is scope to use IVS or the RICS Red Book for valuations conducted on behalf of investors who are not residents of Brazil or for banks outside of Brazil. In these instances the traditional large international valuation consultancy firms such as Colliers, CBRE, Cushman and Wakefield, Jones Lang LaSalle are favoured given that they have practising RICS members. However, some local valuation companies are also seeing the wider opportunities of gaining RICS membership and acting for global clients who take confidence from the RICS badge and from knowing that the Red Book is followed.

The RICS have also been working to create guidance to provide assistance to its members on the application of the RICS Valuation – Professional Standards (the “Red Book”) for valuations in compliance with Brazilian jurisdiction. This project specifically reconciles both the RICS Red Book/IVS guidance with the local standards published by ABNT (Associação Brasileira de Normas Técnicas). A public consultation took place in 2013 and the “Red Book” for Brazil is expected to be available by mid 2014. Furthermore, the RICS has also worked with local firms and other leading industry partners such as Secovi-SP and the Federação Internacional das Profissões Imobiliárias (FIABCI) to gain support for involvement in developing the new International Property Measurement Standards. A continuation of this collaboration with market leaders in Brazil is expected over the coming years to support greater consistency in the approach to both property valuation and measurement.

2.2.2 Enforcement of Valuation Standards in Brazil

The responsibility for the enforcement of the ABNT standards is overseen by CONFEA (Conselho Federal de Engenharia e Agronomia or the Federal Council of Engineering and Agriculture) and carried out by CREA (Conselho Regional de Engenharia e Agronomia or the Regional Council of Engineering and Agriculture) which are responsible for inspecting and judging the practice of engineers, geographers, geologists, agronomists and technicians and their associated activities and therefore have a remit that is much wider than valuation. They also regulate the registration of engineers and issue certificates of technical practice as well as accrediting University courses linked to Engineering. Architecture since 2012 falls under the Council for Architects and Urbanism, which is a new entity that regulates the practices of architecture and urbanism within Brazil. Membership of CREA is difficult for non-Brazilian residents and usually only issued temporarily if there is a shortage of qualified skilled Brazilian professionals to undertake the demand for work. Real estate brokers fall under the registration scheme of the Conselho Regional dos Corretores de Imóveis or the Regional Real Estate Council (CRECI). There is no culture of valuers being sued for negligent valuations in Brazil, so limited enforcement of ABNT standards exists and it is rare for sanctions to be taken against valuers for not conforming to the standards. As a result, professional indemnity insurance is not considered a necessity in Brazil although more and more international clients require it as part of doing business. However, CREA is attempting to set up a registration scheme specifically for valuers which would be governed by the Ministry of Work. Presently valuers in Brazil are not regulated by Government beyond the ABNT rule that the valuer must hold a degree in architecture or engineering. As no CREA Council currently exists solely for valuers, there is the potential for IBAPE or RICS to help institutionalise valuation as a profession within Brazil through some form of registration scheme.
2.2.3 Education and Training of Valuers in Brazil

To gain entry to CREA, a candidate must hold an engineering undergraduate Bachelor’s degree, PhD and Masters in engineering holders do not meet entry requirements. Hence, local real estate valuations are mainly carried out by individuals who hold either an engineering or architecture primary degree. This is further endorsed by the ABNT standards and associated consumer law, which ensures that valuation work in Brazil, is legally directed to professionals with a full university degree. Architecture and engineering courses take 5 years to complete and whilst they cover some financial analysis (such as cost and income methods) they do not cover property valuation as a specialism. Instead this specialism tends to be gained through IBAPE postgraduate training, with dedicated modules on residential and commercial valuation or econometrics. The IBAPE training is available for members and non-members throughout Brazil and is offered as postgraduate modules. However, these professional training courses fall outside the remit of the education system and are not regulated by the Ministry of Education.

Hence there is currently a limited real estate undergraduate and postgraduate educational culture in Brazil as the property profession has traditionally been served by architectural and engineering courses. However, this is slowly starting to change with some dedicated real estate courses, in particular postgraduate Masters Programmes beginning to offer specialism in real estate investment, development, management and finance. However, there remains a cultural difference in teaching real estate in Brazil which focuses more on ‘learning in practice’ with the support of the additional dedicated IBAPE short courses delivered as training modules.

Since the RICS established operations in Brazil in 2011, investor demand has led to a need for more practitioners to use international standards. To meet this rising demand, the RICS has been instrumental in providing training in international valuation practice to firms such as Colliers International, Cushman and Wakefield and CBRE throughout Brazil. Currently, training workshops have been held with around 150 real estate practitioners in the market, focusing on the IVS, RICS Red Book and international standards. This has included a joint event with IBAPE with whom the RICS has an MOU agreement.

2.2.4 Focus of Brazilian Valuation Standards

Brazilian standards (both ABNT and IBAPE) tend to focus on the technical content and methodology rather than the wider conceptual issues or principles such as the scope or purpose of the valuation, the rules of engagement or conflicts of interest. Given that the traditional sectors that feed the valuation profession are technically oriented courses, more emphasis is being placed on objectivity within the valuation process. Local valuers do not subscribe to the view that valuation should be an ‘art rather than a science’. Some practitioners shared the view that the standards are 95% methodology focusing on the ‘how to’ and ‘what to’ with only 5% focusing on the wider principles and concepts that underpin the process. Furthermore, there is a consensus of opinion from the valuers interviewed that the standards are weak on market cycles and how to deal with these. As a result, valuers often felt that the market diagnosis area of reports is limited to one paragraph and in general they are not well trained in this respect. Furthermore, valuers view the diagnosis section as very subjective and some local valuers struggle with the idea of market sentiment and valuer opinion.

The technical focus of both the ABNT and IBAPE standards necessitates specialist knowledge and education with many valuers referring to these as handbooks rather than standards. This technical focus has in part been used to protect the professions that currently undertake the valuations, as brokers do not have the educational qualifications or technical understanding to follow these standards. The role of real estate brokers undertaking valuation reports has become a controversial issue in Brazil with some clients willing to commission these agents for significantly lower fees. This situation culminated in a recent legal case whereby the Federação Nacional dos Corretores de Imóveis (FENACI) challenged the limiting of valuation practice in Brazil to the engineering and architecture professions. Although the case was upheld, in practice many of the major banks such as Caixa still prefer the use of engineers and architects when commissioning valuations. The issue of fees has been further complicated by IBAPE which has produced a fee scale outlining the minimum fee to be charged (R$2,500) with equations to calculate the fee according to valuation complexity and degrees of precision required. However, the proposed introduction of the CREA registration scheme and the continued practice of banks requiring valuations to conform to ABNT standards could safeguard the dominant role of architects and engineers in undertaking valuations in Brazil.
2.3 Valuation Approaches and Practice in Brazil

The last section established the broad regulatory framework of valuation in Brazil but it is also useful to map this to what happens in practice. In particular, within a Brazilian context there is a heavy reliance on the local standards for technical methodological support. Therefore the next section looks at the valuation process operating in Brazil in terms of its four pillars i.e. the engagement or instructions from the client, the valuation bases, the valuation methodology used and finally the method of reporting.

2.3.1 Client Engagement and Valuation Ethics in Brazil

The ABNT and IBAPE standards have limited coverage of client engagement with no explicit reference to the Terms of Engagement or Scope of Work. However, there is some reference to Basic Activities (Section 7 of ABNT; Section 8 of IBAPE) which would appear to encompass aspects associated with the initial engagement process. The type of information referred to includes defining the valuation purpose, identification of the property and its purpose, the rationale and level of precision to be achieved, the report deadline and any associated conditions. There is also further reference to checking documentation, legal restrictions, the typical details that should be reflected when inspecting the property, capturing the characteristics of the wider region, the choice of methodology and a market diagnostic.

As mentioned previously this information is not laid out as Terms of Engagement and instead reads more like factors to be considered by the valuer at the outset of the process. This is further illustrated by some of the banks interviewed who indicated that their sole technical instruction to valuers is to follow ABNT standard 14.653, with some additional guidance on the level of precision and justification needed. When questioned valuers were of the opinion that Part 1 of the ABNT standards could be greatly enriched by incorporating more IVS/Red Book content and guidance notes, which will form part of the current revision of ABNT Part 1. Furthermore many valuers felt that the IVS/Red Book and ABNT standards are complementary as ABNT is more process and methodology driven whereas the IVS/Red Book is more about the client and the valuer responsibilities. In particular they would be happy to see more information on the importance of establishing the purpose of the valuation (at present this is only included if disclosed by the client), the reporting structure, terms of engagement and reference to conflicts of interest.

Section 6 of the ABNT Standards (Part 1) and Section 7 of IBAPE Standards cover procedures for excellence or ethical procedures. Again these sections are light on content with one sentence on each and outline best practice regarding –

- Section 6.1 – professional training;
- Section 6.2 – sensitivity of information;
- Section 6.3 – intellectual property and accurate citation;
- Section 6.4 – conflict of interest;
- Section 6.5 – valuer independence;
- Section 6.6 – price competition for fees; and
- Section 6.7 – expression of technical knowledge only if qualified to do so.

The importance of each of these aspects is not emphasised to the same extent as the IVS/Red Book and therefore there is a danger that not all valuers are operating under the same ethical standards associated with more developed countries.
2.3.2 Brazilian Bases of Value
The Brazilian standards (ABNT/IBAPE) have five different bases of value namely –
1. Market value
2. Value at risk – insurance value
3. Asset value
4. Forced liquidation value
5. Economic value – PV of income associated with an enterprise (investment value).

Market value remains the most commonly used valuation basis but the majority of banks also ask for a forced liquidation value. This liquidation value is normally calculated based on a percentage of the market value (typically 70-80%) or based on a DCF calculation. The DCF calculation takes into account how long the property is likely to take to be absorbed back into the market alongside the associated costs to hold it for that period of time. There is no reference to fair value in the standards, despite Brazil having adopted the International Financial Reporting Standards (IFRS) in 2010, this is also being considered in the revision of ABNT Part 1.

2.3.3 Valuation Methodology utilised in Brazilian Reports
Brazil is famed for having a regimented and technical methodology, the working of which is detailed within their local valuation standards (Section 7 ABNT Part 1; Section 8 ABNT Part 2; Section 9 IBAPE). The choice of methodology remains at the discretion of the valuer but depends on the nature of the valuation, the purpose of the assessment and the market data available. The methodology to be used is not prescribed in terms of what approach must be used, but rather the standards set the specific parameters that must be adhered to in applying a particular valuation method. Wherever possible the standards prescribe the use of the comparative method using direct market data with associated factor adjustments. These adjustments are detailed in tables within the standards for the valuer to follow, but effectively making a large number of comparables homogeneous rather than identifying those that are most similar to the subject property. It is therefore common for valuers to utilise linear regression modelling software with numerous comparables and detailed factor adjustments when determining market value.

Despite the somewhat restrictive manner in which the ABNT/IBAPE standards discuss the use of different methods, there is still some room for valuer subjectivity in terms of the interpretation of the wider economic and property market and the evidence base established to support the value. Brazilian valuers favour a more scientific approach to valuation which many view as very transparent, consistent and easy to understand with logical thinking applied to determine the value. Many valuers also consider this approach adds to the quality and reliability of the reports.

However, some investors expressed concerns over how the technical nature of the Brazilian methodology can result in values that are removed from the market and therefore not representative of what properties are trading at. To avoid this, investors often discuss with the valuer what they are expecting and how they need more interpretation of the market to supplement the technical approach to value.

2.3.4 Valuation Reports in Brazil
There are two ways of presenting the valuation reports in Brazil, namely the Simplified Report and the Complete Report. The Simplified Report contains a broad summary of the information necessary to understand the value, whereas the Complete Report contains all the results from the regression modelling and associated comparables. The minimum number of items that should be included in both types of report is outlined under Section 10 of ABNT Standards Part 1 and Section 15 of IBAPE (see Chapter six for comparison with IVS). However, whilst the items that should be covered are included in the standards there is no indication on how this should be structured with the emphasis instead placed on how the value calculations are undertaken.

Another unique aspect of the valuation reports used in Brazil is the requirement of the valuer to review the valuation in terms of his/her reasoning and precision. The standards outline, through a series of tables, how the methods used and data collected can be graded with three categories to reflect the quality of market data and the value certainty or precision, ranging from Fundamental I (good) through to Fundamental III (excellent). This requires judgement by the valuer on how to grade the data and inputs according to ABNT/IBAPE standards. The process enables an element of self-criticism to reflect uncertainty and the amount of market information available. This overly technical approach to value was criticised by investors who generally felt that reports could be clearer in terms of how the value being quoted was derived and therefore be less mathematical, technical or methodology driven. This could involve an expansion of the market diagnosis section and coverage of due diligence, although concerns were expressed by valuers in terms of feeling ill-equipped to provide deeper interpretation of the wider markets.

The main user of valuation reports in Brazil are the large banks with the majority of valuation reports being standard valuation reports for mortgage lending purposes. As a result many reports are compiled using a standard template to aid banks in dealing with thousands of these on a monthly basis. From an investment perspective, Brazilian law requires properties held as part of a portfolio to be revalued every 3 years. This gets outsourced to at least two valuers from international firms. Similarly, an independent opinion on market value is also outsourced when a decision is taken to sell a property from the investment portfolio.
In general the consensus of opinion from investors, bankers and valuers was that the standard of valuation reports in Brazil is high and in many cases comparable to those undertaken internationally under the IVS/Red Book. The main differences put forward between the reports of local and international companies was the price and the ability of international companies to cover both the buying and selling side of the market perspectives, hence increasing their access to data and ability to formulate wider interpretation of the market within the valuation report. This has resulted in local reports being more process driven in terms of following ABNT rules and therefore less sophisticated in terms of market information. To some extent the round table group agreed that this is reflected in a two tier market with international firms operating on the international deals while the local firms dealt predominantly with local investors. Furthermore, there was evidence to suggest that a number of international firms outsourced their valuation work (especially in more remote markets) to local companies illustrating that the distinction between the two tier operations in terms of the quality of valuation report may be narrowing.

2.4 Market Value Definition and Interpretation in Brazil

Within an emerging market context it is important to establish if the widespread use of market value as the main valuation base is comparable to that applied in more mature markets. This section therefore explores the definition of market value used in Brazil alongside its wider understanding amongst the key local stakeholders.

2.4.1 Brazilian Market Value Definition

In terms of the definition of market value (MV) there is a disparity between the two local valuation standards. IBAPE (Section 3.1) adopt the IVS definition with the breakdown of the key terms whereas ABNT (Section 3.44) have a separate definition. The ABNT definition is as follows –

"Market Value is the most likely amount payable for a good when consciously and voluntarily negotiated at a specific reference date within current market conditions" [ABNT Section 3.44 Part 1].

Another anomaly faced by valuers in Brazil is the fact that the main standard setter ABNT is not a member of the IVS while the professional body IBAPE is. IBAPE have adopted the IVS definition of market value whereas ABNT have not. This situation continues to cause challenges in terms of two definitions of market value but also potentially different views from the standard setters and professional body. The existence of two MV definitions within the local valuation standards is confusing; indeed the consensus amongst the round table discussion participants was agreement that the ABNT should formally adopt IVS.

2 The current revision of ABNT Part 1 is considering full convergence with the IVS definition of market value to eliminate this confusion.
However, the group recognised that this has been an on-going process over the last decade and has constantly been revoked by local committee members on the grounds that change was not needed. Some participants held the opinion, that while the ABNT definition is conceptually similar to IVS, as it does not break the key terms down the deeper understanding of the term can get lost, in particular the concepts of ‘willing buyer’, ‘willing seller’ and ‘arm’s length transaction’. Other participants felt that the main difference between the two standards is mere words and therefore it becomes semantics to enforce a change as in practise, the interpretation should be the same. For a more in-depth comparison of ABNT/IBAPE with IVS and the other local standards see Chapter six.

2.4.2 Brazilian Market Value Interpretation and Understanding

There was a view shared at the round table discussion that Brazilian valuers sometimes find the concept of market value difficult to grasp as they are not sure how to define the problem and the client’s purpose is not always clear. This confirms the earlier problems expressed on the lack of guidance in the local standards on setting the Terms of Engagement with the client. Another potential problem experienced by local valuers is the failure of the local standards to acknowledge the concept of highest and best use in determining economic value (investment value) and therefore the impact that this could have on valuer practice. In the Brazilian standards there is some reference to efficient usage but consideration of this is not a specific requirement as part of the valuation process.

There was also agreement that market value remained relevant even in depressed or distressed markets as the valuers felt it was important to understand the use of market value as the basis to enable better understanding of where the market is at a particular point in time. In contrast, some valuers felt that a depressed market is not in equilibrium and therefore no balance exists between the buyer and seller. The majority of the participants recognise that valuations can contribute to price bubbles if the economic context and position in the market curve are not taken into consideration when forming an opinion of the value in question. Furthermore, there was a feeling that the last part/paragraph within the report should not be the final value but must include an explicit detailed commentary on the property market and economic wider context that has influenced the determination of that value similar to that advocated in the Mallinson Report. Another commonly shared view across valuers was that the market value is more similar to price than it is to intrinsic or economic value (investment value).

2.5 Market Data and Transparency in Brazil

The final area that was investigated was the transparency of the market and the data sources used to underpin the valuation process. It is recognised that any valuation is only as reliable as the information and assumptions used to underpin and support it and this can be challenging in markets that do not have a culture of sharing information. Similarly, opaque markets can cause uncertainty for investors especially where local practices diverge from international norms. In this regard there is a growing recognition that a lack of performance indicators/ benchmarks and accurate market data is hindering inward investment into emerging markets. This section therefore explores the data sources, perceived reliability and how data has been used to formulate the opinions on value within the Brazilian market.
2.5.1 Brazilian Real Estate Market Transparency

The Jones Lang LaSalle Global Real Estate Transparency Index has been quantifying and capturing real estate market transparency across 97 worldwide markets since 1999. The latest index (2012) shows Brazil making steady progress in improving transparency with its tier 1 cities (São Paulo and Rio de Janeiro) ranking an impressive second globally for transparency improvement and becoming the first Latin American representative in the transparent market category (JLL, 2012). Brazil tier 1 cities now rank 27th overall in terms of the composite index and comfortably ahead of other BRIC countries. JLL (2012) put this improvement in transparency down to initiatives by the major international real estate service firms, combined with strong interest from investors and corporate occupiers to improve the depth and quality of real estate data in their primary markets. Further improvements are predicted driven by high levels of commercial real estate investment, with attention still needed on the low availability of market data and wider performance measurement.

2.5.2 Information Providers and Data Sources

Fundamentally transactional data in Brazil is guarded with a degree of secrecy and seldom get properly disclosed. All property sales have to be registered with the Real Estate Registry Office and therefore the notary has records of all property deals. However, the transaction prices quoted to the Registry Office are often misreported in order to reduce the tax liability and therefore any information published from this database tends to be inaccurate. However, it is noteworthy that land acquired for high rise development undertaken by public listed companies tends to be accurately reported given the public disclosure of the information.

A new index for commercial real estate called the General Index of Commercial Real Estate (IGMI-C) was launched by Brazilian higher education establishment Fundação Getulio Vargas (FGV) and the Brazilian Institute of Economics (IBRE) in February 2011. The IGMI-C is a return based index which presents the evolution of prices and returns for commercial real estate in Brazil, focusing on commercial offices, shopping centres, hotels, parking lots and industrial warehouses. At present, the index is calculated and released on a quarterly basis and has a time series analysis back dated to the year 2000. Data are collected from institutional providers on a monthly basis but reported back quarterly in line with other index providers such as the IPD or NCREIF. The index has been further sub-divided into 4 sub-indexes covering the geographical areas of Rio de Janeiro and São Paulo as well as shopping centres and offices. This information is not available to the public and instead is offered as a goodwill gesture to the data providers. Coverage is dominated by Rio de Janeiro and São Paulo but slowly this is increasing and extending to other regions as are the total number of units and overall capital value of the assets reflected.

In the residential market a housing price database has been produced by Fipe-Zap, as a partnership between the Brazilian Institute of Economic Research and Zap (an online ads website). This house price index is based on asking prices but takes into account location, number of bedrooms and floor area. However, the lack of market based information on actual transaction prices continues to reduce the impact and reliability of this index. FGV-IBRE has plans to extend their index of commercial real estate into the residential market and will try and overcome the lack of transactional data through accessing values from the banks. Furthermore, Caixa Economica Federal is also preparing a housing index and this should help provide a more reliable value than the asking price to provide investors with the opportunity to track the performance of residential assets.
2.5.3 Availability and Quality of Market Data in Brazil

The data provided from Government sources and the asking price databases are not considered accurate and reflective of the current markets and therefore more companies are maintaining their own sophisticated in-house data through their own research teams. However, real estate research is still relatively new in Brazil and investors are often not willing to pay any additional fees to cover this service. This is slowly starting to change with some firms viewing their in-house research capabilities as their way of differentiating themselves from their competitors. Some reciprocal arrangements do exist between developers in terms of information sharing on list prices but this culture does not extend amongst valuers where information is considered proprietary. Some companies are gathering more sophisticated market intelligence from their local offices and creating their own in-house databases of information.

The reliability of asking price indexes is openly debated, however in the absence of any alternatives many valuers are forced to utilise these. As a result many valuers openly challenge market information they receive to ascertain its reliability and quality. The establishment of better in-house research capabilities coupled with the introduction of the IGMI-C index should help increase both the availability and quality of real estate market data. Despite IGMI-C remaining in its infancy there is evidence to suggest it has added some confidence to the market given that the time series matched previous highs and lows. By increasing the coverage and unit number feeding this index this will increase the confidence level further and continue to aid the increasing transparency shown in the JLL transparency index.

2.5.4 Use and Interpretation of Market Data

The technical nature of the methodological-driven approach in Brazil makes the valuation only as accurate as the data inputted; use of sophisticated modelling software on poor market information only compounds market distortions. The ability and knowledge of the valuer in using his/her market sentiments to understand and interpret market changes especially in light of limited market data becomes a critical component of the market and one which moves Brazilian valuers outside of their objective and scientific based approach to value. Therefore, the concerns expressed by valuers on their ability to comment on the market cycle and trend shifts, identifies a wider educational and training issue that may need addressing by the local professional body.

2.6 Brazil Concluding Remarks

Brazil is reaching an important stage in its economic development, and, despite emerging market status, Brazil provides good investment and development opportunities. However, tight legislative and bureaucratic controls have slowed real estate activities especially foreign direct investment. Furthermore, investment returns are falling behind some other emerging markets making it less appealing to large institutional investors. This coupled with a conservative banking culture and historic problems with hyperinflation has slowed the expansion of the commercial real estate market. Despite the geographical size of Brazil, investment and development activities continue to be dominated by large cities such as Sao Paulo, Rio de Janeiro and Brasilia, where agglomerations of multi-national companies from the financial and service sectors are concentrated. This has fuelled demand from both domestic and international occupiers and investment markets for valuation services.

Further restrictions on the growth of the real estate market in Brazil have been the relative lack of engagement with the English language, commonly accepted as the international medium for business, and a general lack of understanding amongst foreign investors of the Brazilian valuation culture, reporting styles and methodologies. Whilst local appraisers are very proud of their local standards and the complex mathematical and methodology driven approach to value, this is far removed from international practice. Similarly, the role played by architecture and engineering professions, which is supported through local statute, has led to a scientific and objective approach to valuation with less importance placed on the skills of the valuer, their judgement or market sentiments. In the opinion of local professionals Brazil remains a ‘buyers’ market’ with prime institutional grade commercial properties capable of only attracting a restricted number of Brazilian based buyers, a practice that can cause market distortions in terms of the pricing of assets if the international investors are not in place. There is also a growing awareness that international investors require more information and transparency as well as an understanding of international standards. This will necessitate a shift in local standards towards international best practice, a movement that is already being reflected in revisions to the current ABNT standards.
3.0 China

3.1 Chinese Economy and Real Estate Market

According to the National Bureau of Statistics of China, in 2012, China’s population stood at 1.354 billion, making it the most populated country in the world ahead of India and the US. Of these, 52.5% resided in urban areas and the remaining 47.4% were rural dwellers (National Bureau of Statistics, 2012). The GDP growth rate in 2012 was 7.8% which was lower than the 10% long term growth rate target (RICS, 2013) demonstrating that China is facing a slight slowdown in the economy. However, the overall GDP for 2012 was 51,932.2 billion yuan, of which real estate development continues to be an important contributor, accounting for 7,180.4 billion yuan, driven mainly by residential developments (69%). The inflation rate in 2012 was relatively low at 2.5% while the People’s Bank of China interest rate in 2013 has remained static at 6%. According to the Trading Economic statistics for China, a 10-year government bond provides a yield of 3.94% (Trading Economics, 2013).

China has a socialist bureaucratic system based on a centrally planned economy. The economic reform of 1979 saw a shift in governance structures and policies towards a more democratic and market orientated system. However, the pace of economic reform has not been matched by the institutional changes needed to fully support a market-led system with some element of political oversight still evident. An important aspect of the economic reform was the open door policy which led to opportunities for trade and exports, manufacturing and foreign capital investment. This process fuelled the rapid growth in the Chinese economy and a shift in the perceptions of other world leaders and multi-national corporations in terms of trade with China. A further land and housing reform followed which effectively saw the establishment of the Chinese real estate market.

Prior to the land reform in the 1980s, land was not a tradable commodity and therefore individuals and corporations had no land use rights. The most important aspect of the land reform was the granting of land use rights for sale in the open market. The law stipulates that all land belongs to the state while land in rural areas and the suburbs which does not belong to the state falls under what is known as collective land ownership (Yang and Wu, 1996). There are two types of land use rights in China, namely allocated land use rights (i.e. free transfer from the government with indefinite usage usually to state owned enterprises) and granted land use rights (i.e. land for a fixed period, e.g. residential 70 years, office and industrial 50 years, retail, cultural, recreational and tourism land 40 years, all subject to a fee payable to the government).
The latter form of land use rights can be granted by a public auction and tendering held by the land bureau of the local government or by agreement or negotiation with respective municipal and local governments. As land was not previously tradable the government had to introduce a benchmark land pricing system, based on the location and the scope of the development with a grading system introduced to reflect value. The benchmark land price was established by the China National Standards (2001) according to a grading and ranking of urban land in a city.

Chinese and domestic entities make up over 80% of investors in the real estate market, with State Owned Enterprises (SOE) representing a large proportion of this. A SOE, as the name suggests, is a government controlled legal entity created for the purposes of undertaking commercial activities on behalf of the government. Many SOEs have diversified their activities to move into real estate and increasingly view the steady income generated from real estate as a sound investment. In China, commercial office and retail leases are typically 3 years. Industrial space is generally purpose built for owner-occupation, when leased it tends to be on a 7-10 year rental agreement. Furthermore, some foreign investors and development companies from Hong Kong and Singapore are also active players in the local market with a risk appetite very similar to local investors.

The boom in the Chinese economy over the last decade has had an influence on the real estate industry and has undoubtedly led to an increase in demand for appraisal services. Given the rapid development and immature property market environment, appraisal practice has been expanding rapidly and continues to play a critical role in the economic development of China. Property valuation services includes advice on acquisition and disposal of residential and commercial properties, development and investment appraisals, taxation, mortgage lending appraisals, asset and business valuation such as IPO listings or valuation of arts and antiques, plant and machinery.

The relative immaturity of the real estate market in China means that it needs to overcome a number of challenges including a lack of well-trained appraisers and data shortages. To meet the current demand for appraisals the market has become dominated by large international consultancy firms with a small but growing number of local appraisal firms. Most of these local firms focus mainly on appraisal services with limited involvement in the management and agency side of real estate services. Whereas major international firms such as CBRE, Colliers, Cushman and Wakefield, JLL, Savills etc offer a more diverse range of services including property market research, investment appraisal and property asset management.

3.2 Appraisal Regulatory Environment in China

The regulatory environment in China is directly governed by various ministries and local professional bodies. One such example of a professional body is the China Institute of Real Estate Appraisers (CIREA) which was set up as a real estate standard setter as well as to oversee the certification and licensing of firms and practising valuers including training and education of appraisers. In fact, to support the growing demands of the real estate profession, a number of government departments have established their own laws or codes of practice relating to real estate at central, provincial and city levels. This section focuses on the real estate standards and their enforcement in China. Furthermore, it also considers how real estate appraisers are educated and trained to deal with the challenges faced by China’s emerging market status.

3.2.1 Appraisal Standards Operating in China

In China there are three separate professional bodies and associated ministries who each publish their own appraisal standards covering land, real property and asset valuations. The China Real Estate Valuers Association (CREVA) under the Ministry of Land and Resources, the People’s Republic of China govern the appraisal of land under the regulations for valuation on urban land. The China Institute of Real Estate Appraisers (CIREA) under the Ministry of Housing and Urban-Rural Development deals with the appraisal of buildings through the code for real estate appraisal. The Chinese Appraisal Society (CAS) under the direction of the Ministry of Finance covers appraisal in general, including asset and business valuation, land and buildings for financial reporting and also plant and machinery via the asset appraisal standard. The fact that each agency has its own standards, prescribed methodologies and procedures to some extent has created confusion in the industry and a rivalry or competition amongst the professional bodies and ministries.

Appraisal standards started to receive more interest when land reform encouraged private capital investment and development in real estate. When the government started to grant land to developers and investors, this triggered demand for land appraisal and therefore the need to assess the premium when a lease or land use rights were granted to the private sector. Without a land market, the land values or the premium payable to the government was normally agreed by private treaty between the government and potential buyers. These settlements did not necessarily reflect the market value of the land.

Like other sectors of the Chinese economy, the real estate industry began to emerge in 1990s. This created its own challenges given that land was not traded and therefore had no established market pricing mechanism. As a result CREVA and the Ministry of Land and Resources saw the need for the establishment of the governments’ benchmark land price. In 2001, two technical regulations were promulgated – the Regulation for Gradation and Classification on Urban Land, and the Regulation for Valuation on Urban Land. In the latter, the land datum value method alongside the market comparison approach is recommended while the cost and income methods are considered optional in land assessment.

CIREA established China’s first uniform property appraisal local standard in 1999 known as the “real estate appraisal code”. This code was structured as follows –

• Section 1 – General
• Section 2 – Terminology
• Section 3 – Valuation principles
• Section 4 – Valuation procedures
• Section 5 – Valuation methods
• Section 6 – Valuation applications
• Section 7 – Valuation results
• Section 8 – Valuation report
• Section 9 – Ethics.

CIREA is also responsible for drawing up a code of conduct which includes regulations for professional conduct, independence requirements, as well as governing the content of valuation reports etc. In relation to fee charging, CIREA also sets the standard fee for valuation work which in practice is used as guidance or as a benchmark for negotiation of the fee rather than strict conformity to the price set by the Institute. However, the views from the roundtable discussion was that the Institute is a regimented way of controlling fees that can be charged and that this needs more flexibility given the complexity and time commitment varies for each individual valuation task.

The CAS produces the asset appraisal standards which are subdivided into two parts namely, professional codes of ethics and practice norms. The professional code of ethics contains two levels –

• General code of conduct – which applies to certified public valuers (CPVs) and covers their professional competence and relationship with clients.
• Specific standards – which covers issues such as valuer independence and confidentiality of information.

4. The benchmark land price system provides a guideline for land use rights in sale and transfer. This is the price of land based on the average conditions in a region. A town is divided into multiple regions where the benchmark land price reflects the land grade, type of land rights, purpose, maturity date, plot ratio/density, tenant resettlement costs etc.
5. This Code, established in 1999 is the main regulatory standard for the appraisal of land and buildings and their improvement.
6. Potential disciplinary action can include reminders, warnings or exclusion for any violation of the Institute’s bye laws.
The second part covering the practice norms of asset valuation has four key areas –

- **General principles of valuation** – containing the basic standard for CPVs to follow in undertaking valuation assignments.

- **Specific standard of valuation** – combining a procedural standard and substantive standard. The former regulates the process which CPVs undertake, including reporting and engagement. Whereas, the substantive standard regulates valuation assignments on various asset types including business valuation, intangible assets, real property and machinery and equipment.

- **Valuation guidance notes** – including information on valuation for financial reporting, mortgage purposes and asset litigation purposes.

- **Valuation directive opinion** – covering some problems areas in valuations.

The use of valuation standards depends on client requirements and also on the purpose and use of the report. Similar to many other countries a home rule on the use of appraisal standards applies and therefore if foreign investors undertake local projects in China and require financing from local banks then the local valuation standards must be followed. If the report is for government appraisal there is a mandatory need to comply with local standards. If the valuation report is for internal review or decision making, then appraisers have the flexibility to use IVS or RICS standards, which mostly cater for international clients. Some local firms at the round table felt that their understanding, knowledge and utilisation of the IVS/RICS is an added advantage for their company as it demonstrates to clients the level of expertise the firm can offer, allows more transparency and helps improve their professional standards. Other respondents indicated that clients are happy as long as they know that the valuation firms are using more than two methods to undertake the valuations.

In terms of the use of international standards the RICS Red Book is mainly used by international companies in Tier 1 cities (Beijing, Shanghai and Guangzhou) which have the presence of most foreign investors. The key benefit noted of using the RICS standards is the international recognition that a RICS badged firm provides which would appeal to SOEs, insurance companies and private equity funds, each of whom are increasingly looking to employ international firms to undertake valuation and provide investment advice.

Research participants felt that the IVS is too broad and too generic, and therefore has no practical application to their local practice. They felt it is therefore the responsibility of the local standard setters/professional bodies to promote local standards, and ensure consistency in the methodological approach, and the training and education of the practising valuers. The local standards are viewed as more detailed and explicit including the outline of all steps needed to undertake the appraisal task including methods, formulae, analysis and reporting. It was also felt that they contain very detailed procedures and process guidelines which help ensure some level of consistency in appraisals.
The consensus of opinion from the round table discussion was that there is not much difference between the international standards and local standards on the valuation principles and concepts. However, on the technical side there are clear differences in the reporting style, the prescription of methods and techniques to be used. On the other hand, a number of participants commented that the local Chinese standards are very much drawn from the institutional perspective and therefore do not necessarily reflect current market practice, which may become more of an issue as the real estate market matures.

Given the infancy of the Chinese real estate market, the infrastructure environment for appraisal standards and practice in China was considered to be lagging behind international standards such as RICS and USPAP. To some extent there are widespread differences in the definitions and practice that can change from province to province and city to city. Some cities have developed more quickly, such as Beijing, Shanghai or Guangzhou, so the presence of larger local and international firms is correspondingly stronger and hence valuation services and market information is better, whereas emerging Tier 2 and 3 cities may be lagging behind. Nonetheless, the real estate code remains the main real estate standard that is being applied and enforced across China for real property and it continues to provide guidance to appraisers. This ensures that there is consistency, impartiality and accountability in the approach so that investors/clients/general public have confidence that the local appraisers are working under a recognised code.

3.2.2 Enforcement of Appraisal Standards in China

Appraisal activities are regulated by the government through three agencies, the China Institute of Real Estate Appraisers (CIREA), the China Real Estate Valuers Association (CREVA) and the China Appraisal Society (CAS). These three agencies, as discussed in the previous section, develop their own appraisal standards but also regulate appraisers through licensing and firms through registration. Each professional body confers appraisal designations on its members namely –

- Real Estate Appraiser (CIREA)
- Land Valuer/Appraiser (CREVA)
- Certified Public Valuer (CSA).

In addition, China also has government regulations for Securities (China Securities Regulatory Committee) and Banking (China Banking Regulatory Committee and China Investment Regulatory Committee), therefore ensuring that there is regulatory oversight for all real estate, investment and banking activities.

As far as appraisal of buildings is concerned, licensed or certified appraisers are assessed for competency under the CIREA’s real estate appraisal code. CIREA membership covers both the buy and sell side of the market, in terms of both appraisers and brokers. There is also the potential to become either an individual practising member or a non-practising member of a regulated firm.

By way of enforcement CIREA may take disciplinary action against any members who breach its rules or associated practice standards. These actions can include a warning, public censure, suspension or cancellation of membership. Furthermore, all members must have relevant qualifications and experience to gain entry to CIREA as well as comply with continuing professional development standards. Hence, all licensed and certified appraisers must comply with the CIREA standards in all appraisal assignments. The standard contains very detailed valuation principles and a procedures-based methodology which practising members should comply with making it straightforward for CIREA officials to check for non-compliance.

The licensing and certification of valuers is catered specifically to each individual Institute/Society/Association, with each having its own areas of specialism. For example, the CAS certification of public valuer focuses on business valuation, tangible/intangible assets, IPO listings, arts and antiques etc., and therefore a CPV does not have specific expertise and knowledge in undertaking real estate or land appraisals. CIREA licensed appraisers have the competency to undertake both statutory and non-statutory real estate appraisal. CREVA certified appraisers, on the other hand, have the skill sets and knowledge to value land for sale, development or auction with their key focus being land appraisal. The licensing of CIREA valuers is reviewed every three years whereas CREVA members are reviewed annually only during the first two year probationary period. Despite the distinct areas that each professional body controls there is increasing evidence of many appraisers holding at least two if not all three designations. This is particularly true of holding CREVA and CIREA designations so that an appraiser can be qualified to carry out appraisal of land and buildings.
In China, property appraisal firms are graded by the Ministry of Construction according to six criteria namely the company’s registered capital, structure of shareholders, the number of certified or licenced appraisers and the scale and scope of appraisals or projects undertaken. This grading was introduced to provide a form of quality control and effectively regulate the large influx of small untrained businesses that started to enter the appraisal market on the back of the land reforms. This grading regulation has ensured that property appraisal companies are competent and this has helped improve the professional image and reputation of the appraisal industry. The requirements for each of the three grades are –

**Grade A:**
- **Time:** operating appraisal activities for at least 6 consecutive years, with at least 3 years after being certified as Grade B
- **Registered capital:** demonstrate more than RMB 2 million for a limited company, or more than RMB 1.2 million for a partnership
- **Structure of shareholders:** 3 or more of the shareholders must be qualified as property appraiser for a limited company, 2 or more for a partnership. At least 50% of the shareholders must be a practising property appraiser for at least 3 years
- **Number of qualified appraisers:** 15 or more employees must be qualified as property appraisers
- **Scale of projects undertaken:** from the date of the application, firms must have averaged an annual appraised scale of 500,000 m² of Gross Floor Area, or 250,000 m² of land area in the past three years
- **Scope of activities:** all kinds of property valuation activities.

**Grade B:**
- **Time:** operating appraisal activities for at least 4 consecutive years after being certified as Grade C
- **Registered capital:** demonstrate more than RMB 1 million for a limited company, or more than RMB 0.6 million for a partnership
- **Structure of shareholders:** same as Grade A
- **Number of qualified appraisers:** 8 or more employees must be qualified as property appraisers
- **Scale of projects undertaken:** from the date of application, firms must have averaged an annual appraised scale of 300,000 m² of Gross Floor Area, or 150,000 m² of land area in the past three years
- **Scope of activities:** all kinds of property valuation activities except IPO and listing.

**Grade C:**
- **Time:** no requirement. Any new appraisal firm can be certified at Grade C, if they fulfill the following requirements. However, the first year of achieving Grade C is called as Provisional Grade C, which will affect their scope of business.
- **Registered capital:** demonstrate more than RMB 0.5 million for a limited company, or more than RMB 0.3 million for a partnership
- **Structure of shareholders:** 2 or more of the shareholders must be qualified as a property appraiser for a limited company, 2 or more for a partnership. 50% or more of the shareholders must be practising as a property appraiser for at least 3 years
- **Number of qualified appraisers:** 15 or more employees must be qualified as property appraisers
- **Scale of projects undertaken:** complete an appraised scale of 30,000 m² of Gross Floor Area, or 80,000 m² of land area, in its Provisional year
- **Scope of activities:** all kinds of property valuation activities except IPO and listing, corporate liquidation, juridical purpose or expert witness.

Land appraisal companies have separate grading requirements as their activities are regulated by the Ministry of Land and Resources which include regional restrictions which outline where companies are allowed to undertake valuation work. This reflects the fact that each province/county or city may have its own land and real estate codes and regulations and most large valuation firms will have regional offices located across China, hence have no need to work outside of its own local jurisdiction. This grading will therefore ensure that only appraisal firms with the most diverse range of expertise and local knowledge can undertake valuation work in all cities. The appointment of any firm for a valuation exercise also depends on the importance, size and value of the project. For large scale projects, clients will normally, use two different valuation firms and if the difference between value is more than 5-10%, then the client will instruct a third party to verify the valuation. In fact, the SOEs often deploy a list of valuation firms they can use.

Some duplication of activities across the three professional bodies can lead to confusion and rivalry, with many round table respondents expressing a desire to see the membership and standards converged into one body and one standard. However, one senior executive contested this view on the amalgamation of the land and building appraisals (in particular CIREA and CREVA) into one professional entity as each has its own strength and expertise. Similarly, there is an established tradition of land and buildings being valued separately under the auspices of two separate ministries, hence there would need to be major cultural and institutional change before such a move could be implemented.
3.2.3 Education and Training of Valuers in China

Recent years have seen more regulations being introduced by the government ministries to manage the appraisal institutes, certification of firms, licensing examination of individual valuers, the governing standards and valuation practice. Other aspects such as ethics and code of conduct are constantly being reviewed. This undoubtedly has brought about a more integrated appraisal industry and has opened up more opportunities and competition between valuation firms.

Table 3.1 shows the requirements for an applicant to apply for the various appraisers’ licensing/certification examinations. For example, the applicant should have a relevant academic background and a minimum number of years of work experience within the appraisals industry before they can gain membership. The CIREA real estate appraisal licensing national examination is a 2.5 hour examination of each section consisting of mainly multiple choice questions drawn from four sections, namely –

- **Real estate basic institutions and policies and real estate appraisal related knowledge** – this covers the institutional framework and standards as well as planning, the environment, measurement, construction costs, building economics, financial basics, securities, insurance statistics, accountancy, law and auctioneering
- **Real estate development and management** – this includes development, investment, cash flow projection, feasibility studies, risk management and decision making, property management and property finance
- **Real estate valuation and theory** – this covers basic valuation theory
- **Real estate appraisal case and analysis** – this includes how to write a valuation report, valuation practice by property type and purpose and valuation consultancy activities. This section is based on real life case studies.

Most appraisers come from undergraduate degree programmes such as economics, civil engineering, construction and law degrees as traditionally the number of real estate/surveying courses in China remains low. However, increasingly more Chinese universities are seeing the benefits of having a professional organisation accrediting their courses by way of industry recognition. In 2013, there are ten universities accredited by the RICS offering construction and real estate programmes, the majority of which still specialise in quantity surveying and project management. Four out of ten offer undergraduate and/or postgraduate programmes with Commercial Property Practice, Residential Property and Valuation APC pathways. As the China real estate market matures the demand for more qualified appraisers will increase, thereby triggering a greater need for more RICS accredited degrees in China complemented by increased numbers of Chinese graduates returning from foreign universities. There is also evidence of major international firms employing Chinese postgraduates from overseas institutions with degrees mainly in business, property, economics or finance.

In contrast to the criteria of other international professional bodies such as the RICS, there is no strict requirement in China that appraisers should meet any minimum mandatory and/or core technical or professional competences prior to gaining membership, although some prior experience of working in the industry is required. However, as a result of international influence there is increasing awareness being shown for the need to undertake continued professional development education and training beyond the licensing process. CIREA undertakes annual checks on the certification of companies where a random sample of reports are reviewed and audited against a point based checklist to ensure that their practising members are conforming to the local standards.

<table>
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<tr>
<th>Membership Designation</th>
<th>Examination Format</th>
<th>Education Qualification</th>
<th>Practical Experience</th>
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<tbody>
<tr>
<td>CIREA (Real Estate Appraiser)</td>
<td>• Written examination</td>
<td>• College degree</td>
<td>• Possess at least four years’ experience in appraisal</td>
</tr>
<tr>
<td>CREVA (Real Estate Valuer)</td>
<td>• Written examination</td>
<td>• College degree</td>
<td>• At least two years’ experience in appraisal</td>
</tr>
<tr>
<td>CSA (Certified Public Valuer)</td>
<td>• Written examination</td>
<td>• College degree</td>
<td>• College degree</td>
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The role of the RICS was queried amongst the research interviews especially potential conflicts with local appraisal professional bodies. In this regard, some interviewees viewed the RICS as standard setters and drivers of international best practice, but that this should not interfere with the local certification of valuers the responsibility of which should still reside with the local ministries. Some research respondents also expressed their concerns over the current licensing format of appraisers which centres on three distinct designations. Current local practice is encouraging young valuers to obtain membership of all three professional bodies and this is therefore placing a high burden on graduates and to some extent is diluting the impact of the individual specialisms.

3.2.4 Focus of Chinese Appraisal Standards

The Chinese appraisal standards are prescriptive and technical in nature with clear steps and procedures outlined which appraisers must follow. To some extent this is reflective of the relative immaturity of the real estate market and the fact state ownership of all urban land makes the dynamics and operation of the real estate market function differently from established economies. In this way valuation in China is very much viewed as a mathematical and calculation based approach that is formulae driven and therefore does not confirm to the IVS definition of an open market.

This relative immaturity has influenced the development, focus and content of Chinese standards with the added influence of overseas standards. For example to help compile the real estate appraisal code, CIREA looked at international best practice and regulation in Taiwan, Hong Kong and the US. Furthermore they consulted the IVS and the RICS Red Book as a guide on the overarching appraisal theory and principles but did not draw directly from them. Although CIREA has adopted its own format and structure, it has drawn on international best practice in formulating its own set of guidance, principles and procedures catered specifically for the Chinese market. It has also used this international experience to alter its original standards to now consider the use of five methods (instead of just three) depending on which is most applicable to the assignment.
3.3 Appraisal Approaches and Practice in China

The appraisal sector in China is growing in maturity and numbers with good progress being made in the areas of standards, ethics and codes of practice. Learning from international experience has been the foundation of this growth and the growing influence of international clients will see the IVS and the RICS Red Book becoming more and more important in the future.

In China, there are three distinct tiers of valuation operations – Tier 1 consists of international firms who have the pool of expertise across a range of real estate services such as agency, professional services and management. These firms also have a good understanding of the real estate market which is well supported by their in-house research teams, and actively uphold the reputation and the integrity of the profession at global, regional and local levels. Tier 2 comprises the top, large scale domestic firms with the capital and capability to undertake large appraisal instructions mainly for SOEs and/or large corporations, whereas Tier 3 are mainly smaller appraisal firms that deal with the residential sector and offer some estate agency and property management services.

This section focuses solely on CIREA7 governed appraisal practice in China, in particular the ethics, client engagement and bases of value. Furthermore the section outlines the methodological approaches followed and how appraisal reports are structured within China.

3.3.1 Client Engagement and Valuation Ethics in China

China, like other emerging market countries, has faced challenges in terms of corruption and fraudulent behaviour in the real estate appraisal sector. However, the government has been proactive in trying to eliminate some of the fraud and bribery that has been a feature of the industry in the past. This has been implemented through the local professional bodies setting strong codes of ethics and professional conduct to ensure that appraisers are aware of their responsibilities in eradicating these practices from the wider real estate industry. These positive strides are also reflected in the increased transparency that China has demonstrated in the JLL real estate transparency index (see section 3.5).

Section 9 of the code for real estate appraisal covers ethics and the need for appraisers to be honest, objective and independent. The code also discusses the importance of an appraiser only accepting a valuation assignment that they feel competent to conduct and how there is a need for confidentiality of all client information unless permission has been obtained in writing. The code outlines how valuation fees must conform to that laid down by the professional body so as not to create unfair competition. However, in practice some valuation firms do offer huge discounts of up to 60-80% of the benchmark fees, as the guidance sets a ceiling fee but no minimum fee. In this regard valuation fees depend on the firm, the purpose and the type of reporting. For Tier 1 cities this can command a higher fee than Tier 2 cities, while domestic firms normally charge about 80% of the fees charged by international firms. The exact fees scale to be charged is outlined in the code.

7 This report is focused primarily on real property and CIREA are the main professional body which regulate real estate practice, as the other two bodies CREVA (land) and CSA (businesses) focus on other aspects of the market.
The last part of the ethics section refers to the need to have appraisal reports signed by a qualified appraiser and how appraisers should not lend their names to any report that they did not author. In general this ethics section is much less detailed than the RICS Red Book and covers the broad principles without detailing how this would be applied in practice. More guidance on the ethics and responsibilities of appraisers would be beneficial to ensure they are all aware of their duty of care and wider fiduciary responsibilities in terms of their conduct.

In terms of client influence, some appraisal firms indicated that there is often pressure from clients to obtain a favourable outcome but the eradication of this depends on the appraisal company’s policy and practice as well the wider code of ethics. Furthermore, some interviewees indicated that because of the power and scale of the SOEs, they can in some cases, dictate the values they want and appraisers are under pressure to make adjustments. To combat this, larger firms will have their own internal review by a senior director before reporting the figure to the client to ensure that they are confident about the opinion on value, the methods and the comparables used to derive the final figure. Whereas smaller firms are unlikely to implement this form of best practice and therefore can sometimes be more prone to client pressure. This issue is not unique to China and is being faced even in established economies and therefore may need more coverage in the local and international standards.

The terms of engagement between the client and the appraiser are barely mentioned within the code for real estate appraisal with some limited reference only to the commissioning party and associated commissioning letter. The detail contained within this commissioning letter or its minimum content has not been fully detailed, unlike in the IVS and RICS Red Book. Whilst there is some recognition of the importance of the client and appraiser relationship in terms of wider confidentiality and impartiality there is less emphasis in the commissioning letter to the actual process of defining the valuation purpose and factors upon which the report is based. This is therefore one area where the Chinese standards could learn from international best practice as the terms of engagement formulate a key part of the valuation process and the subsequent value determination and therefore need greater clarity and guidance before the assignment commences.

Most of the international firms like Colliers, CBRE, JLL and Savills etc. have their own Professional Indemnity Insurance to limit their liability. Although such a PI clause is often embedded in the engagement letter, the banks in general do not specify the amount of cover. It is also not a mandatory requirement within the local standards for practising firms to have PI cover and therefore the use of PI insurance in China is limited.

Respondents felt that self-regulation in China would not work as there is a lack of trust in the real estate industry, which would only be exacerbated by self-regulation. Furthermore, there is a need to emphasise the moral obligations of appraisers and the level of professionalism expected from the profession, which are two key components that will advance appraisal practice towards established market status. The challenge for practising appraisers and the standard setters in China is overcoming any ethical, moral or conflicts of interest, which although covered by the Chinese standards, are often not followed in practice therefore diminishing the impact of the standards.
3.3.2 Chinese Bases of Value

The code for real estate appraisal does not have a specific section outlining the bases of value to be used in an appraisal report. Instead the code makes reference within the terminology section to open market value and the importance of establishing the valuation purpose and corresponding methods to make sure the value basis meets the required purpose and outcome. There appears to be an understanding within local industry that different bases of value exist despite this not being explicitly outlined in the real estate code. One appraiser referred to appraisal value if being used for taxation purposes, mortgage value if for financing or lending purposes or transaction value if for sales and disposal purposes. This lack of clarity of the wider bases of value and when they should be applied could hamper the real estate market as it matures and should be addressed within the real estate code.

3.3.3 Methodology utilised in Chinese Appraisal Reports

In the early 1990s, appraisals were mostly undertaken by appraisers from a construction background and therefore they had limited knowledge of market practice and relied on the cost approach. To change this, the Ministry established the real estate code which requires the ‘technical side of valuation’ to form part of the appraisal process.

The real estate appraisal approaches specified in the CIREA standard include –

- Market comparison approach
- Cost approach
- Income approach
- Hypothetical development method (residual)
- Benchmark land price calculation (land datum price method).

The real estate appraisal code requires that appraisers should use at least two or more approaches to appraising the value of real estate. For example, when undertaking an assessment of land use rights transfer, the development approach, cost approach and the benchmark land price correction method should be used. In the case of a real estate acquisition and disposal, the market comparison approach and the income approach should be adopted and in cases where the cost method is used the appraiser should also utilise the hypothetical development method.

Where figures vary widely amongst the different methods, the appraiser should base the value on his/her expertise and knowledge of the market, providing a rationale and reasoning for the value differences. All adjustments should be explained and shown clearly in the report. There is a requirement on the appraiser to check the figures to ensure –

- No calculation errors
- Data accuracy
- The selection of comparables was reasonable
- Compliance with the principles of valuation
- The chosen formula was appropriate for the purpose of the valuation.

The code contains a detailed formula which should be applied for each method depending on the appraisal purpose. The code also highlights the principles that appraisers should follow when conducting the appraisal e.g. the legitimate principle (based on a legitimate use for the building or land), highest and best use principle (based on the use which would generate the highest investment or development value), alternative principle (requiring that valuation results do not deviate from other similar real estate) and lastly the valuation point principle (values should not deviate from open market price).
The real estate code outlines an eight step procedure in section 4.0.1 that appraisers should adhere to when undertaking a valuation assignment –

1. Identification of a clear valuation basis;
2. Valuation task process;
3. Collection of required information;
4. Intended purpose/party;
5. Selection of valuation method;
6. Determination of the valuation figures
7. Writing the valuation report;
8. Data archiving.

Section 6 of the code “valuation under different valuation purposes” lists a range of valuation purposes, the associated legislation and the valuation methods to be used. These include –

- Land use right transfer price assessment
- Real estate transfer price assessment
- Real estate leasing price assessment
- Real estate collateral valuation
- Real estate insurance valuation
- Taxable valuation of real estate
- Land acquisition and house demolition compensation valuation
- Real estate division, merger valuation
- Real estate disputes valuation
- Real estate auction reserve price evaluation
- Enterprises of various economic activities involved in the real estate appraisal
- Other purpose real estate appraisal.

The Chinese standards have similar valuation methods to both the American and British approaches to valuing property, with the exception of the land datum value method used to value land. The three distinct professional bodies each have a different view on the content and format of the valuation standards, which reduces the consistency across the three standards. However, it appears that all three regulators agree on the need to emphasise the mechanics of the methodology rather than the framing of the valuation task within their standards.

It was felt that this prescription of the methodology helps ensure a consistent and standardised approach and in turn this could help increase the professionalism and amount of due diligence expected of appraisers. However, on the other hand, valuers at the roundtable discussion felt that they should be given ‘more freedom’ to undertake a valuation task without this detailed prescription especially as the transparency of market information improves within Tier 1 cities. The interviewees also recognised that the prescribed appraisal type manual was still appropriate for emerging cities from Tier 2 and 3 markets, as it acts as a good starting point to help standardise the process until such times when the level of competence of local appraisers’ increases and market information becomes more readily available.

3.3.4 Valuation Reports in China

There are two reporting formats used in China, namely the appraisal technical report and the appraisal result report. The technical report focuses on the detailed methodology applied, the calculation method and the market comparables used to derive the value. The appraisal result report contains the same information as the technical report, except for the detailed calculation. The technical report is retained by the appraiser and is normally only given to the client upon request. The content of the technical report includes a description of the subject property, the appraisal approach taken, the detailed calculations and associated assumptions and the final reconciliation of the adjusted value. To reconcile the values the appraiser will exercise judgement and review the sources of information and assumptions underlying each method. For example, if there is good sales evidence, then the value determined by comparables carries more weight or if the appraiser has less confidence in the cost approach, then less weight is given to that method.

In order to standardise and improve the quality of the valuation reports, CIREA has developed a ‘100 points’ system to grade reports for review purposes. This points-based review system enables CIREA to monitor compliance with their real estate code; therefore failure to include the items contained in the checklist results in a points deduction. While formal disciplinary action is rarely taken there are reminders and warnings issued and sometimes in severe cases violations can result in exclusion from CIREA.

Over the last few years the reporting style of appraisal reports in China has evolved from a simplified tick box style towards a more sophisticated RICS style approach which includes a much more comprehensive evidence base. For example, the property description (including condition, title, location and photographs) inspection details, comparables, detailed calculations, assumptions and adjustment of values etc. that are now contained within the technical report are more in line with international practices. Similarly, the quality of report does not differ between local and international firms as it is driven by the local standards and depends on how much a client is willing to pay for information to be presented comprehensively.
3.4 Market Value Definition and Interpretation

Given China’s unique land rights tenure system and the separation of appraising land and buildings, it is important to establish how widespread the use of market value for real estate is as the main valuation basis. Furthermore it is important to explore if the local interpretation of market value is comparable to that applied in mature real estate markets. This section therefore examines the definition of market value used in China alongside its wider understanding amongst the key local players.

3.4.1 China Market Value Definition

In terms of the definition of market value, China has adopted a different market value definition within the CIREA standards than that adopted by the IVS (see chapter 6 for comparison). The real estate code, within its terminology section, loosely defines what is meant by open market (section 2.0.7) and open market value (section 2.0.8). The definition of open market loosely mentions an economic interest, having the necessary market information, timely transactions, necessary expertise and appropriate trading conditions. Similarly, the market value definition contained within the CIREA real estate code is short on detail –

- Open market value is the ‘most likely price formed in the open market’. The standard also requires an assessment of the ‘objective reasonable price or value’ (CIREA, Section 2.08).

This definition does not contain the vital conceptual framework components outlined by the IVS definition. This can be explained by the fact that government ownership of land and the granting of land use rights makes the Chinese real estate market function somewhat differently from established markets. Similarly, as far as land appraisal is concerned, there is no definition of market value in the CREVA standards. This is reflective of the benchmark land pricing model adopted in China and this makes land appraisal very different from the open market value definition favoured by market-led economies.

3.4.2 China Market Value Interpretation and Understanding

There is a solid understanding of market value, but differing opinions on whether it is relevant in a Chinese market. One group of valuers felt that they understand the market value concept but the standards have implemented a rather regimented way of quantifying the land values, which makes market value irrelevant. Although the real estate market to some extent operates by market forces, appraisal practice is still hampered by historical regulations and restrictions on ownership rights to land. In many ways this makes it difficult to apply the concept of market value given certain restrictions on the trade or sale of land. Another group of valuers felt that the understanding of the concept and principles of market value is similar to the RICS Red Book but the Chinese market is still emerging and therefore will continue to learn and draw from international best practice.

These conceptual differences on market value in China are not well understood outside of China and therefore market value interpretation by foreign investors may well be very different from the domestic market. In this regard, some appraisers opened the debate on whether allocated land has a market value given the restrictions it has on its sale and transfer. There was a view from one appraiser that allocated land should be treated like the RICS definition of investment value given that the value is directly linked to a specific entity, in other words the SOE that it has been allocated to. Another appraiser indicated that provided the use of allocated land conforms to current planning usage it can be changed to a granted land use right by paying a land premium. Or alternatively, the market value of allocated land when in compliance with current planning requirements equates to the market value of granted land minus the land premium.

It was recognised that the local standards are not clear in their definitions of market value or indeed other bases of value. One of the round table participants is actively involved in the revision of the CIREA standards and intimated that this is being looked at and that it is anticipated that the market value definitions and understanding will continue to evolve as the real estate market continues to mature and respond more like an open market. Similarly, just as the utilisation of accounting and financial reporting standards in China are moving towards international standards; there was a feeling that in time real estate will also become more receptive to the IVS.
3.5 Market Data and Transparency

Valuation services in China prior to land reform were solely provided by government departments at both municipal and district levels. To create a more open and fair market post reform triggered a need to privatise valuation services, which initially was facilitated by ex-employees of government departments taking up executive positions in either local companies or setting up appraisal practices. The real estate appraisal companies that were established by public sector valuers therefore still have a close affiliation with these former institutions. Given these close affiliations with government departments there is a need to ensure that valuation services remain independent and that any government intervention is restricted to regulation of firms and appraisers in complying with the local valuation standards and practices. In terms of government procurement of appraisal service providers, there is currently a drive towards the formation of a panel list which would be reviewed periodically according to the quality of the valuation service provided. Indeed, all round table participants were in agreement that resolving conflict of interests, client engagement and independence issues are critical in terms of driving a more open, accountable, independent and mature appraisal industry in China.

This section focuses on the real estate market transparency in China and the problems and barriers it faces in relation to data availability and market transparency. The key sources of market information are outlined as well as a commentary on data quality and interpretation.

3.5.1 Chinese Real Estate Market Transparency

According to the Jones Lang LaSalle Real Estate Transparency Index, China’s overall transparency scoring in the index remains low when compared to the speed of their economic growth. China has improved significantly with its Tier 1 cities moving into the ‘Transparent’ category now ranking at 32nd position (JLL, 2012). Tier 2 and 3 cities have also shifted from the ‘Low’ to ‘Semi-Transparent’ category and are now ranked at 46th and 55th respectively. Nonetheless, despite these improvements the level of information on market fundamentals other than those in the office sectors remains relatively low. There is still a lack of high quality, reliable and comprehensive market information within the commercial sectors. Furthermore, it can be argued that the bidding and negotiation processes can be unfair and opaque when compared to the mature markets such as Hong Kong, Singapore and Australia. In summary, accurate and reliable data and market transparency is still a big issue in China, given the lack of a centralised register of transactions outside of tier 1 cities coupled with limited public disclosure of this information.

3.5.2 Information Providers and Data Sources

The problems of poor market transparency have to some extent been overcome by the large companies sourcing and collecting their own in-house data through their research teams. However, each company has its own methods and databases to capture and analyse this market data which results in many different interpretations of this information. This potential inconsistency in data collection and analysis can contribute to market distortions and therefore mispricing of assets. Outside of these larger appraisal companies there are limited resources or capabilities to access this research based market information and therefore many appraisers are operating with incomplete market information.

China has extensive coverage of the general economic and demographic statistical data and reports which are provided by various public agencies. There are also some housing market research and land prices being published at the municipal and city levels by the likes of the Beijing Municipal Statistics Bureau. Even though some of the data in the public domain is good, real estate data in general for specific market segments such as commercial is limited. Coverage may only include the big cities such as Beijing, Shanghai, Guangzhou and Chongqing etc which are mainly provided by international firms who have their own in-house research teams. The exception to this is the data collected and sold by the China Index Academy which tracks both land and property transaction data in nearly 300 cities in China. The databank is information includes records of more than 180,000 land plots, 100,000 residential projects, nearly 50,000 commercial buildings and this is rapidly expanding. This market information is purchased by many large consultancies as well as developers and financial institutions. Other property market reports provided by the private sector include amongst others the Soufun Quarterly Property Market Report; CREIS China real estate reports, the JLL China Market Review; Asia Pacific Property Digest; CBRE People Market index Brief.

The research has shown that emerging markets such as China are characterised by a lack of consistency in the recording and assembling of data, which raises issues relating to the potential for greater standardisation of the data being collected, recorded and disseminated. The reliance and faith put in data purchased from data companies remains questionable given potential issues over how this information is compiled and the date it was collected. Furthermore, the lack of transparency in the Chinese real estate market is linked to a degree of secrecy and reluctance to share data with competitors, although this position may change as the market matures and access to information increases.

8 According to the JLL (2012) research the Tier 1 cities are Beijing, Guangzhou, Shenzhen and Shanghai. Tier 2 cities include Chengdu, Chongqing, Dalian, Dongguan, Fuzhou, Hangzhou, Ningbo, Shenyang, Suzhou, Tianjin, Qingdao, Xiamen and Wuxi. Tier 3 cities comprise Changchun, Hefei, Foshan, Guiyang, Harbin, Jinhua, Jiaxing, Jinan, Kunming, Lanzhou, Nanning, Nanchang, Urumqi, Shaoxing, Yantai, Zhengzhou and Zhuhai.
3.5.3 Availability and Quality of Market Data in China

In terms of data availability, most of the larger firms have their own in-house database of transactions and also maintain an archive of case files. They also undertake market research and trend analysis for external clients, which are often used as contextualisation of the market. In this regard, firms see this as a ‘value added service’ and a competitive advantage over rival firms as they can produce monthly market reports and forecasting analysis which is utilised heavily within the appraisal reports. Again, it is evident that larger valuation firms would have strategic alliance partners in other major cities which add to the amount and richness of data they have available to them. There is also a divergence in the quality of data held by firms with information for Tier 1 markets more readily available. There is also limited sharing of information between central, provincial, municipalities and city levels. Contrary to the western practice, some officials in China felt a lack of transparency protected their local appraisers and therefore they did not necessarily seek a more data rich environment. Currently, there is no existence of a main property data provider or a culture of sharing of property information amongst property companies. Some interviewees were of the opinion that the market intelligence undertaken by large property companies should be shared with the government so that this can be verified and ensure that consistent and genuine market information is being collected and used by practising valuers.

In terms of the measurement of buildings and land there is evidence that the local practice in China is for this service to be undertaken by certain authorised government bodies. Similarly, where valuers cannot gain access to this information it tends to be derived from the blueprint plans of developments rather than the physical measurement of buildings/land. This practice can lead to major distortions in the calculated areas and associated links to value.

China is not a transparent market and there is a lot of ‘scepticism’ about the benchmark land value. This is especially prevalent in emerging cities where there are no benchmark values or there is limited transactions leaving a high element of subjectivity in the interpretation of value. Another interviewee also commented that there is often false reporting of the actual transaction price for tax evasion and therefore it is imperative that appraisers must have their own data to support their valuation.

3.5.4 Use and Interpretation of Market Data

The Chinese government’s use of the benchmark land price does not reflect actual market transactions and therefore the effectiveness of this method to derive land value was challenged by the round table participants. Furthermore, issues were raised with the time lag of the benchmark data which means the values derived from this method will seldom reflect market value. Furthermore, the sheer size and scale of Chinese cities and their corresponding real estate markets makes it difficult to ensure that there is a consistent and timely approach to data collection. In this regard decisions on how to grade cities and define CBD boundaries to help determine what constitutes prime versus secondary or grade A versus grade B property becomes critical. Similarly, how yields, lettable floor areas and rental values get reflected across China needs consistency and standardisation to ensure a common basis is being adopted and understood by industry professionals.
3.6 China Concluding Remarks

The Chinese economy has experienced rapid growth and increased foreign direct investment since the economic reform and open door policy was first introduced. Despite this, the real estate market is still relatively immature with a high degree of government control/intervention in both land use rights and the allocation of land to state owned enterprises. The Chinese real estate market does not therefore operate a fully market orientated system. Furthermore, the regulation of appraisal services in China remains fragmented given the control of three different ministries and the clear separation between land and buildings in the valuation process. This is further confused by the existence of three separate professional designations from the professional bodies, each of which has their own set of standards and codes of practice. Fragmentation of the appraisal industry may add to the confusion of foreign investors and can create a reticence to pursue investment and development opportunities.

However, continued growth in the real estate market has seen high demand for appraisal services and this is increasingly met by both large domestic and international consultancies. Local appraisal firms are becoming better trained and more competent with central and regional government backed certification with licensing programmes starting to change outward perceptions of the local appraisal industry. Despite the increase in professionalism it must be noted that the appraisal industry is still relatively immature with many appraisers having yet to experience a market downturn and their awareness of market risk and economic indicators is often underdeveloped. Furthermore, there remains a need for convergence in the local valuation standards as well as cultural and institutional changes to help streamline the appraisal industry and ensure it reflects international standards and best practice. Despite the fragmentation of the appraisal institutional framework, Chinese valuation standards and the broad code of practice under which appraisers operate is well developed albeit in a regimented and closely monitored manner. In this regard, Chinese standards remain prescriptive with detailed formulas and procedures that must be followed. Similarly, mandatory grading of local appraisal firms has improved the competency and quality of local appraisers and helped to develop greater investor confidence in the appraisals being undertaken. It is therefore anticipated that, as the real estate market continues to mature, Chinese appraisal practice will develop and further reflect international best practice.
4.0 United States of America

4.1 US Economy and Real Estate Market

The 2010 Census reported a population of 308.7 million making the US the third most populous country in the world, behind China and India (US Census Bureau, 2010). According to the statistics collated by the International Monetary Fund (2013) GDP growth in 2012 was 2.2% with this predicted to decrease to 1.9% in 2013, to reflect significant legacy effects of the financial crisis. However, the same report also points to some signs of recovery with an increase in bank lending, some construction activity, house price increases and job creation. On a positive note, inflation rates continue to stay low with the Consumer Price Index for May 2013 showing a rate of 1.4% up just 0.3% on the previous month (US Bureau of Labour and Statistics, 2013). Similarly, in July 2013 the Federal Reserve benchmark interest rate was at an all-time low of just 0.25% with a 10 year Government bond yielding 2.6% (Trading Economics, 2013).

In light of these economic indicators, the US residential and investment property markets are showing tentative signs of a recovery following the 2007 Global Financial Crisis when the collapse of the subprime mortgage market saw record foreclosures and a significant decrease in assets and property values. The legacy factor of this financial crisis continues to be felt with a slow-down in construction activity and a reduction in bank lending to real estate. Many investors and funds had to liquidate large parts of their investment portfolios as appraisers responded quickly by marking value to market. However, according to a recent joint Urban Land Institute and PWC report on the Emerging Trends in Real Estate, optimism is slowly returning to the US market with real estate assets continuing to offer diversification benefits and command attractive returns over fixed-income investments whilst offering more stability than stocks (ULI, 2013).
4.2 Appraisal Regulatory Environment in the US

The regulatory environment relating to real estate and appraisal in the US is well established and reflective of its status as one of the world economic leaders. To some extent the regulatory side of appraisal was developed on the back of appraiser malpractice in the Savings and Loans crises of the 1980s and 1990s when unregulated residential appraisers were found to be incompetent and performing fraudulent appraisals for federally regulated financial institutions. This was legislated against through Title XI of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) 1989 which introduced both uniform standards and monitoring of the state regulation of appraisers. The outworking of this Act and the legacy impacts it has had on US regulation of appraiser practice is outlined in the following sub-sections.

4.2.1 Valuation Standards Operating in the US

The key standard required by statute in the US is the Uniform Standards of Professional Appraisal and Practice (USPAP) which is produced by the Appraisal Standards Board of the Appraisal Foundation. USPAP was first developed in 1987 by a joint committee representing the interests of 8 major US and Canadian appraisal organisations, although there is a long standing presence of real estate standards dating back to the 1930s. The Uniform Standards became officially endorsed into statute through FIRREA and adopted by the Appraisal Foundation in 1989. This ensured that there was a set of standards which appraisers could follow when conducting an appraisal. Under the FIRREA statute, appraisers must comply with USPAP in all federally related transactions. Similarly, USPAP is further endorsed by State Appraiser Certification and Licensing Boards and professional bodies such as the Appraisal Institute. USPAP is mandated at a federal level and must be followed in addition to any special requirements that should also be observed at a municipal or state level. In this regard the Appraisal Institute, the Federal Reserve and the Bank Regulators all specify the use of USPAP in real estate appraisals.

USPAP has a wider remit than just real property, as it also covers mass appraisal, personal property appraisal, consulting and business valuation. The USPAP standards are split into five key sections namely, Definitions, Preamble, Rules, Standards and Standards Rules, and Statements on Appraisal Standards. The Rules section deals with the broad ethics and due diligence required in a property appraisal (see Section 5.3), whereas the Standards section gives appraisers detailed information on how to conduct an appraisal and what issues the appraiser should include in their report. In total there are 10 USPAP Standards, the first 5 of which cover real property –

- **Standard 1** – Real Property Appraisal, Development
- **Standard 2** – Real Property Appraisal, Reporting
- **Standard 3** – Appraisal Review, Development and Reporting
- **Standard 4** – Real Property Appraisal Consulting, Development
- **Standard 5** – Real Property Appraisal Consulting, Reporting
- **Standard 6** – Mass Appraisal, Development and Reporting
- **Standard 7** – Personal Property Appraisal, Development
- **Standard 8** – Personal Property Appraisal, Reporting
- **Standard 9** – Business Appraisal, Development
- **Standard 10** – Business Appraisal, Reporting.

According to the latest edition of USPAP (2012-13) the following purposes are established by the 10 standards –

- Standards 1 and 2 establish the requirements for the development and communication of a real property appraisal
- Standards 3 outlines the requirements for the development and communication of an appraisal review
- Standards 4 and 5 overview the requirements for the development and communication of a real property appraisal consulting assignment
- Standard 6 communicates the requirements for the development and communication of a mass appraisal
- Standards 7 and 8 establish the requirements for the development and communication of a personal property appraisal (i.e., plant and machinery, gems and jewellery, fine art, antiques, etc.)
- Standards 9 and 10 outline the requirements for the development and communication of a business or intangible asset appraisal.

9 Standards 4 and 5 are being retired from USPAP from January 2014.
Some of the local professional bodies or associations also issue additional standards which are generally considered as enhancements to the information contained in USPAP. For example, the American Society of Appraisers (ASA) is primarily associated with business/asset valuations and issue standards specifically relating to business valuation. Similarly, the Appraisal Institute, the main real estate professional body, issues a Code of Professional Ethics, a Certification Standard and a series of Guide Notes to the Standards of Professional Appraisal Practice. There has also been increasing influence on real estate from financial regulators; for example, the Financial Accounting Standards Board (FASB) through the US General Accepted Accounting Principles (US GAAP) and the International Accounting Standards Board (IASB) through the International Financial Reporting Standards (IFRS), are starting to have an impact on property appraisal in terms of fair value appraisals. Furthermore, any federal work on land acquisition has to follow the Uniform Appraisal Standards for Federal Land Acquisitions or ‘Yellow Book’.

Which standards are applied is dependent on who has commissioned the appraisal and whether or not it is being reviewed and decided on in the US. Most banks apply a ‘home rule’ when considering what appraisal standard should be considered, with USPAP applicable in the US and the IVS/Red Book (sometimes with USPAP compliance additions) applied if the property is being appraised internationally. From a compliance perspective the banks recognise the need to specify the standard that is mandated through local statutes rather than dictate a standard which has no legal basis in that jurisdiction.
4.2.2 Enforcement of Appraisal Standards in the US

The Appraisal Foundation, through its Appraisal Qualifications Board, establishes the minimum education qualifications, practical experience or exam requirements needed to obtain a state licence or certificate. The Appraisal Foundation therefore acts as the standard setter not the enforcer, outlining the broad qualification standards needed to become a licensed or certified appraiser. The State Appraiser Regulatory Agency of each state is responsible for enforcing compliance with state law, including compliance with USPAP standards. Under the FIRREA, in 1989 the Appraisal Sub Committee (ASC) was formed by Congress to provide further oversight of the regulatory monitoring at a state level of appraisers through the state licensing and certification programs. The activities of the ASC are independent of the work of the Appraisal Foundation as they are responsible for overseeing the state level regulatory agencies. Hence, the Appraisal Foundation set the qualification standards while the ASC monitor the State regulators to ensure compliance.

In the US there are four categories of licence/certificate that an appraiser can obtain to carry out real estate appraisals, for example –

- Trainee Appraiser (property under the supervision of a certified appraiser)
- Licensed Residential Real Property Appraiser (non-complex residential units with a transaction value of less than $1,000,000)
- Certified Residential Real Property Appraiser (residential units of any complexity or value)
- Certified General Real Property Appraiser (all property types).

It is important that a State licensed or certified appraiser employs the recognised methods or techniques and performs in an ethical and competent manner as laid down in USPAP. Any non-compliance to the local standard would be considered in violation of USPAP and could result in disciplinary action. The State appraiser regulatory agencies investigate and monitor such complaints and undertake thorough checks to see if the appraiser has complied with applicable State laws and USPAP standards. The ASC performs a monitoring role of each State appraiser regulatory agency to determine if they have adequate policies and resources in place to process complaints and complete investigations within a reasonable time period. The ASC also ensures that appropriate disciplinary sanctions have been implemented and any such disciplinary action or complaints have been reported to the National Registry operated by the Appraisal Subcommittee.

Business or asset appraisers have no government licensing programme in place and this has been a focus of attention for Congress and the Securities & Exchange Commission, which have suggested that the business appraisal industry should take responsibility by implementing a regulatory programme like the RICS Registered Valuer Scheme in the UK. It was felt by some business appraisers that such a programme for business valuation would be highly beneficial, but introducing this to real property appraisal where a state licensing programme already exists would not garner the same support from industry.

Real estate brokers are regulated under a separate trade body known as the National Association of Realtors (NAR) which operates as a self-regulatory organisation for real estate brokerage covering both residential and commercial agents. NAR produce a detailed Code of Ethics and Standards of Practice which need to be complied with and therefore brokers are not governed by USPAP. Brokers in the US are allowed to provide an opinion on value but this cannot be used in place of an appraisal, as such an opinion needs various disclaimers and could not be used by financial institutions as brokers do not follow USPAP. In addition, certain states have issued regulations governing the use of broker’s opinions that effectively limit their use to a broker’s efforts to procure a listing of a specific property.
4.2.3 Education and Training of Appraisers in the US

The US has a growing number of dedicated undergraduate real estate programmes despite the appraisal industry traditionally employing economics, finance or business degrees or postgraduate real estate courses. These courses are increasingly offered by a variety of real estate research centres and business schools in many major Universities. The Appraisal Institute has some oversight of real estate education but this is not a formal degree accreditation process, unlike the role undertaken by the RICS in the UK. Instead, the Appraisal Institute offer a Master’s degree programme through eight US-based partner universities which upon successful completion may result in some courses/exams being waived depending on the degree content.

The Appraisal Institute remains the main real estate professional body and it has challenging requirements to gain membership. It operates a clear mandate for membership which is education orientated with a robust curriculum and practice based requirements before the entrance exams can be undertaken. To become a member of the Appraisal Institute an appraiser needs to demonstrate a 5-7 year portfolio of experience, show evidence that he/she has undertaken the designated courses, produce a demonstration report of learning experiences and completed an entry examination.

The Appraisal Institute membership courses are the same training courses needed for state licenses/certificates; hence the professional body plays a key role in providing the necessary real estate training needed to become a qualified appraiser. There is a further requirement to undertake a USPAP compliance and ethics course every 2 years to keep abreast of any USPAP changes through Continued Professional Development. Long standing real estate appraisers and MAI members who are held in high esteem by their profession and have more than 20 years experience can be invited to become a member of the Counselors of Real Estate (CRE) and thereby also use the prestigious CRE designation. Furthermore, there are many appraisers actively seeking both MAI and RICS designations to enable them to demonstrate their qualified status to both local and international clients.

To become licenced or certified the appraiser must pass an examination set by the state appraisal board where appraisals will be undertaken and meet certain qualifying education and experience thresholds. Table 4.1 summarises how the minimum licence/certificate requirements differ across the 4 categories of appraiser. It is important to note that these are only the minimum requirements and therefore at a state level there could be further additional requirements expected of appraisers.
4.2.4 Focus of the USPAP Standards

The current focus of the USPAP standards has become more prescriptive and rules based to ensure the independence of the appraiser and demonstrate best practice in relation to due diligence. This rules and standards based focus has its origins in the aftermath of the Savings and Loans crisis in the early 1990s when appraisers were charged with conducting appraisals at the direction of their clients. Congress therefore introduced the Appraisal Foundation and its associated boards as the mechanism to provide regulatory oversight of appraisers. Many of the participants at the round table discussions conducted by the research team felt that the Standards part of USPAP is rather benign and therefore relatively easy to adhere to, especially with the addition of the comments that accompany each standard and rule. These comments carry the same weight as the component they address and therefore help provide additional interpretation to aid application of the standard. USPAP also includes statements on the appraisal standards which take a specific issue and discuss the problems or pitfalls that need to be guarded against.

The purpose of the statements is to help clarify, interpret and elaborate on either a rule or a standard. This acts as a further advisory source with the issues explored including avoiding the misuse of DCF, retrospective value opinions, prospective value opinions, reasonable exposure time and intended use and intended users.

A further resource available to appraisers is the USPAP advisory opinions which act as a form of guidance, issued by the Appraisal Standards Board, to illustrate the use of USPAP in specific situations and thereby provide advice on how to resolve associated appraisal problems. It does not form part of USPAP from a compliance perspective, but acts as a valuable resource for appraisers on how to deal with specific appraisal problems that they may have encountered. The ASB also publish USPAP frequently asked questions to provide further guidance in response to questions raised by either appraisers or enforcement officials. Again this does not form part of USPAP but helps provide appraisers with practical advice on real life problem issues.
4.3 Appraisal Approaches and Practice in the US

As a world economy with a well-established and mature real estate market, the appraisal approach in the US is underpinned by the mandated USPAP standards and excellent market data. The following sub-sections focus on the practice based approach to appraisal and some of the nuances that make the US approach different from that in the UK.

4.3.1 Client Engagement and Appraisal Ethics in the US

The Rules section of USPAP outlines the due diligence and ethics expected of an appraiser. The rules (listed below) help an appraiser to frame the appraisal task and make sure basic competencies and compliance issues are met –

- **Ethics rule** – ensures an appraiser follows the highest standards of professional ethics through his/her conduct as well as maintaining high levels of integrity and impartiality.
- **Record keeping rule** – makes sure that a work file is maintained on all appraisals for a minimum of 5 years.
- **Competency rule** – ensures that the appraiser has the necessary skills to undertake the appraisal assignment.
- **Scope of work rule** – outlines the need to identify the appraisal problem, its associated workload and any disclosures.
- **Jurisdictional exception rule** – resolves the issue of compliance with USPAP in cases where local regulations/statute precludes compliance with any part of USPAP.

In terms of the Ethics rule there are 3 key areas that this rule covers notably –

1. **Conduct** – this lists a number of conduct based issues that an appraiser must not do including introduce bias, act in the interests of a specific party, report predetermined opinions, mislead or defraud, engage in criminal conduct, violate record keeping rules, use or rely on unsupported conclusions or perform in a grossly negligent manner. There is also a need for full disclosure of any vested interests the appraiser has in the subject property or parties involved in the assignment or any previous services provided in relation to the subject property in the preceding 3 year period.

2. **Management** – this identifies the need to disclose the payment of any fee or equivalent to procure the appraisal. It also mentions how affixing the appraiser’s signature certifies recognition and acceptance of USPAP responsibilities.

3. **Confidentiality** – this indicates that the appraiser must protect the confidential nature of the appraiser-client relationship and therefore not disclose confidential information or results to anyone other than those entitled to view it.
Ethics is also covered by the Appraisal Institute in their Code of Professional Ethics (2013) and this is considered complementary to USPAP. The Code of Professional Ethics state that a member –

- Must refrain from conduct that is detrimental to the Appraisal Institute, the profession and the public.
- Must assist the Appraisal Institute in fulfilling its role relating to qualifications and compliance with ethics and standards.
- Must not develop or report biased analyses, opinions or conclusions.
- Must not disclose confidential information to unauthorised parties.
- Must not advertise or solicit in a manner that is misleading or contrary to public interest.

Both these sets of standards show the emphasis placed on professional ethics and acting in a manner that is befitting of the profession. It is clear that the federally backed programme of state licensing/certification has helped influence this core focus on ethics within appraisal assignments. Furthermore, the need to review ethics every two years as part of the license/certificate renewal process further ensures appraisers are kept abreast of the latest ethical issues facing appraisers.

In terms of the client engagement process this is governed by the Scope of Work rule in the 2012-13 edition of USPAP, which states that an appraiser must do the following –

- **Identify the problem to be solved** – including the client and other intended users, the intended use of the appraisal, the type and definition of value, effective date, subject property and associated characteristics and the assignment conditions (assumptions, extraordinary assumptions, laws/ regulations).

- **Determine and perform the scope of work necessary to develop credible results** – for example when it meets or exceeds the expectations of intended user parties or what an appraiser’s peers would be performing on a similar assignment. An appraiser must also ensure that the intended use of the appraisal or a client’s objectives do not cause the results to become biased.

- **Disclose the scope of work in the appraisal report** – this must contain sufficient information to allow intended users to understand the scope of work undertaken.

This prescriptive approach to the scope of work is reflective of the role of banks in being the client in a federally regulated financial transaction and therefore they must engage the appraiser. This is not typical of the rest of the world where the appraiser is often engaged by the owner, developer or borrower. However, in practice most engagement letters in the US will stipulate the deliverables, time deadlines, the fee, the bases of value and legal compliance language. Likewise, local banks and investors will look for a qualified person to sign the appraisal and would check internally that it is consistent with local standards. If the appraisal is being carried out in the US there will be explicit reference to USPAP, but for overseas appraisals it will make reference to IVS/Red Book to reflect the local marketplace.

Some investors indicated that they were wary in making the instruction letter too detailed in case they unduly influence or steer the valuer towards a number. Instead the focus is placed on getting the professional appraiser to follow good market practice, adhere to international rules and be ethical in how they approach the task. Other investors specifically made reference to fair value determination alongside the need for a designated appraiser who locally would hold a state licence/ certificate and who internationally would be either RICS affiliated or the equivalent best in class for that country.
However, the consensus of opinion was that the main stumbling block for investors was the need for much more dialogue with the appraiser in particular on the bases of value to ensure they get either a market value or a fair value opinion rather than investment value.

4.3.2 US Bases of Value
The main bases of value referred to in the USPAP standards are as follows –

- Market value
- Investment value
- Liquidation/forced sale value
- Fair value.

However, USPAP does not provide a market value definition per se but instead directs the appraiser to determine the applicable definition. Market value remains the most common basis used in appraisal reports. Some clients, such as banks, also ask for liquidation or forced sale value or insurable value. Liquidation value has become more common since the financial crisis of 2007 with values typically reduced by 25-40% based on sales of other foreclosed properties. The use of insurable value provides an indication of the amount that needs to be applied for insurance purposes and it is therefore not used as a value determination in mortgage calculations.

Investors may also ask for fair value, ‘as is value’ or stabilised value. All value determinations, especially those instructed by banks, should be calculated on an ‘as is’ basis unless specifically told otherwise in the engagement letter. However, the introduction of stabilised value for development/investment projects enables a projected value to be considered based on market conditions and how long it is likely to take for the building to reach stabilised occupancy. Hence, the use of stabilised value represents a formal means of capturing market sentiments as the appraiser needs to anticipate market movement and supply and demand factors in determining the absorption rate. Typically appraisers assume one year from the date of valuation as the stabilised value point in time, but it is market specific and as a prospective value appraisers remain cautious in its use. These additional bases of value, although common in the real estate industry, are not explicitly mentioned in the USPAP standards section nor defined within the definitions, but retrospective and prospective values are mentioned in the statements section.

4.3.3 Appraisal Methodology utilised in US Reports
USPAP provides the mechanism to perform quality control and regulation of appraisers but it does not prescribe the actual methods that should be used in the appraisal. Instead it places the emphasis on ensuring the most appropriate methods are chosen and that the decision to choose that method is fully explained in the appraisal report. USPAP previously advocated the use of all three main valuation methods namely sales comparison, income and cost. However, this has since evolved to recognise that the appraiser should exercise professional judgement in deciding which methods are considered, based on their relevance to the property type being appraised. For example, a major office building will be driven by the income approach and the sales comparison approach will often be included to provide a second check on value, but it would rarely include a cost approach unless specifically asked for. Hence, the decision to exclude one or more method should be explained in the appraisal report. Appraisers, therefore usually comment on all three approaches and then justify the approach adopted or reconcile the value conclusions based on the values determined.
There is consensus amongst appraisers at the roundtable discussions that there is good knowledge and regulatory oversight of the methodologies used in the US. However, there was also recognition that there are many different nuances applied to the use of the same techniques in other countries. Similarly, the US approach of using a sales comparison grid to convey logic in the adjustments made to rental levels versus the UK careful selection of the most homogenous comparables demonstrated another example of where culturally even two established real estate markets can differ substantially. In this regard there was recognition given to the trust and respect of the UK chartered surveying profession which more readily accepts a valuer’s expert judgement compared to the US mindset of needing to produce detailed analysis and reporting to justify the subjective decisions made on value. However, despite differences in the appraisal methods, the agreement amongst US appraisers was that the most important aspect was to fully explain the methodology which was adopted in the report.

4.3.4 Appraisal Reports in the US

There are three ways of presenting appraisal reports in the US namely, a summary appraisal report, a restricted use appraisal report and a self-contained appraisal report, the latter being the most comprehensive. All three reports include 11 items, but the restricted use report as the name suggested includes a caveat restricting use of the report to the client, whereas the summary appraisal report provides a shortened summary of both the scope of work and analysis/reasoning sections (see Table 6.7 in Chapter 6 for comparison of report content with IVS). The prescription of what should be included in the three different styles of report means that appraisal reports tend to be relatively uniform especially as it is designed to make sure the reports are transparent and not misleading.

There was a perception amongst appraisers that UK and US reports were of a similar quality although US reports tend to be underpinned by much more comparable data resulting in reports that routinely run to 100-150 pages. While this length lends itself to greater transparency, the reports can sometimes be unnecessarily long and some of the critical information can therefore get lost in the report. There was also a consensus that European appraisal reports tended to be more forward looking while the US tended to be retrospective given their view that appraisers do not create the market but merely report on it. In terms of comparability the view of the appraisers was that a USPAP report would comply with the RICS Red Book, whereas a Red Book report would only be around 90% compliant with USPAP. The main differences were considered semantic, with dual terminology needed as well as some certification and compliance clauses. Some major property consultancies are training their appraisers to understand the differences between USPAP and the IVS/Red Book to enable them to undertake quality control reviews. Another major firm had explored the idea of standardising reports across all its global offices, but faced deep opposition given differing styles, methods and detail included. The reality was that the branding and broad content was as far as the standardisation could go given challenges of data availability and what is prescribed in many of the local standards.

In terms of local practice there was a view shared by the bankers that the appraisal comes towards the end of the lending process based on in-house due diligence and initial borrower negotiations. Some appraisers felt that this was too late as the decision to underwrite the loan has often already occurred, therefore making their appraisal become a box ticking exercise. However, most banks discussed the existence of a robust in-house review process which made sure the standards were complied with and that the correct approach was adopted. Finally, there was a shared opinion amongst both bankers and investors that the quality of appraisal reports between international and local companies differed significantly. This raised the important issue of valuation consistency across appraisal firms with the local appraisers struggling to compete due to the limited resources they can allocate to data sourcing and collection. In this regard, there was a consensus that the appraiser needs to focus on applying reason and logic to ensure that the data analysed directly links to and supports the final value conclusion.

10 The reporting formats included in USPAP will be changing as of January 2014.
4.4 Market Value Definition and Interpretation in the US

The way of defining market value remains a contentious issue especially with some world regions adopting the IVS definition and others remaining loyal to the definition contained in their local standards. The US is one of the countries that fall into the latter category and therefore this section explores how market value is defined in the US and whether this difference in definition results in any practical application differences.

4.4.1 US Market Value Definition

USPAP within its definitions section provides a broad outline of market value, but this is not phrased as a formal definition with the appraiser directed to determine an applicable definition. The outline of market value states –

“a type of value, stated as an opinion, that presumes the transfer of a property (i.e. a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal” [USPAP 2012-13, pU-3].

In the accompanying clarifying comment, USPAP provides some additional conditions that establish the market perspectives for the development of an opinion on market value. These fall into the following categories –

1. The relationship, knowledge, and motivation of the parties (seller and buyer)
2. The terms of sale (cash, cash equivalent or other terms)
3. The conditions of sale (exposure in a competitive market for a reasonable time prior to sale).

USPAP also cautions the appraiser to make sure that they include the exact definition of market value and its associated authority in the appraisal report. This requirement to include the market value definition ensures that appraisers are clear in what is being reported on and how this influences the value conclusions. There are therefore often many different sources of market value quoted, for example banks are obligated to use the Interagency Guidelines while other clients may stipulate alternative sources. Effectively, most market value definitions will result in a similar valuation but the source cited will vary.

The market value outline and its accompanying conditions is constructed and articulated differently from the IVS market value definition (see Table 6.6). However, many round table participants felt that conceptually the USPAP market value outline and IVS were similar. There was also general agreement that the most widely used definition of market value is the IVS definition. This observation is interesting as despite the signing of the Madison Agreement in 2006, in which the Appraisal Foundation and the IVSC agreed to work towards a convergence in their respective standards, there still remains no USPAP adoption of the IVS definition of market value. However, this did not overly concern panellists as they felt that the consistency in how a market value definition is applied within a country is more important than how it differs from other countries, provided that the appraisal report outlines the specific definition applied and its source.

In this regard, a working group has been formed to harmonise USPAP and IVS which should help resolve any market value differences and move the US towards the recognised international norm.
4.4.2 US Market Value Interpretation and Understanding

There was a proposal from one round table panellist to standardise real estate terms on a global basis including market value, but other panellists queried if real estate professionals owned that space given the number of other professions involved. This lack of a common language was cited as a key reason for a wider lack of understanding. Another panellist cited the commonality achieved by the International Accounting Standards Board (IASB) when they first started engaging with the Financial Accounting Standards Board (FASB) on the IFRS, as an example of how collaboration can work and suggested that it was a case that everyone needed to be more open to change in gaining the wider understanding required.

In general, across the interviews and round table discussion, the consensus was that market value is understood within the US alongside the other valuation bases. What was of more importance to a number of respondents was the fact that the client often defines the basis of value that they require, but it is really up to the appraiser to determine if this is an appropriate request. In this regard, the feeling was that many appraisers engage on a job to appraise a property without spending enough time talking to the client and understanding the exact purpose of the appraisal. USPAP requires the purpose (Intended Use) to be established and reported upon, with the appraiser responsible for determining that the Scope of Work is consistent with that intended use.

In terms of using market value in distressed market scenarios, there was a feeling shared by panellists that market value is the only relevant benchmark, as supply and demand of distressed assets is dictating where the market is at. Furthermore, panellists felt that too much emphasis is placed on the distressed market situation and less so on the inflated market position which never gets referred to as ‘fantasy value’. There was some understanding of the German approach to ‘sustainable value’ used in their Pfandbrief valuations, but the premise is not widely recognised outside of German banks. Furthermore, some felt that the uncertainty in the market got factored into the buy and sell strategies of knowledgeable investors and therefore appraisals were effectively capturing the market situation.

The consensus of the round table was that USPAP was better than the IVS/Red Book at explaining issues like reasonable exposure time on the market which is fundamental to understanding and interpreting market value in the current economic climate. In this regard, some appraisers felt that distressed markets become a pricing decision rather than a market decision depending on whether the owner can afford to hold the asset and absorb associated losses until the market improves again. Similarly, the issue of liquidation value with a maximum marketing period of six months was put forward by one of the banks as the way of modifying the distressed market situation, especially where the only sale evidence is other distressed assets.

4.5 Market Data and Transparency in the US

The US is one of the most transparent real estate markets in the world with good access to data from a variety of sources. Sometimes access to too much market information can also become confusing to appraisers who have to analyse and interpret these abundant data in relation to the subject property. This section explores the US position as the market leader on real estate market information and examines the key suppliers of data as well as its quality and wider interpretation within appraisal reports.

4.5.1 US Real Estate Market Transparency

The latest Jones Lang La Salle Real Estate Transparency index, released in 2012, shows the US continues its dominance as the top ranked country in the index. In this regard, the US scores well across all five sub-indices (2nd for Performance measurement, 1st for market fundamentals, 1st for governance of listed vehicles, 7th for regulatory and legal, and 9th for the transaction process). The number 1 ranking is therefore systematic of the long historic time series data and extensive database coverage that the US has across multiple sectors as well as their data availability and regulatory oversight of the real estate market.

There was a feeling amongst the appraisers interviewed that the US market in the last 20 years has gone from 25% big brand valuation companies to 75% and, as a result, this has improved the reliability of appraisals and reduced market fragmentation. Similarly, the US has a clearer separation between the appraisal and brokerage functions of the market. In this regard, it is only the big international real estate consultancy firms that have dual functions in-house and therefore are able to benefit most from increased market insights. However this creates problems with confidentiality of information and many appraisers reported an increase in the number of clients asking them to sign confidentiality or non-disclosure agreements, with clients becoming more reluctant to have appraisers or brokers share their information with others.

4.5.2 US Information Providers and Data Sources

The US is awash with data providers offering sophisticated information for both commercial and residential real estate sectors. Companies such as Co-star, Real Capital Analytics and CoreLogic provide information on either commercial or residential property sales and also provide the functionality to create market analysis and research reports. Similarly, the US has a culture of having Multiple Listing Services (MLS) where brokers can share property databases and listings of residential properties for sale. This same listing type service has also started to become more common in commercial real estate, through Commercial Information Exchanges (CIE) where brokers
in the commercial sector can openly share listing information. The problem with both the multiple listing sites and the data provider companies is the cost to the appraiser and therefore the fragmentation of the market in terms of those appraisal companies which can afford these services and those without the resources to be able to avail of the services.

Alongside the key data providers there is a proliferation of real estate indices which capture real estate performance trends in commercial, residential and investment market sectors. The NCREIF Property Index or Moody’s/Real Capital Analytics Commercial Property Price Index (CPPI) chart the returns on commercial property. The residential sector utilises the Case Shiller House Price Index and Winan’s Real Estate Index of House Prices to chart changes in house prices. While the investment sector, driven primarily by Real Estate Investment Trusts (REITs), has numerous indexes including the FTSE NAREIT US Real Estate Index or the Dow Jones US Select REIT Index. Each of these indexes enables investors to compare and contrast real estate returns across sectors and across property types in terms of income, capital and total returns or trend based changes in price. This enables in-house benchmarking of real estate performance against the best in class to help determine the buy and sell strategies of investors.

4.5.3 Availability and Quality of Market Data in the US

There were no major issues raised in relation to data availability or quality in the US, a reflection of the real estate market maturity due to the abundance of real estate data easily accessible at a cost and some freely available to appraisers. Trends in property prices can be charted using time series data which in turn can help an appraiser gain confidence and consistency in the values that he/she is assessing. Furthermore, the introduction of the securitised market and performance based return indexes has led to a greater transparency as reflected in the continued number one ranking for the US in the JLL real estate transparency index. However, in the aftermath of the recent economic downturn there was a need to fall back on some time series based sales data, which resulted in some appraisers introducing caveats into their appraisal given the historic nature of some of the data used. This was indicative of global real estate markets and not unique to the US. Unlike some emerging real estate markets there is no reliance on asking prices as transactional data is available. However the multiple listing service information can also be used to add to the evidence base in terms of asking price movements in the real estate market.

4.5.4 US Use and Interpretation of Market Data

In terms of the interpretation of real estate data there was a general view expressed by appraisers in favour of using market sentiments, given that by its very nature transaction prices reflect a historic price position. Similarly, some appraisers felt that US reporting format was becoming too driven by quantitative and statistical data with less emphasis needed on the data sources and more on the interpretation of the values. In this regard the panellists felt that the US approach as prescribed by USPAP becomes too process driven with the appraiser focusing on the mechanics of complying with USPAP and less on economic and market commentary in particular the interpretation of the values presented.

Furthermore, some appraisers recognised that getting the data was only the start of the process, as interpreting and acting upon it is where the appraiser’s expertise and knowledge become critical. This necessitates dialogue with brokers as well as buyers and sellers including those who opted out of a sale to gain real market perspectives. It was accepted that appraisal is not an objective science and therefore it is the appraisers duty to gather as many facts as possible and then utilise his/her expert judgement on where the real estate market is positioned in the curve.
4.6 US Concluding Remarks

The US has a strong and well established appraisal profession and regulatory environment which includes a reputable professional body, a uniform set of standards and state level regulation of appraisers. In this regard, the regulatory environment governing real estate has evolved in response to the Savings and Loans crises of the 1980s and 1990s and therefore now ensures that real estate appraisers follow a prescriptive and rules based approach to property appraisal. However, the remit of USPAP standards is wider than real property as they also cover mass appraisal, business valuation and personal property appraisal.

In the US, there is increasing pressure on appraiser practice from both the financial reporting and accountancy standards, especially in relation to fair value appraisal. Furthermore, the IVS and RICS Red Book are becoming more prominent in their use especially for international transactions, despite USPAP remaining the only mandatory standard applicable to local appraisers. In this regard local appraisers are beginning to recognise the importance of being aware of international valuation, accounting and financial standards. The regulatory environment governing US appraisal also benefits from challenging professional body entry requirements based on an extensive portfolio of experience and completion of education based courses, with on-going compliance and ethics courses mandatory for Appraisal Institute members every 2 years. This therefore ensures that the appraisal profession upholds ethics and professionalism as the cornerstones of their industry.

The standards based approach to real estate appraisal coupled with the state level oversight of real estate activities through licensing and certification programmes, has ensured that the US is acknowledged as one of the world leaders in appraisal practice. However, the continued reluctance of the Appraisal Foundation to adopt the IVS definition of market value and the detailed approach preferred in appraisal reports does make the US approach out of sync with its European counterparts. Nevertheless, the strong emphasis in the US, on the independence of the valuer, ethics and the scope of work gives confidence to investors that appraisers are practising with due diligence and integrity. Furthermore, the highly transparent nature of the US real estate market, which continues to be ranked number one in the JLL Real Estate Transparency Index, coupled with the sophisticated information readily available across all market sectors, helps appraisers provide detailed supporting evidence for their value conclusions. In this regard other countries have much to learn from the US approach to reporting, data capture and market transparency including how these can facilitate in-depth value analysis.
5.0 United Kingdom

5.1 UK Economy and Real Estate Market

According to the 2011 Census produced by the Office for National Statistics, the population of the UK was 63.2 million the highest ever recorded for the country (ONS, 2012). The latest prediction from the International Monetary Fund has been revised upwards to forecast a slight increase in GDP growth from 0.3% in 2012 to 0.9% in 2013 reflecting a continued weak recovery (IMF, 2013b). Consumer Price Index inflation rose to 2.8% in May 2013 and is predicted to remain above the 2% target for much of the next two years (Bank of England, 2013). The Bank of England base interest rate has been maintained at 0.5% whereas the 10 year Government Bond currently yields 2.3% (Financial Times, 2013).

Currently, in 2013, residential owner occupier markets are strong and in London prices have exceeded their pre-financial crisis levels for the first time since the crisis. Price levels are also rising in the South-East around London but markets are more subdued outside this area. Savills (2013) suggest that a “combination of government intervention, improving consumer confidence and low interest rates have come together to make current improvements look more prolonged than the short-lived bounce seen in 2010”. They predict that the average house price in the UK will overtake its 2007 pre-crisis peak by 2015.

Deloitte (2013) outline increasing overseas demand for UK property at both ends of the price spectrum during 2013. This overseas demand is further supported locally by increasing availability of finance, with the UK government backed Funding for Lending Scheme (FLS) launched in July 2012 by the Bank of England and HM Treasury, helping to incentivise banks and building societies to lend to local households and businesses. Similarly, the Help to Buy mortgage guarantees due to commence in January 2014, which will enable low deposits of just 5%, will start to bring some much needed confidence back into the residential market. It is too early to evaluate the impact, however the Help to Buy initiative with its twin pillars of equity loan and mortgage guarantee schemes will be assessed on the degree to which it will assist both first-time buyers and first movers both of which are required to increase turnover in transactions currently running at half the pre-crisis level.

Commercial property has also experienced a minor boom in 2013 with commercial development activity at its highest since 2007 (Savills, 2013). Rental values have remained fairly static with average prime rents less now
than 5 years ago but the property investment market in London has been buoyant, reflected in cap rates which continue to be below 5% for some sectors, although the average cap rate outside London is far higher approaching 7% (CBRE, 2013). London continues to attract significant overseas capital which is one driver of the low capitalisation rates despite the mediocre rental growth.

5.2 Valuation Regulatory Environment in the UK

The regulatory environment which governs valuation in the UK is firmly entwined with the professional body the Royal Institution of Chartered Surveyors (RICS). The RICS were first formed back in 1868 and received its Royal Charter in 1881. It remains responsible, through its professional groups, for setting standards, developing guidance and providing industry best practice. The last 10 years has seen the RICS undertake a concerted push to increase its membership globally and as a result (aside from the IVS) the Red Book has become the dominant valuation standard applied in over 146 countries by more than 140,000 members. This section will explain the role the RICS play in self-regulating the UK valuation profession as well as the linkages formed with the International Valuation Standards Council (IVSC) in adopting and promoting the International Valuation Standards (IVS). Furthermore, the implementation in 2011 of the Registered Valuers Scheme and the content and focus of the main RICS Valuation Standard the ‘Red Book’ (RICS, 2012) will be discussed to provide the backdrop to the enforcement of self-regulation in the UK.

5.2.1 Valuation Standards Operating in the UK

The UK is in the somewhat unique position of adopting the IVS in its entirety within its own valuation standard, the Red Book. The latest edition of the Red Book published in March 2012 has a full reproduction of the IVS standard (IVSC, 2011), as well as both global and UK specific valuation standards. Thus a valuation that is undertaken in accordance with the Red Book is also considered compliant with the IVS. However, for RICS members working abroad, local jurisdiction will overrule both IVS and the Red Book if it is mandated to follow the local standards through legislation. The Red book therefore adopts the principles of IVS in their entirety but issues instructions and guidance to UK based members concerning local practices through its UK practice statements and guidance notes.

The IVS, whilst applied by valuation professionals, is intended to give confidence to the users of valuation services and to help the regulation of real estate markets. The content of the IVS is structured into three clear categories, namely General Standards, Asset Standards and Valuation Applications. Within the General Standards section there are three standards that apply to all asset types and valuation purposes –

- IVS 101 – Scope of work
- IVS 102 – Implementation
- IVS 103 – Reporting.

As the IVS refers to valuation across all asset classes there are a further six asset standards, of which IVS 230 and IVS 233 are specific to real estate –

- IVS 200 – Businesses and business interests
- IVS 210 – Intangible assets
- IVS 220 – Plant and equipment
- IVS 230 – Real property interests
- IVS 233 – Investment property under construction
- IVS 250 – Financial instruments.

Further guidance in the form of valuation applications of the standards in specific circumstances such as financial reporting or secured lending is provided through –

- IVS 300 – Valuations for financial reporting
- IVS 310 – Valuations of real property interests for secured lending.

The IVS is supplemented within the latest edition of the Red Book by six global valuation standards that apply within all RICS member countries and four UK specific valuation standards that are applicable only within the UK market. Each valuation standard comprises a short statement or rule and associated commentary to assist in wider interpretation and application. The global valuation standards within the Red Book cover the following –

- VS 1 – Compliance and ethical requirements
- VS 2 – Agreement of terms of engagement
- VS 3 – Basis of value
- VS 4 – Applications (including valuations for inclusion in financial statements, for secured lending or for public sector assets for financial reporting)
- VS 5 – Investigations (including inspections and verification of information)
- VS 6 – Valuation reports.
In addition to the global valuation standards, the national association standards have mandatory status within the UK and are designed to supplement, expand or amend the global valuation standards so they meet UK statutory or regulatory requirements. The UK specific standards within the Red Book relate to the specific application of global standards in specific sectors and cover the following –

- **UKVS 1** – Valuations for financial statements
- **UKVS 2** – Valuations for financial statements – specific applications
- **UKVS 3** – Valuations of residential property
- **UKVS 4** – Regulated purpose valuations.

There are also a series of appendices, designed to provide further supporting information to help aid the context of the valuation standard; and guidance notes, which provide best practice examples of high standards of professional competency.

Alongside the IVS and the Red Book, in the UK many professionals during the course of this research mentioned the growing influence of banking regulations such as Insolvency II or Basle III as this affects the availability of loans and hence drives the pricing of assets. In particular, how these regulations have made it more expensive for investors to borrow and therefore how this has impacted on depressing values in the secondary markets.

### 5.2.2 Enforcement of Valuation Standards in the UK

The valuation profession in the UK is not regulated by Government and is instead self-regulated through the professional body the RICS. However, it is possible to practice as a surveyor in the UK without being a member of the RICS. In this regard, unlike the valuer licensing programmes introduced in some other countries, the RICS is not a monopoly professional body and therefore not all market participants are governed by the RICS Red Book. Despite this RICS membership is given high recognition and most clients will seek a valuer who is either a member of the RICS or attached to a major surveying firm.

The RICS is responsible not only for enforcing valuation standards on its individual members but also for regulating large firms that undertake valuation practice. Hence regulation of valuers operates at both an individual and company level. At a company level, the firm must register for RICS regulation if the firm offers surveying services to third parties and 50% or more of the principals are RICS members. This usually necessitates the completion of an annual return which outlines the activities the company undertakes, the volume of activity, its geographical remit, any claims against its valuers and wider professional indemnity insurance cover.
All individual RICS members, who conduct Red Book valuations, as of April 2011, have had to join the Registered Valuer Scheme (RVS). This scheme is mandatory for all UK RICS members who conduct Red Book valuations, but operates on a voluntary basis outside of the UK, although the RICS is in the process of extending the mandatory scheme to the Netherlands, Cayman Islands and the Republic of Ireland in the near future. The RVS was introduced based on a desire from members to ensure all RICS members were complying with the Red Book and therefore upholding the professional standards expected of a chartered surveyor.

The RVS is a membership scheme for individual valuers, but often large regulated firms underwrite the subscription fees for their employees. In these circumstances there is a reduction in the subscription cost to reflect the economies of scale from having a company-wide annual return. The information contained in the annual returns forms the basis of a desktop risk based analysis which may identify areas of concern that warrant a follow-up. If a follow-up visit is required to inspect the work files the company and/or individual will receive 4-6 weeks’ notice for the impending visit. This visit is conducted by a qualified RICS member who will utilise a detailed checklist based on Red Book compliance to undertake the inspection. Normally the visits are conducted to give the individual or company the chance to put right any non-compliance issues and only in serious fraudulent cases would this result in the de-registration of a valuer from the scheme. The RICS publishes examples of non-compliance so that other firms can learn from this and ensure that their in-house practices are adhering to the Red Book.

5.2.3 Education and Training of Valuers in the UK

The UK has perhaps the most comprehensive valuation education system in place offering both undergraduate and postgraduate accredited property degree courses across more than 50 universities. To help ensure the relevance of these degree courses in delivering graduates capable of fulfilling positions in the real estate industry the RICS enters into partnership arrangements with the universities based on five quality principles, namely –

- **Student selection** – setting a minimum threshold in a particular country
- **Innovation** – exposing students to new ideas and cutting edge research
- **Teaching quality** – ensuring a high quality teaching and learning environment
- **Curriculum** – incorporating subjects that prepare graduates for the profession
- **Graduate output** – producing high calibre graduates.

The accreditation process continues to be very demanding to ensure that only courses that meet industry requirements and expose students to best practice or cutting edge research gain accreditation. Typical courses that provide graduates for the real estate industry include commercial property, asset management, property investment, real estate finance, property management and property valuation.

There are four main routes to gain entry into the RICS as a member, including –

- **Associate** – a minimum of 4 years’ relevant work experience or vocational qualifications, but without a University degree
- **Graduate** – University graduates with a RICS accredited degree
- **Academic** – academic members of staff who demonstrate teaching, research and external engagement activities in chosen pathway
- **Experience** – experienced professionals who hold a degree qualification and have a minimum of 5 years’ relevant professional experience.

To reflect the level of experience and knowledge of the member there are three designations that members may attain, such as FRICS (Fellow), MRICS (Member) and AssocRICS (Associate). The ‘Fellow’ designation is only awarded to individuals who have made significant achievements in their real estate careers, whereas the ‘AssocRICS’ reflects an entry level qualification for those members with practical experience and vocational qualifications but no University degree.

In the UK the RICS operates strict education and qualification standards to gain entry under any of the main routes requiring a mix of evidence including practical experience, qualifications and structured training (Table 5.1). Furthermore, there is a requirement for Continued Professional Development (CPD) to ensure surveyors keep abreast of issues facing the profession or any changes/updates in practice. In this regard members must undertake a minimum of 20 hours CPD training each year which should be recorded and capable of being presented as verifiable evidence in support of any new activities undertaken.

In addition to the education and CPD training that UK based valuers undertake as part of their RICS membership, there is also a further on the job training aspect that many trainee valuers benefit from. The UK real estate market has a number of large international consultancies which have both the valuation and agency sides of the business residing within the one company. This is possible given that there is a fiduciary responsibility to one party or the other which enables the two teams to talk to each other whilst not breaching this trust. The advantage of having both functions in-house is that trainee surveyors can then spend time in lettings, valuation and management to gain a better all-round perspective of the business.
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<thead>
<tr>
<th>RICS Membership Route</th>
<th>Academic/Professional Qualifications</th>
<th>Prior Experience</th>
<th>Structured Training</th>
<th>Final Assessment Submissions</th>
<th>Final Assessment Interview</th>
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<tbody>
<tr>
<td><strong>Graduate</strong></td>
<td>• RICS accredited degree&lt;br&gt;• Placement year counts towards maximum of 12 months structured training</td>
<td>• None</td>
<td>• 24 months to meet competency requirements&lt;br&gt;• 96 hours of CPD</td>
<td>• Confirmed mandatory and technical achievement records&lt;br&gt;• Logbook&lt;br&gt;• CPD record over last 24 months&lt;br&gt;• Critical analysis (3,000 words)</td>
<td>• 60 minute interview including 10 minute presentation on critical analysis&lt;br&gt;• Testing on professional practice/ethics</td>
</tr>
<tr>
<td><strong>Academic</strong></td>
<td>• RICS accredited degree; or&lt;br&gt;• Relevant higher degree</td>
<td>• Undertake academic activities relevant to the profession over a 3 year period</td>
<td>N/A</td>
<td>• 4 items from list below (with at least 1 to level 3 in the core competency pathway)&lt;br&gt;• Teaching – postgraduate teaching qualification; successful mentoring of research students; course leadership and development&lt;br&gt;• Research – refereed research paper; book; book chapter; conference paper; patent; consultancy report&lt;br&gt;• External engagement – engagement with employers; consultancy activities; engagement with professional organisation&lt;br&gt;• 3,000 word statement on relevance of portfolio to profession&lt;br&gt;• CPD records for previous 12 months</td>
<td>• 60 minute interview based on portfolio of experience with a 10 minute presentation on one item to demonstrate core and mandatory competencies as well as professional practice, research ethics and professional ethics</td>
</tr>
<tr>
<td><strong>Professional</strong></td>
<td>• Bachelor’s degree; or&lt;br&gt;• RICS approved professional body membership</td>
<td>• Minimum of 5 years’ experience post-qualification</td>
<td>N/A</td>
<td>• Summary of experience against pathway competencies (2,000 words)&lt;br&gt;• Case study (2,000 words)&lt;br&gt;• CPD record (12 months completed and 12 months planned)&lt;br&gt;• Organisation Chart</td>
<td>• 60 minute interview including 10 minute presentation on one case study&lt;br&gt;• Testing on professional practice/ethics</td>
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A relatively recent real estate phenomenon in Europe has been the interest of some non-real estate professions, particularly accountants, in conducting valuations. This has become increasingly evident in the post 2007 global financial crisis era, when many accountants were contacted to deal with the insolvency side of businesses. Some valuers have expressed concerns that accountants are now increasingly moving into real estate valuations, especially in Central and Eastern Europe, despite not being trained in this field and the challenging conflicts of interests that this could cause.

5.2.4 Focus of the RICS Standards

The Red Book has been re-engineered in the last few editions to make it more relevant and less ambiguous, with the addition of the IVS reflecting a change in philosophy towards embracing international standards. The Red Book is also available in twelve different languages. The current edition tends to focus more on the client relationship, ethics and the responsibilities of the valuer rather than the technical aspects of valuation. This is demonstrated through VS 1 and VS 2 which focus on the professional valuer approach through coverage of the need to comply with professional standards and ensure that all departures from the standards are communicated and agreed with the client. These standards also outline the importance of using an appropriately qualified and independent valuer who has the knowledge and skills in that particular market to undertake the valuation in a competent manner.

The Red Book is famous for having no prescriptive reference to valuation methods, with this being left to the discretion and expertise of the valuer to select and apply the most appropriate method for the specific valuation assignment. To some extent the established and effective legal system in the UK, whereby disputes can be resolved in courts helps enable the technical aspects of valuation to be absent from the standards. Instead these technical aspects are dealt with through information papers and CPD events. There are exceptions to this, for example there are a number of guidance notes on Depreciated Replacement Cost, DCF and lease incentives that do illustrate valuation method. However, these are either technical approaches which have a number of assumptions associated or illustrate a range of techniques that could be adopted, hence some further clarity on their use is provided. To some extent this lack of prescription on the technical aspects of valuation mirrors the approach of the IVS, given that these methods are often governed by local standards or legislation making it difficult for uniform application.

A quote from the then Chairman of the IVSC, Michel Prada, on the latest version of the IVS helps to encapsulate this changing role –

“The IVS may be likened to a navigation chart. The chart will show the crew of a ship the starting and finishing point of the voyage; it will also show the safe channel and of hazards such as reefs and wrecks. However, it will not tell them exactly which course they must steer. That is still a matter for their skill and judgment depending upon their observations of variables such as the weather conditions on the day and the movements of other ships. Just as no chart will tell them how to react to these variables, the IVS cannot instruct valuers how to value within the overall framework that is set. Valuers must be able to react to the variables on a case by case basis.....The framework provided by the IVS is designed to give users of valuations sufficient understanding to provide them with confidence that a valuation is produced within recognised norms. However, the standards are not a training manual and the skill and experience of the valuer is still a vital component in ensuring that the result is as accurate as possible.”

(IVSC, 2010, pi-ii)

This quote from the past IVSC chairman supports the role of the standards in providing a guide to how the valuation should be framed, but not becoming the training manual upon which the answers are based. This non-prescriptive approach to valuation represents the major difference in the Red Book/IVS approach compared to other countries. However, there is a huge supporting valuation literature in the UK, much of it relating to valuation method.
5.3 Valuation Approaches and Practice in the UK

The chartered surveying profession, presided over by the RICS, provides a strong context for valuation regulation and practice in the UK. This section focuses on the established valuation practices in the UK and how this links to the Red Book and IVS.

5.3.1 Client Engagement and Valuation Ethics in the UK

The broad ethics that govern UK valuers can be linked directly to the RICS and its royal charter which requires the profession to work for the public advantage and therefore display excellence and integrity. Furthermore, the charter necessitates that any changes to the RICS constitution be ratified by the UK government, through its Privy Council, hence whilst the profession is self-regulatory there remains some government oversight in its activities. Both the RICS and the IVSC have been proactive in developing standards or codes of principles relating to ethical behaviour, to ensure that valuers are aware of their wider ethical responsibilities to both the profession but also the public.

The latest version of the IVS has removed ethics from the actual standard but has developed a separate Code of Ethical Principles for Professional Valuers (IVSC, 2011b). The rationale for removing the code of ethics from the main standard can be linked to the difficulties it posed to adoption of the standard in countries where this differed from their own code of practice. Member organisations of the IVSC can either adopt this code or maintain its own sets of rules provided they broadly reflect these five fundamental principles –

1. **Integrity** – being straightforward and honest in business relationships
2. **Objectivity** – not allowing conflicts of interest, undue influence or bias to override professional judgement
3. **Competence** – applying professional knowledge and skills
4. **Confidentiality** – respecting confidentiality of information and agreeing to not disclose information without the appropriate authority
5. **Professional behaviour** – acting diligently and producing work in accordance with legal, technical and professional standards.
Within the Red Book, VS 1 deals with compliance and ethical requirements, including when to apply the standards and any notable exceptions (VS 1.1); the need to follow the Red Book and disclose departures (VS 1.2); the hierarchy between global and national standards (VS 1.3); the qualifications of the valuer (VS 1.5); the knowledge and skills to ensure competency (VS 1.6); the need to act independently and objectively (VS 1.7); compliance with additional criteria for independence (VS 1.8) and additional disclosures needed for public interest or 3rd party valuations (VS 1.9). These govern the broad ethics involved in the valuation process, whereas additional guidance from the RICS through the Global Professional and Ethical Standards help govern the behavioural aspects of the valuer. This additional guidance stands separate from the Red Book as it applies to the ethics of all categories of members and is underpinned by five standards and a series of ethical questions –

- **Act with integrity** – honest, trustworthy and without bias
- **Always provide a high standard of service** – providing the best possible advice for the terms of engagement agreed
- **Act in a way that promotes trust in the profession** – within your professional and private life
- **Treat others with respect** – courtesy, politeness and without prejudice
- **Take responsibility** – being accountable for own actions through due diligence.

It is apparent from all three sets of ethical standards that UK valuers both understand their duty of care but also the role they play in upholding the integrity of the valuation profession. In the opinion of the round table panellists who participated in this research, ethical standards should be viewed merely as a means to an end but not the end itself, which remains to produce a robust and supportable valuation conclusion in accordance with the professional standards. In this regard the Red Book was praised for capturing best practice in relation to disclosure, conflicts of interest and ensuring that both parties understand the terms of engagement under which the valuation assignment is being conducted. For international clients, who are not necessarily always aware of the Red Book, the valuers spoke of having to explain how it is more than a technical standard and embraces professional delivery standards which the IVS does not deal with. This interpretation helps to reassure clients that UK practising chartered surveyors comply with technical and wider codes of conduct and ethics.

The terms of engagement is covered in the Red Book by global standard VS 2 which outlines the process that the valuer and client should go through in agreeing a valuation assignment. This includes coverage of the confirmation of the terms of engagement (VS 2.1); explicit listing and agreement of all special assumptions (VS 2.2); disclosure of any marketing constraints on sale (VS 2.3); outline of any restrictions the valuer was operating under (VS 2.4); confirmation of no material changes where a property was revalued without inspection (VS 2.5); and the need for full possession of the facts before undertaking critical reviews (VS 2.6). For more comparative analysis of the terms of engagement suggested by the Red Book versus the IVS, see Chapter 6.

Within the UK the engagement letter, particularly from banks, can run to many pages to reflect the amount of due diligence that they expect the valuer to undertake and to ensure that all deliverables are clearly stated. Furthermore, some banks are choosing to stipulate a liability amount in their instruction letter which makes the valuer responsible for losses incurred up to the stipulated amount. This protects the bank but also ensures quality and due diligence in the valuation report as a valuer would be liable for potential losses of substantially more than their fee and Professional Indemnity Insurance (PII) cover. The downside is that it often returns a more conservative value for the banks and increases the financial burden on the valuer through PII cover. In this regard many valuers...
expressed concerns, estimating that within the UK for every £1 received in fees up to 20-30 pence of this was going on PI premiums. This uncovers a further valuer problem in terms of fee reductions that has been occurring over the last 20 years where firms have effectively made valuations a commoditised service and in competing with each other for clients have undervalued the service they provide.

5.3.2 UK Bases of Value
There are four bases of value recognised in the Red Book, namely –

- **Market value** (VS 3.2)
- **Market rent** (VS 3.3)
- **Worth or investment value** (VS 3.4)
- **Fair value** (VS 3.5).

Of the investors and banks interviewed by the research team the majority of respondents were engaging valuers on the basis of market value, although fair value especially for financial balance sheets was starting to become more common. Many valuers indicated that fair value is an area of weakness in their knowledge and often when requested, they approached it as a market value. Other valuers suggested that they viewed fair value as an accounting term and despite RICS and IVSC issuing guidance notes on the distinction between fair value and market value, in practice they seldom approached it differently. There is no reference in the Red Book to ‘liquidation value’; in fact within VS 2.3 there is explicit mention of the fact that the term ‘forced sale value’ should not be used to describe an actual or anticipated marketing constraint. In this regard the Red Book advises the valuer to determine if a property has any actual or anticipated marketing constraints and if so these should be stated clearly in the terms of engagement to show that the value is provided on this basis. In such circumstances the valuer may also provide an alternative valuation on the special assumption that the constraint did not exist in order to demonstrate its impact. This is a very different approach to some other countries that calculate liquidation or forced sale value as a percentage of the market value.

The issue of the German Mortgage Lending Value (MLV) or Sustainable Value was discussed in light of the global financial crisis, with the overwhelming opinion of valuers that such an approach was over-complicated and not reflective of the real estate market but rather creates a hypothetical market that does not exist. Investors and bankers, in particular, were more receptive to the MLV approach, recognising its ability to smooth real estate cycles and construct a more stable lending environment in the medium to long terms. Some banks and valuers reported a movement towards constructing a sustainable value definition but on an ad hoc basis, with the consensus of opinion being that the IVSC or RICS needed to step in and make sure that the same definition is being applied by the banking, investment and appraisal sectors. It was felt that some form of sustainable value definition as being used in the insolvency environment, could help the current disconnect in many markets between market value and the level that sales were being released at.

Of further note was the bankers’ appetite for either the RICS or IVSC to develop a basis or definition in relation to forecasting or forward looking valuations. Such a basis would need to make it essential to clearly express all assumptions underpinning the forecast. This type of forecasting basis has been discussed informally amongst the Association of Property Lenders, but as yet not progressed any further. Similarly, the RICS indicated that it held some discussions with their American counterparts in relation to their use of prospective value or stabilised value. However, valuers expressed concern over such a basis given the potential for client influence, any potential professional liability associated with a forecast and the problems it could cause in terms of the already problematic PI cover.
5.3.3 Valuation Methodology utilised in UK Reports

UK valuation methodology although not prescribed or detailed within the Red Book is well established and market driven in terms of utilising the market comparative approach. The five main UK approaches to value include –

- **Comparable method** – for properties with a number of similar transactions
- **Income/investment method** – for income producing properties such as offices or shops
- **Accounts/profit method** – for specialised trading properties
- **Residual/development method** – for land with development potential
- **Contractors/cost method** – for properties not normally bought and sold on the open market.

It remains the knowledge and skill of the valuer to select and apply the most appropriate methodology for the property being valued. However, the valuers’ job should be to replicate the market approach, in terms of whatever methods are used in practice to best meet the client’s terms of engagement. In this regard UK valuers felt there was no need to prescribe methods within the standards as the most important aspect of valuation is to replicate what properties are being transacted at in the market and that the prescription of a particular approach seldom equals market value. There was also a feeling from valuers that this can lead to mis-valuing either in terms of incorrect inputs into software driven models or through valuers failing to grasp the fundamentals that underpin the valuation in the first place.

5.3.4 Valuation Reports in the UK

In the UK there is only one style of valuation report with the minimum content outlined in the Red Book in VS 6 (see Chapter 6 for a comparison of the Red Book report content with IVS). The report is self-sufficient and contains all the evidence material used to formulate the opinion on value. However, according to VS 6.2 the report should never be described as a ‘certificate’ or ‘statement of value’ which implies an element of guarantee in the value derived. Similarly, the Red Book necessitates the inclusion of the basis of value and any special assumptions made and agreed with the client. This enables the report to be transparent and readily understood by others especially where an alternative basis, other than market value, has been used or where special assumptions have altered the value from that achievable in the market.

In general, valuation reports in the UK tend to be more concise than say the US or Brazil due to the consideration of fewer valuation bases but also due to careful selection of homogenous market comparables. The major difference in UK valuation reports, in terms of length and content, comes between those conducted for mortgage lending and those undertaken for investor balance sheets. Depending on property type, the client requirements and the complexity of the building(s), a typical valuation report for investment purposes could be 10-30 pages, whereas for mortgage lending purposes it may be 50-80 pages. These reports differ greatly in the amount of due diligence undertaken given that some investment fund valuation reports are often undertaken on a quarterly basis for performance measurement purposes, and even monthly for Property Unit Trusts, on properties that have limited tenancy changes or physical alterations, hence requiring less valuer expertise as reflected in the lower valuation fee. The mortgage lending report on the other hand will include a more in-depth market analysis including more detail on the property description, justification on the selected valuation method, macroeconomic context setting and a wider interpretation of the market to justify both the higher fee but also the loan collateral liability upon which the bank is underwriting. Hence, the purpose of report becomes critical in tailoring the valuation service for a specific individual assignment.

There was a feeling amongst the round table panellists who participated in this research that there is a great deal of consistency in the style and content of UK valuation reports, given the use of the Red Book but also due to the similarity in the instructions received from banks. There was also a consensus amongst valuers, bankers and investors that the least important aspect of the report is the value, with much more emphasis placed on the commentary that justifies that number based on the market interpretation. Variations in reporting style between countries was often overcome by commissioning the work through the London based office. The London office therefore effectively stage-manages the valuer in the foreign county to ensure the style and content of the report meets the Red Book and client requirements.

Some of the valuers who were interviewed by the research team indicated that the need to limit professional liability more and more has seen not only the introduction of more caveats on the value to reflect uncertainty but also an increase in the wider commentary on macroeconomics of European markets and their impact on the UK, to demonstrate due diligence. As every market has different degrees of certainty and transparency, the valuers consider that there needs to be some way of expressing this certainty in order to fully contextualise the market. Valuers also recognised that the phrasing of certainty needs to be carefully crafted so that it does not become viewed as a valuer cop-out clause, but rather a means of providing the recipient with some much needed context and confidence.
5.4 Market Value Definition and Interpretation in the UK

Market value, as defined by the IVS, has its early origins in the RICS Red Book and the definition of ‘open market value’ dating back to the early 1970s. Various iterations of the ‘open market value’ definition and others such as ‘estimated realisation price’ were introduced and refined. In 2003 the RICS dropped ‘open market value’ in favour of adopting the IVS market value definition. Hence, the UK conceptual understanding of the term is probably significantly higher than anywhere else in the world. This section outlines the IVS/Red Book market value definition and wider interpretation of this definition by valuers within the UK.

5.4.1 UK Market Value Definition

Market value remains the most common basis under which a valuation is commissioned in the UK. In this regard the Red Book has adopted the IVS definition of market value –

“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” (RICS, 2012 p30).

The definition is further defined in paragraphs 31-35 of the IVS Framework with each key term (in bold in the definition) given an additional commentary to ensure it is properly understood. This IVS/Red Book definition of market value is the most widely used market value definition in the world and has become the conceptual basis against which all other market value definitions are compared. The adoption of the IVS definition of market value in the Red Book was designed to eliminate any lingering confusion or ambiguity between open market value and market value, although some valuers still feel that the exclusion of the word ‘price’ in favour of ‘estimated amount’ has in fact lessened the clarity of the market value term.

5.4.2 UK and European Market Value Interpretation and Understanding

In general there was a feeling across the discussion group and interviews that market value was understood and interpreted correctly within the vast majority of UK valuation reports. The one area of concern remains the treatment of market value in a market downturn, when some valuers become reluctant to commit themselves to a low number. One valuer commented that this uncertainty can be traced back to the philosophical question of a ‘willing seller’, which most valuers agreed any property owner becomes when he instructs a valuer to value his/her property. Furthermore, some interviewees suggested that in the economic downturn (post 2007) some valuers reinterpreted the market to sustain values at an artificially high level or to reflect their uneasiness of potential PI claims. Recent research in the UK suggests that the type of ownership was a factor in which property valuations fell the most in the crisis period with property companies having the lowest falls and property unit trust the highest (Crosby, et al, 2010).

The bank representatives interviewed by the research team indicated that they are searching for consistency in terms of how a valuation is conducted but more importantly consistency in the interpretation of market value. In many cases this is making sure that the correct questions are asked of the valuer to enhance the bank’s understanding of the value conclusion. In a UK context there was generally a good level of understanding shown for market value. However, UK valuers who operated in a wider European market context noted more variation in market value interpretation. While there was recognition for a level of consistency in the interpretation of market value in the UK, the valuers interviewed felt that this consistency dropped considerably when moving into continental Europe, particularly in the South and East of Europe. In many cases the problem with the interpretation of market value in continental Europe could be traced to valuing property as if it would only be purchased by a local rather than international buyer. In doing so the local valuers were undervaluing the property as they were effectively excluding a segment of willing buyers who would be able to pay considerably more than the local investors to hold the property as an investment.

A further issue identified was the problem of some European valuers not understanding the differences between price, worth and market value, which could result in a false opinion on market value. An example was provided of a German valuer who reinterpreted market value under the special assumption of a stabilised market given that in his opinion there were no willing sellers. This in effect created a virtual marketplace which was not reflective of what buyers would purchase at. Valuers agreed that the IVS was helpful in being explicit about these terms but that perhaps more awareness of the nuances of market value and how this differs from price or worth was needed through CPD events in continental Europe. Furthermore, valuers were concerned at the widespread use of special assumptions and how these are poorly captured within valuation reports particularly through incorrectly reinterpreting the market or failing to coherently disclose the reasoning for these assumptions. In many cases the UK based valuation team have to re-engage with the local valuation team in other European cities in an attempt to reconcile the values with the market.
5.5 Market Data and Transparency in the UK

The UK real estate market is considered to be highly transparent given the culture of sharing data and the strong research focus of the major valuation consultancies. It may not be considered as data rich as the US but it does operate in an efficient manner, particularly the large real estate markets like London. This section explores the transparency of the market and the use and interpretation of data within a UK market perspective.

5.5.1 UK Real Estate Market Transparency

The 2012 Jones Lang LaSalle Real Estate Transparency index ranks the UK 2nd just behind the US and this falls within the highly transparent category. The UK also features within the top 10 ranks of all five sub-indices (1st for Performance measurement, 8th for market fundamentals, 5th for governance of listed vehicles, 9th for regulatory and legal, and 7th for the transaction process) which demonstrate the maturity of the market and the continued capital flows that are targeted at UK real estate. Part of this transparency can be directly linked to the “sharing of information” culture that exists between UK valuers, even rival firms, who are willing to exchange information on yields, rentals and capital values, as well as the impact of having investment and valuation sides to the business within the one organisation. A further factor in this transparency has been the speed at which the UK valuers marked to market, which in turn was facilitated by the quality of real estate data and the relative liquidity of the London market.

5.5.2 Information Providers and Data Sources

From a market information perspective, the UK property market, given its maturity, is considered one of the most transparent markets where a large amount of market intelligence and analysis is available. Hence, the UK relies more on the research capabilities of the major property consultancies, which each report on the different market sectors on either a monthly or quarterly basis. This is supplemented on the residential side by house price indexes from some of the major banks (Halifax/Nationwide) or from the RICS in providing various market commentaries and economic analysis. There is also increasing coverage and usage of commercial real estate database information from suppliers such as Costar/Focus and Real Capital Analytics, but these still do not replace the local network of property professionals who regularly exchange information.

Furthermore, from an investment perspective the UK has excellent time series coverage of all the major market segments through the various Investment Property Databank (IPD) indices that enable investment performance to be tracked and benchmarked by market sectors and segments at a global or local level. The UK IPD has the widest coverage and the longest set of continual data of any country within the IPD international network. However, as the IPD is an appraisal based database, some of the valuation discrepancies between nations described above have resulted in a failure to integrate data held in overseas ownership with the data in national ownership within any one country’s IPD. Given the significant cross-border flows this is a major constraint to the development of comprehensive national data sets and analysis. Only when commercial property valuation regimes conform can these datasets be successfully integrated.
Similarly, from a public listed real estate perspective, the European Public Real Estate Association (EPRA) provides detailed information and research on the UK and Europe as well as other world countries. Both of these organisations provide data on the basis of an annual subscription and thereby enable other investors to track the performance of their portfolios against the industry benchmarks.

Additional information is also available from the public sector through the Land Registry or the Valuation Office Agency (VOA). Land Registry holds all the information on property titles within England and Wales as well as compiling a House Price Index based on repeat sales. The VOA is the only government body which holds information on every property in the UK, both residential and commercial, for the purposes of statutory valuations and calculating tax liability. They also hold information on all transacted properties which have to be reported for stamp duty taxes. The VOA also used this information up until 2011 to produce an in-house property market report for the Great Britain and Northern Ireland.

5.5.3 Availability and Quality of Market Data in the UK

In general participants in both the interviews and round table discussions felt that UK real estate market information was readily available and reliable. UK based valuers spoke of the ease with which they can access information and how this market based information becomes much less reliable and more difficult to source in mainland Europe particularly in emerging cities. There was also more confidence in UK valuations due to the frequency the valuations are undertaken and the independency of the valuer from the investor. In this regard, many valuers and investors commented on how the rest of Europe is hampered by a lack of transactional data and many more internal investment valuations. This is further supported by IPD information on the proportion of assets within their indices that are valued externally and which differ greatly within Europe. To combat this, many UK based investors conduct their own in-house price based estimates as valuers remain reluctant to mark to market coupled with the different definitions and bases of market value. This caution is demonstrated through higher risk premiums being associated with European compared to UK real estate.

5.5.4 Use and Interpretation of Market Data

The bankers and investors interviewed as part of this research were both in agreement that they would like to see as much interpretation of the market data as possible, but not just the inclusion of a wider economic context if it is not made relevant to the particular property being valued. In this regard, it was considered that the valuers should consider themselves the ‘academics of the market’ having studied it, analysed it, considered the wider macroeconomic indicators, market sentiments and identified the market players. This linked to a wider debate on the relevance of market sentiment and the valuer’s opinion on the market cycle. The bank representatives commented that they had more confidence to employ large real estate consultancies as they know they have a greater depth of knowledge and information available to them to help frame the opinion on value. However, there was also a cautionary note that some valuation reports were starting to exhibit signs of pre-cut text which was the same in a number of valuation reports and not made specific to the subject property. In many cases it was felt that the market context is often included as ‘filler’ rather than adding significantly to the content of the valuation report. A comment was made by a banker that too many valuers incorporate regional or European market information without demonstrating how this impacts on the value through discussing the market players or demand for real estate. A valuer commented on the need to provide an outline of the local economy where the business is dependent on trade from a specific outlet (e.g. coal mining village pub, which loses its trade after the coal mine closes) but that commentary on wider economic cycles was not their role and could become difficult due to PI cover. However, the consensus of opinion across the discussion group and interviews was that the valuer has some role to play in interpreting the macro economic conditions affecting large commercial real estate but less so for residential mortgages, which should be the responsibility of financial analysts.
5.6 UK Concluding Remarks

The UK, in contrast to many non-Commonwealth countries, operates self-regulation of the property industry and its professionals through the professional body the RICS. The RICS, as the world’s oldest, most established and recognised professional body for chartered surveyors, has an increasing global membership, all of whom accept the responsibilities and standards to be upheld in representing the profession through RICS membership and compliance with the Red Book. The RICS also actively regulates firms and enforces the Red Book/IVS standards through the Registered Valuer Scheme. The professionalism expected of a RICS member is further embedded into the UK education system through accredited property/real estate and business/finance degree courses which offer a route towards RICS membership provided that entry examinations and competency thresholds can be met. Furthermore, despite some market players not being RICS members and therefore not compelled to use the Red Book, most clients still seek the assurance of engaging an RICS member for valuation activities. This demonstrates the respected and dominant position of the RICS in a UK valuation context and why regulation by government was not considered necessary.

The RICS Red Book acts as the main property valuation standard in the UK although recent editions of the Red Book have also reproduced the IVS in its entirety to ensure members are reflecting the international nature of property investment and valuation. This is a somewhat unique position for a local standard to adopt and converge with the complete IVS text, but again demonstrates the increasingly important role played by international property standards. A further unique aspect of the property valuation community in the UK is the open sharing of market information between competitor firms and within in-house agency and valuation departments. This sharing culture reflects a fiduciary responsibility between parties which prevents trust being breached. However, despite the international badge of recognition of the RICS as an organisation, there is a need to carefully monitor Red Book compliance of RICS members outside of the UK to ensure that the same level of professionalism is evident around the globe. Similarly, it is important that the RICS continues to engage with other professional bodies and indeed local associations/societies to ensure that their members are familiar with the practices and standards operating internationally.
6.0 Case Study Comparison

6.1 Introduction

The growth potential of emerging real estate markets continues to be high but it is important to understand the risk factors and opportunities that need to be balanced when considering an international real estate investment or engaging a valuer overseas. This chapter focuses on exploring the nuances between the established and emerging markets to determine how valuation practice and regulation differs and whether there are any lessons to be learnt from the respective practices. This enables a better understanding of the different challenges and approaches to valuation regulation and practice within emerging and established real estate markets.

6.2 Economy and Real Estate Markets

Table 6.1 outlines the population totals drawn from local census data in the four case study areas, providing an impression of the size and scale of the different countries. Three of the four countries investigated, rank within the top five most populated in the world (China, US and Brazil) demonstrating the sheer size of the domestic economies and real estate markets before international investment is taken into account. China and Brazil have significantly increased their number of urban dwellers over the last 30 years and both have a growing young population which has helped create an increased demand for residential real estate. Furthermore, both China and Brazil have witnessed the emergence of a new middle class of affluent individuals keen to consume new products and seek new investment opportunities. This new middle class has helped GDP growth and introduced fresh domestic investors into the housing market who have the disposable income to invest in real estate.

The GDP growth figures in Table 6.1 show a clear distinction between the emerging and established markets, as the US and UK slowly move out of recession. Brazil and China have emerged relatively unscathed by the global financial crisis although there has been some evidence of a slowdown in both economies and a fall back in targeted growth levels due to reduced exports. However, at 3% and 7.8% respectively, Brazil and China still return solid GDP growth and therefore demonstrate a steady economy for real estate investment. Despite the attractive GDP growth, both countries continue to be dominated by domestic and local investors, although this position is evolving as more international investors gain further confidence in these markets and as controls on foreign investor activities become more relaxed. It is interesting to note that the inflation rate across all four countries is broadly similar, with the exception of Brazil which has a long standing history of operating in a very high inflationary environment.

The inflation rates have an impact on nominal Interest rates which again show a clear split between emerging and established markets. The UK and US have set very low interest rates to try and encourage lending which in turn can stimulate growth in the economy. In the UK, real bond interest rates are actually negative based on the current (rather than predicted) inflation rates. In contrast, China and Brazil's real interest rates are more savings friendly, with the cost of loan repayments high thereby restricting the number of domestic market participants. However, government initiatives such as stipulating a percentage allocation of bank securities in Brazil that must be allocated to real estate helps support new domestic investment and development.

The low nominal and real interest rates and 10-year government bond rates (Table 6.1) experienced in the UK and the US makes real estate an attractive investment as the returns are shown to be potentially higher than investing in the bond market or the interest return from bank deposits.

Table 6.1

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>190.7 million</td>
<td>1.354 billion</td>
<td>308.7 million</td>
<td>63.2 million</td>
</tr>
<tr>
<td>GDP growth rate</td>
<td>3%</td>
<td>7.8%</td>
<td>1.9%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Inflation rate</td>
<td>6.7%</td>
<td>2.5%</td>
<td>1.4%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Interest rate</td>
<td>8.5%</td>
<td>6%</td>
<td>0.25%</td>
<td>0.5%</td>
</tr>
<tr>
<td>10-year government bonds</td>
<td>11.01%</td>
<td>3.94%</td>
<td>2.6%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Real 10 year Bond Interest rates</td>
<td>4.31%</td>
<td>1.44%</td>
<td>1.2%</td>
<td>-0.5%</td>
</tr>
</tbody>
</table>
The very high 10-year bond rate in Brazil which currently is over 11% can be traced to the need for government to increase its cash reserves to help fund the infrastructure needed for the forthcoming football World Cup in 2014 and the Olympic Games in 2016 and the high inflation rates. Indeed it is the increasingly affluent middle class that recently protested against monies being pumped into infrastructure for these sporting events, demonstrating the progression in the Brazilian economy.

Table 6.2 compares commercial office leasing and measurement practice and demonstrates some commonality and variance across the four case study countries. Both China and Brazil tend to use metric measurements in square metres whereas the US uses imperial measurement in square feet. The UK often quotes the space measurement in both units. All four countries use an A, B, C grading or classification for their office buildings to denote quality. However Brazil has also introduced a AAA grade to denote the best in class and, in the US and UK, Co Star have introduced a 5 star system for building quality in all commercial and industrial properties based on published criteria concerning attributes. However, the list of attributes is combined at the 4 and 5 star levels and 1 and 2 star levels so these also effectively work off a three tier grading system.

When measuring the efficiency of the buildings, Brazil and the UK make reference to the carpetable area or net internal area floorspace. In contrast, China and the US apply a load factor and load loss calculation to determine the ratio of usable space. Both approaches, although calculated differently should result in a similar basis being used to calculate rental values as the common factor is charging for usable space. However, there is evidence to suggest that the efficiency rates and rentable space in commercial buildings in China and Brazil is reduced due to the grand scale and location of some commercial buildings especially those at the top end of the market which often have large atrium or lobby areas. Lease lengths in Brazil and China tend to be shorter (average 3-5 years) than in the US or UK (average 5-10 years). Brazil in particular opts for shorter leases due to the historic inflation linked rental values and the automatic right to renewal after 5 years. For larger tenants, the lease length increases across all four countries typically ranging from 5-15 years to reflect tenant quality and covenant strength.

Table 6.3 shows a degree of variation in the frequency of rental payments with the majority being made on a monthly basis (Brazil, China and the US) while the UK favours payment on a quarterly basis.

---

**Table 6.2** Comparison of Commercial Leasing Practice and Building Measurement

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unit of Measurement</strong></td>
<td>• Square Metre</td>
<td>• Square Metre</td>
<td>• Square Feet</td>
<td>• Square Feet/Square Metre&lt;sup&gt;11&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>Office Classification</strong></td>
<td>• AAA, A, B, C</td>
<td>• Grade A, B, C</td>
<td>• Class A, B, C</td>
<td>• Grade A, B, C</td>
</tr>
<tr>
<td><strong>Efficiency Ratio (ratio of net area to gross area)</strong></td>
<td>• Carpetable area or net usable area</td>
<td>• Load/loss factors</td>
<td>• Load/loss factors</td>
<td>• Net internal area</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 70-75% for Class A building in Beijing</td>
<td>• Generally 85-88% and varies from city to city</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 65-75% for Class A building in Shanghai</td>
<td>• 82%-75% for buildings built prior 1967 and after 2000</td>
<td></td>
</tr>
<tr>
<td><strong>Lease Term – Typical Tenants</strong></td>
<td>• 5 years</td>
<td>• 2-3 years</td>
<td>• 5-10 years</td>
<td>• 5/10 years, depending on size and quality</td>
</tr>
<tr>
<td><strong>Lease Term – Large Tenants</strong></td>
<td>• 1-10 years</td>
<td>• 5-6 years (predominately in major cities like BJ, SH)</td>
<td>• 15 years</td>
<td>• 15 years – occasionally more</td>
</tr>
</tbody>
</table>


---

<sup>11</sup> The UK largely employs metric measurements for the public sector and imperial units in the private sector.
There is also a clear distinction between rent payable in arrears and in advance, with China, the US and the UK all favouring payment in advance whereas Brazil expects payment in arrears. Investors need to be mindful of these distinct differences as well as any subtleties in the landlord and tenant responsibilities to ensure that they are not liable for any hidden charges. In terms of lease incentives there is increasing evidence of rent free periods being offered to tenants which typically ranged from 1-3 months across all four countries, with some further variation apparent when dealing with longer lease terms.

All four countries as shown in Table 6.3 have incorporated provision for rent escalation, although the form and method used to calculate these rent increases varied. The UK has for some years been an advocate of upward only rent reviews which usually get reviewed on a 5-yearly basis, with increasing evidence of inflation also being built into the rent review. On the other hand, the inclusion of inflation is well established in Brazil which implements inflation linked annual rental increases. The US, is similar to Brazil as it adjusts for inflation and rentals on an annual basis. China typically fixes its rent for 5 year leases, although longer leases will have a rental increase built into the lease terms. All four countries offer a right to negotiate a lease termination although potential termination penalties are payable in Brazil and China. Similarly, in both the UK and Brazil there is security of tenure through a statutory right to renewal after a set number of years. China and the US do not have this statutory renewal right although negotiation at lease end is common practice.

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Frequency of Rent Payment</strong></td>
<td>Monthly in arrears</td>
<td>Monthly in advance, based on either gross or net area</td>
<td>Normally monthly in advance</td>
<td>Quarterly in Advance</td>
</tr>
<tr>
<td><strong>Rent Free</strong></td>
<td>1 – 3 months, for a 5 year lease</td>
<td>1 – 3 months, depending on size</td>
<td>Varies, depending on lease term, rent payable, other incentives provided and current market conditions</td>
<td>From 2-3 months for fitting out up to 2/3 years on longer leases</td>
</tr>
<tr>
<td></td>
<td>Larger leases may be longer</td>
<td></td>
<td></td>
<td>Varies, depending on lease term, quality of tenant and current market conditions</td>
</tr>
<tr>
<td><strong>Rent Escalation</strong></td>
<td>Applied annually, based on local inflation rate under the IGPM (Indícios Geral de Precos – valor de Mercado)</td>
<td>Fixed during term of contract for leases that are less than 5 years</td>
<td>Fixed annual increase agreed with tenant or increase at a specified future dates</td>
<td>Upward only rent review</td>
</tr>
<tr>
<td></td>
<td>For longer leases, rent escalates at an agreed rate</td>
<td></td>
<td>It is also based on the Consumer Price Index</td>
<td>Adjusted to open market level on a 5 yearly basis</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Typically 2-3.5% per year</td>
<td>Can also be inflation-linked</td>
</tr>
<tr>
<td><strong>Expiry of Lease</strong></td>
<td>Negotiable, subject to lease contract</td>
<td>Negotiable, subject to lease contract</td>
<td>Tenant has a right to exercise its option to terminate only when a break clause is included in the lease agreement</td>
<td>Negotiable, and normally on similar terms</td>
</tr>
<tr>
<td></td>
<td>Tenant has a right to terminate agreement</td>
<td>Penalty for early termination</td>
<td></td>
<td>Options to break are negotiable and usually at 3 or 5 years</td>
</tr>
<tr>
<td></td>
<td>Local legislation provides a formulae for calculating termination penalties</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Statutory Right to renew</strong></td>
<td>Yes, after 5 years if Tenant meets lease obligation</td>
<td>No</td>
<td>No, but is negotiable, and normally the revised rent is 95% of fair market rent</td>
<td>Yes</td>
</tr>
</tbody>
</table>

6.3 Valuation Regulatory Environment

The previous four chapters have outlined the standards content and broad regulatory framework which governs valuation practice in each country. This section therefore focuses on comparing these governance structures and the impact that this has on regulating the valuation industry.

6.3.1 Standards and Enforcement

Table 6.4 shows the standards that operate across the four case study countries and this demonstrates that there is a clearer emphasis in the established markets on having one main standard governing valuation practice with USPAP in the US and the IVS/Red Book hybrid in the UK. This is reflective of these two countries having just one main professional organisation to help oversee the regulation of the industry namely the Appraisal Foundation in the US and the RICS in the UK. In contrast, within Brazil there is the existence of the ABNT standards which are mandated by government on Engineers and Architects as well as the local professional body IBAPE standards which have further standards at national and city levels.

This proliferation of standards between those mandated and those which are voluntary and exist at both a national and city level adds to the confusion of international investors and can result in a normative disassociation. A similar bifurcation of standards exists in China, with separate standards governing different aspects of the real estate industry, namely land and property.

Of further note is the fact that international investors are increasingly asking for IVS or Red Book standards to be used or referred to by local valuers especially if the loan provider or investor is not resident in that country. This process is either overseen by a valuer proficient in IVS/Red Book from the investor’s country or it relies on the local valuer being able to apply the international standard despite not being trained in this area. This would seem like an obvious area that the RICS or equivalent local professional body could promulgate by introducing training programmes for local valuers in the IVS/Red Book standards. However, there remains reluctance within Brazil and China to move from their scientific or mathematical-led approach towards a more subjective and knowledge based approach favoured in the UK. It is therefore more likely that values will still be determined using the local methodologies with the report structure, and engagement with the client influenced by international standards.

One of the key differences that this research found was whether the standards are mandated through government’s legislation or if the use of standards is governed by industry best practice. The mandating of standards proved to be the case in Brazil and the US, both of which clearly make reference to ABNT and USPAP in their statute. In the case of Brazil, this was made applicable only to the architecture and engineering professions. China, whilst not naming the three professional bodies’ standards in their statutes, have strategically positioned the professional bodies under the control and advisory capacity of three distinct government ministries ensuring that political oversight is a key feature of how the appraisal industry functions in China. In the UK it has become established practice, given the influential role of the RICS, to follow the Red Book standard but the self-regulatory role of the RICS precludes non-RICS members from having to comply with the Red Book.

While, the regulation of the valuation profession within the four case studies is based upon some form of licensing or certification in reality the level of direct intervention and control differs substantially. For example, the UK unlike China, Brazil and the US, does not implement their regulation through the government but instead operate a form of self-regulation through the professional body which has thus far been viewed as a success. In the countries with the state controlled licenses and certificates the effectiveness of these is often questionable given where the enforcement powers reside and associated disciplinary actions. Table 6.5 shows how each country operates different licensing/certification designations which reflect the area of specialism in which the valuer is considered competent. These designations operate independently from the membership routes and qualifications needed to become a member of any of the associated professional bodies and therefore often require separate competency tests and registration. However, in the likes of the US approximately 50% of appraisers opt to join the professional body so often state licence is the only form of oversight of appraiser activities. Furthermore, whilst each license/certificate has been designed to ensure compliance with the appropriate local standards there is still limited enforcement taken by these respective bodies beyond those reported through either complaints or ‘whistle blowers’. Within a UK context, many valuers feel the pressure to be Red Book compliant comes more from the threat of PI claims rather than the Registered Valuer Scheme. Similarly, whilst no real culture of suing the valuer exists in the emerging economies this is bound to become more of an issue in the future, just as it has in the US post economic downturn.

Furthermore, the role of legislation in providing institutional control of valuation was raised as a key issue by the IVSC as they advocate the naming of a standard rather than the inclusion of the standard detail in the legislation. This ensures that subsequent revisions of the standards do not necessitate changes to the legislation, as has happened in the Philippines. The UK as a self-regulated valuation industry does not name any standards in government legislation. Whilst this creates challenges in terms of the judicial and standard legislator role the RICS plays in enforcing the standards, this meant that a recent decision to adopt the IVS as the main valuation standard within the Red Book did not require any government legislative changes.
### Table 6.4 Valuation Standards Adopted across the 4 Case Studies

<table>
<thead>
<tr>
<th>Country</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABNT Standards for Evaluating Urban Property</td>
<td>CIREA Code of Real Estate Appraisal (property)</td>
<td>USPAP</td>
<td>IVS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>CREVA Regulations for Valuation on Urban Land (land)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Table 6.5 Licensing/Regulation Designations

<table>
<thead>
<tr>
<th>Country</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered Engineer (CREA)</td>
<td>Licensed Real Estate Appraiser (CIREA)</td>
<td>Licensed Residential Real Property Appraiser</td>
<td>RICS Registered Valuer</td>
<td></td>
</tr>
<tr>
<td>Registered Real Estate Agent (CRECI)</td>
<td>Licensed Land Valuer/Appraiser [CREVA]</td>
<td>Certified Residential Real Property Appraiser</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Certified Public Valuer (CAS)</td>
<td>Certified General Real Property Appraiser</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
6.3.2 Education and Training

Another aspect of valuation regulation that is important to understand is the respective education and qualification backgrounds of valuers, which differs greatly across all four countries. The UK has a long standing tradition in valuation and surveying, which is governed by the RICS through the accreditation of dedicated property degrees and membership examinations. In the last 50 years it has moved from a majority undertaking professional examinations to almost universal degree entry. It has also shifted from being a built environment discipline to a mixture of built environment and economics and finance – with a number of major Universities placing their real estate departments within the Business School. The appraisal profession in the US has evolved over the last 30 years due to the demand for more practitioners who possessed a comprehensive real estate education. This saw the introduction of more dedicated real estate programmes, particularly at a Masters level, with these delivered through a mix of business schools and dedicated real estate centres across a number of the major Universities. China, in contrast, tends to be serviced primarily by economics, business and finance related degrees with a limited number of dedicated real estate programmes available. Brazil, through legislation, has ensured that valuations are undertaken by either Architects or Engineers, who then learn the real estate skills through their local professional body in postgraduate short courses. Hence across emerging markets there is limited specific property valuation education at either an undergraduate or postgraduate level. This is starting to slowly change with some universities in China and Brazil offering RICS or equivalent accredited courses to ensure that the underpinning market fundamentals are taught formally through the education system.

In addition to the education background of valuers, there is evidence that local professional bodies provide training programmes normally linked to membership criteria of their organisation. It is fair to say that membership criteria differ across organisations in terms of both content, work experience and education qualifications. In this regard, the Appraisal Institute in the US followed by the RICS in the UK tend to be the most stringent in terms of entry criteria which reflects the maturity of the two markets and the need to uphold the integrity of the profession. However, the internationalisation of the RICS with the increase in membership globally does raise some important compliance and competency questions of overseas members which will need to be addressed either through the roll-out of the RVS or through competency examinations. Entry criteria in Brazil, given the close links to the Architecture and Engineering professions, stipulates the need for a 5-year undergraduate degree and some practical training prior to entrance examination. In China, given the distinct separation of land, buildings and assets, membership tends to focus on the entry examination and practical experience, but increasingly individual practitioners are seeking dual professional memberships of CREVA (land appraisal) and CIREA (building appraisal) respectively.

6.3.3 Focus and Effectiveness of Standards

In terms of the focus of the valuation standards there are two very different approaches evident across the four case study countries. The first approach, favoured by Brazil, and China (and to a lesser extent the US), focuses primarily on the technical aspects of the valuation process, in particular the methodology and step or rules-based procedures. This technical approach includes coverage of each methodological step and whilst the standards stop short of prescribing when each method should be used, they are effectively more like a manual than a set of principles. The UK, on the other hand, makes no reference to methodology and is instead much more principle and concept based, setting the context to the valuer’s responsibilities, ethics and wider engagement with a client.

To some extent, certainly within Brazil and China, the use of the more prescriptive form of standard can be linked to the relative immaturity of the markets and the need to ensure uniformity across valuer activities. The use of the rules based approach within the US is more closely linked to the poor reputation of the appraisal sector following previous Savings and Loans crises, and hence was used to inspire confidence and compliance. It is likely that the focus of the standards in both Brazil and China may change as their real estate markets mature and market information becomes more plentiful.

The Chinese and Brazilian standards are considered effective locally but confusing for foreign investors especially given some terminology and methodology differences as well as different approaches to the execution of the valuation assignment. While the detailed nature of both sets of standards was considered important in a wider judicial context, both countries recognise the need to evolve to ensure their local standards more closely resemble international norms. Interestingly, many research participants saw the complementarity between international and local standards with the international standards capable of establishing the broad ethics and engagement responsibilities, whereas the local standards helped to operationalise these through the methods and reporting styles.
6.4 Valuation Process and Practice

Many clients, including investors and financial institutions, appeared less concerned by the actual standards used and instead more interested in a valuation consistency across the marketplace. This draws a renewed focus on the valuation process in ensuring this consistency and this section focuses on how this consistency potentially differs in the four countries.

6.4.1 Ethics, Engagement and Valuer Responsibilities

The emerging economies have faced more challenges than established markets given their relative immature stage of the real estate market with corruption and fraudulent behaviour from the wider industry. Both China and Brazil have been proactive in trying to use the appraisal standards and wider codes of ethics as the basis for eliminating this behaviour from the marketplace with a clear emphasis on the need to be honest, objective and independent. Despite some initial progress there remains a greater need for the ethics sections or separate codes of conduct to be brought closely in line with the likes of USPAP or the IVS/Red Book. In this regard IVSC see their role as a lifting of the veil through providing a better understanding of the underlying principles so that the correct questions are asked at the instruction stage.

Both the Appraisal Foundation and the RICS regularly publish information on where appraisers/valuers have breached their standards or codes of conduct and this can act as a warning for others also engaging in unacceptable behaviour. These regulatory bodies in the US and UK also provide frequently asked questions by posing typical scenarios that valuers may find themselves in to ensure that valuers have supporting guidance on how to behave and react in challenging circumstances. Furthermore, the RVS and State Appraiser Regulatory Agencies ensure that both the general public and the industry have a framework in place to enable complaints or unacceptable behaviour to be reported and pursued. The process for investigating such problems in both Brazil and China appears less established.

The wider process of client engagement or the broad scope of work is also loosely defined in the Brazilian and Chinese standards. Many appraisers in both China and Brazil reflected that IVS/Red Book clearly provides more contextualisation of the importance of detailing the terms of engagement prior to accepting an instruction and how this in turn can help safeguard the appraiser and strengthen their opinion on value. Proposed revisions to the ABNT standards will start to incorporate this engagement issue while the Chinese standards are likely to evolve further as industry practice shifts to reflect an increasing number of international players.
6.4.2 Valuation Bases and Definitions

When considering the valuation bases used in reports there was a variation evident across the four countries. All countries make reference to market value with this still the most commonly used basis of value for valuation reports. Most countries, with the exception of China, made reference to investment value or worth to an individual or corporation. However, despite the growing influence of international accounting and financial reporting standards, only the US and the UK made reference to fair value although Brazil is addressing this issue in their current revision of ABNT Part 1.

Some other locally specific bases of value mentioned in the local standards include insurance value and liquidation or forced sale value, the latter with specific definitions within both the US and Brazilian standards. The UK in contrast to the US and Brazil, actually prohibit the use of the term ‘forced sale’ as it potentially distorts the market value definition which requires any marketing constraints to be reflected in the terms of the engagement so it is clear that market value is not being provided. China explicitly only makes reference to market value within the standards but the wider industry is familiar with other bases and definitions of value from the IVS/Red Book but some of these are not currently applicable to the Chinese market position.

In terms of the market value definitions only the IBAPE and RICS Red Book adopt the IVS definition of market value. Table 6.6 shows how the market value definitions deviate from the IVS market value conceptual framework terms. From this table it is clear that in some cases there are semantic differences but the broad conceptual understanding is similar. In this regard, the US and China have clarified some aspects of the market value definition/outline either through other definitions (CIREA open market definition) or through additional clarifying conditions (USPAP footnotes).

<table>
<thead>
<tr>
<th>IVS MV Conceptual Framework</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
<th>RICS</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘The estimated amount...’</td>
<td>‘The most likely amount...’ ✓</td>
<td>‘The most likely price...’ ✓</td>
<td>‘A type of value, stated as an opinion...’ ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...a property should exchange...’</td>
<td>‘...payable for a good...’ ✓</td>
<td>1a</td>
<td>‘...that presumes the transfer of a property [i.e. a right of ownership or a bundle of such rights...]’ ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...on the date of valuation...’</td>
<td>‘...at a specific reference date...’ ✓</td>
<td>✗</td>
<td>‘...as of a certain date...’ ✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...between a willing buyer...’</td>
<td>✗ ✓ ✗</td>
<td>2a</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...a willing seller...’</td>
<td>✗ ✓ ✗</td>
<td>2a</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...in an arm’s-length transaction...’</td>
<td>✗ ✓ ✗</td>
<td>2c</td>
<td>2b</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...after proper marketing...’</td>
<td>‘...within current market conditions.’ ✓</td>
<td>1c</td>
<td>2c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...wherein the parties had each acted knowledgeably, prudently...’</td>
<td>‘...when consciously...’ ✓</td>
<td>1d</td>
<td>2a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘...and without compulsion.’</td>
<td>‘...and voluntarily negotiated...’ ✓</td>
<td>✗</td>
<td>‘...under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.’ ✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table Notes:
1 CIREA provides some further contextualization of the market value definition in their definition of open market. See below 1a-1d.
2a – relationship, knowledge and motivation of the parties (i.e. seller and buyer)
2b – the terms of sale (e.g. cash, cash equivalent or other terms)
1a – economic interest
1b – appropriate trading conditions
1c – necessary market information
1d – necessary expertise.
2 USPAP attaches certain conditions that may be applied to the MV. See below 2a-2c.
In other cases, the concepts of ‘willing buyer’ and ‘willing seller’ are excluded, most notably from the ABNT and CIREA definitions. This failure to make reference to two of the important underpinning principles of how market value is derived could result in a differing interpretation of market value in practice. Another important deviation from the IVS market value definition is China’s exclusion of the words ‘without compulsion’ which again can result in Chinese appraisers including either forced sales or sales that have resulted from coercion or other unreported restrictions. It is true to say that the Chinese market at present does not fully represent an open market and therefore the current definition reflects this. However, this is an issue that may need to be addressed as the market matures to ensure that international investors have confidence that the same bases of value and value definitions are being used to determine the valuer’s opinion.

There is some evidence of differing interpretations and level of understanding of market value within the four countries, especially China and Brazil. To some extent this confusion over the market value term can be linked back to the standards and the lack of adoption of the IVS market value definition within ABNT and the three Chinese standards. Furthermore, even within the established markets there has been some re-interpretation of market value in light of the global financial crisis. In this regard some valuers were uncomfortable reporting a low value and therefore have made additional special assumptions so the market value more closely reflects a stabilised market. This practice is not widespread but if it continues to creep into valuation assignments it could cause market distortions and become the market norm. In this instance consideration of other value definitions may be necessary including sustainable value or forced sale value provided these terms are well defined within the standards with clear guidelines on their use.

6.4.3 Valuation Methods and Reporting

One of the areas that showed the biggest variation in the valuation process was the valuation methods used and their supporting rationale. As outlined previously, the UK makes no reference to valuation methodology and leaves the selection of the method to the skill and experience of the valuer. However, appraisal practice in China and Brazil are very different and are heavily influenced by extensive and comprehensive coverage of methodology within their local standards. This includes a process-driven outline detailing how the methodology should be applied and the calculations that support this. Indeed, Brazilian valuation standards set the specific parameters which must be adhered to if a particular method is chosen and this often includes use of complex linear regression models to support their scientific approach to value. There is danger that the prescriptive methodological approaches apparent in Brazil and China place an over-reliance on a false science as the software models become the dominant factor rather than the skills of the valuer in determining the correct inputs and evaluation of outputs.

In the US, the USPAP standards make reference to methodology but do not adopt a prescriptive approach and instead focus more on the need to adopt three methods to support the value conclusions or explain why certain methods were not considered. This need to adopt more than one approach is also a feature of the CIREA standards in China, who advocate use of at least two methods. However, in both instances this creates a challenge for the appraiser in terms of the value reconciliation and therefore needs careful consideration in the training of new valuers. The personnel interviewed in all four countries agreed that they would not be in favour of the introduction of a standardised approach to methodology especially if this meant a mandatory approach other than those methods currently used in their country.

Table 6.7 outlines the minimum report contents advocated in the IVS and how this compares to that adopted in each case study country. There are a number of items that are common across all four countries namely, identification of the client, the valuation purpose, subject property, basis of value, date of valuation, investigations undertaken, information used to formulate the value opinion, valuation reasoning and the date and signature of the valuer. The UK adopts the IVS report content and therefore includes all the recommended minimum items. Beyond the UK there are some small variations with Brazil not stipulating the need to outline the interest to be valued, or disclose any material involvement or restrictions on the use or liability of the parties, China, aside from the UK, includes the most comprehensive number of items advocated by the IVS. This is somewhat surprising but to be applauded given the infancy of the real estate market and is probably reflective of the best practice consultations that were undertaken by the ministries prior to the crafting and implementing of the local valuation standards.

None of the standards stipulate the need to name the standards that the report complies with; however this is common practice in the industry despite not being a requirement of the standards. This suggests that industry practice has evolved to include more items than those recommended in the standards, often resembling the more comprehensive list advocated by the IVS. To some extent this has been influenced by the international clients who want to receive a similar style report no matter what country they are investing in and/or who the appraising company is. Interestingly, the IVSC is not advocating rigid templates to make all reports look alike, but rather focuses on the need to make reporting and the associated methods used, basis of value and accompanying rationale easily understood and disclosed.
### Table 6.7: Comparison of Minimum Valuation Report Contents

<table>
<thead>
<tr>
<th>IVS Minimum Report Contents</th>
<th>Brazil</th>
<th>China</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identification of the client</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Purpose of the valuation</td>
<td>✓ [when informed by the client]</td>
<td>✓ [when informed by the client]</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The subject of the valuation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The interest to be valued</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Property type &amp; how it is used by the client</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Basis or bases of value</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The date of valuation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Disclosure of any material involvement</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Statement of the status of the valuer</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Where appropriate the currency adopted</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Assumptions, special assumptions, reservations, special instructions or departures</td>
<td>Assumptions, qualifications &amp; limiting factors</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Extent of the investigation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Nature &amp; source of the information relied upon</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Restrictions on use, distribution &amp; publication</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Any limits or exclusion of liability to parties other than the client</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Confirmation valuation undertaken in accordance with standards</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Valuation approach &amp; reasoning</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Statement that valuer has knowledge skills &amp; understanding to undertake valuation competently</td>
<td>Qualifications</td>
<td>Qualifications</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Opinion of value in figures and words</td>
<td>Market diagnosis</td>
<td>Market diagnosis</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Signature &amp; date of valuation report</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

**Table Notes:**
3 When signing a report in the US an appraiser can only use the MAI or ASA designation after their name of the report if it is USPAP compliant.
In Brazil, China and the US there is the potential to present the appraisal report in more than one style, with one format presenting a simplified content and the other presenting all worked calculations, comparables and methodological assumptions. Furthermore, in Brazil the self grading of reports is mandatory to reflect the quality of information and valuer confidence and precision in the value opinion. Similarly, in China there is a detailed point scoring review process that is undertaken by the regulating authority to check the report content and its compliance with the standards. These variations in the reporting format and review processes demonstrate the difficulties faced in attempting to agree a standardised reporting format. Table 6.7 suggests however that there is more commonality in the broad report content across the four countries than first suspected.

In reality, the differences in the quality of information available and the state of property market immaturity means the value conclusions are often less robust in China and Brazil, especially when crafted using the technically driven methodological approach. However, it should also be noted that despite the US reports being the most detailed and lengthy there is a perception that some do not provide the level of interpretation associated with the UK. This often reflects the deeper understanding needed to fully capture market sentiments, which has always been an underpinning aspect of UK valuation reports. However, it remains more important to establish consistency in the valuation reporting within a country rather than across countries where local nuances will prevail.
6.5 Market Data and Transparency

The country specific chapters have outlined the individual position in relation to the maturity of the real estate markets. This section therefore focuses on the comparative differences between the established and emerging countries.

6.5.1 Real Estate Market Transparency

Table 6.8 clearly illustrates the disparity in terms of real estate transparency between the established economies of the US and the UK and that experienced in the tiered cities of Brazil and China. The US and UK rank in the top 10 (highly transparent) categories for all of the JLL sub-indicators, in recognition of their well regulated, data rich and long established real estate markets. In contrast, Brazil and China are still regarded as emerging or transitional economies that are slowly developing both the institutional regulatory frameworks and wider market data infrastructure to become competitive in international real estate investment.

The growing maturity of the investment markets is reflected in the good overall performance in the investment category with both Brazil and China now considered in the ‘transparent’ category. This increased investment transparency factor is attributed to the establishment of some index-linked benchmarks for both direct and indirect real estate investment. Another area that is showing good progress is the market fundamentals with solid rankings returned in the ‘transparent’ and ‘semi-transparent’ categories. This is reflective of the increasing amount of real estate market statistics and research that is available across various property sectors, although this remains patchy when moving into tier 2 or tier 3 cities.

The transaction process demonstrates a poorer overall performance within the index with only ‘semi-transparent’ or ‘low transparency’ returned across Brazil and China. This is linked to the quality of pre-sale information, confidentiality issues, professional ethics and provision of occupier services. Similarly, the regulation and legal sub-indicator performance falls in the ‘semi-transparent’ or ‘opaque’ categories. This relates to some problems with consistency of the tax and building codes, information available for foreign investors, availability of title deeds and wider debt regulation. However, both Brazil and China have improved their overall rankings from the 2010 JLL index; with Brazil tier 1 cities moving from 38th to 27th and China tier 1 cities moving from 45th to 32nd. China also improved in tier 2 cities (from 54th to 46th) and tier 3 cities (from 65th to 55th) demonstrating that improvements are present even beyond the tier 1 cities in the more remote markets. Undoubtedly, the improvements in transparency within both Brazil and China can be linked to the need to show international investors that institutionally governments are addressing the issues that may concern foreign investors and in turn make their respective countries more competitive in the global markets.

Table 6.8 Comparison of Country Ranks in JLL Transparency Index

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Brazil Tier 1</th>
<th>Brazil Tier 2</th>
<th>China Tier 1</th>
<th>China Tier 2</th>
<th>China Tier 3</th>
<th>US</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment performance</td>
<td>28th</td>
<td>28th</td>
<td>23rd</td>
<td>23rd</td>
<td>23rd</td>
<td>2nd</td>
<td>1st</td>
</tr>
<tr>
<td>Market fundamentals</td>
<td>17th</td>
<td>42nd</td>
<td>19th</td>
<td>72nd</td>
<td>32nd</td>
<td>1st</td>
<td>8th</td>
</tr>
<tr>
<td>Governance of listed vehicles</td>
<td>29th</td>
<td>29th</td>
<td>54th</td>
<td>54th</td>
<td>54th</td>
<td>=1st</td>
<td>5th</td>
</tr>
<tr>
<td>Regulation and legal</td>
<td>40th</td>
<td>40th</td>
<td>48th</td>
<td>57th</td>
<td>87th</td>
<td>7th</td>
<td>9th</td>
</tr>
<tr>
<td>Transaction process</td>
<td>32nd</td>
<td>32nd</td>
<td>64th</td>
<td>76th</td>
<td>83rd</td>
<td>9th</td>
<td>7th</td>
</tr>
</tbody>
</table>

Opaque  Low transparency  Semi-transparent  Transparent  Highly transparent
6.5.2 Data Quality and Availability

There are still some substantial differences in the amount and quality of data in emerging versus established economies. In both Brazil and to a lesser extent China, appraisals are still often based on asking prices rather than transacted prices. However, primarily led by the large real estate consultancy firms there is now greater coverage of real estate market information, beyond tier 1 cities in both countries. This information is still primarily focused on the residential and office sectors, but slowly is extending to include some segments such as industrial, shopping centres and retail properties. Furthermore, there have been some additional data providers beginning to emerge which present statistics and indices on both investment and transaction based data. Market maturity and international investment will ensure that this data quality and availability increases further over the next few years as both Brazil and China expand their real estate markets beyond the dominant domestic investors.

6.6 Comparison Concluding Remarks

In general, there are some local nuances that need to be considered if investing into either Brazil or China, notably the differing legal terms and tenant rights. However, from a wider real estate market perspective these emerging economies offer attractive returns for investors but these higher returns need to be balanced against the regulatory, political and institutional risks that the country may pose. China and Brazil offer potential opportunities to undertake large scale developments within markets that do not suffer from the planning constraints or the enabling infrastructure delays that hold-up many development projects in established economies. However, these emerging countries continue to be highly influenced by local culture and government controls, many of which are not fully understood outside of their home country. Sound market research and due diligence are therefore essential in uncovering local practices, although in time as these emerging markets mature institutional and practice based differences will lessen.

The emerging market countries are undoubtedly at a different stage of development than established markets, but there are signs that both Brazil and China are moving towards established market practice. The standards in Brazil and China remain technically and methodology focused, but there is increasing acceptance of IVS/Red Book valuation standards for international investments. Similarly, there is also growing recognition of the importance of ethics and appropriate codes of conduct in governing the valuation profession in these countries that will persist, as both real estate markets continue to develop. However, the presence of more than one valuation standard in both Brazil and China and how these standards are only binding on certain professionals lessens international investor confidence.

Similarly, the dominance of the engineering and architecture disciplines in undertaking valuation services in Brazil and the separation of land and building valuations in China creates some unnecessary confusion. Although the presence of some form of regulatory licence or certificate in each of the four countries does at least demonstrate a measure of competency and potential enforcement against malpractice. Furthermore, the active role taken by all the local valuation professional bodies in setting threshold standards to qualify for membership and the need for on-going training shows a universal commitment to maintaining the integrity of the valuation profession.

The methodological differences between countries, continues to remain a challenge not only for valuers operating across borders but also for investors seeking to operate in other real estate markets. This is further complicated by the need for some form of value reconciliation due to the use of more than one method or the reliance on science based approaches which do not always mirror the market. A similar issue is faced across countries by the different valuation reporting styles, minimum report content and depth of supporting analysis undertaken. Given the attachment to the respective local valuation methods and reporting styles it is unlikely that this position will change in the short term, although these gaps are narrowing. Furthermore, there appears to be some complementarity between international and local standards if the ethics and valuer responsibilities utilised at an international level are followed and complemented by the local valuation approach and reporting style. In contrast, there appears less complementarity on the valuation bases and definitions of value. Some of these definitions are not properly detailed in the valuation standards leading to the local market players devising their own definitions which can be inconsistently applied. Conceptually, market value is generally understood across countries, but the use of different terms does create semantic differences which can lead to inconsistency and could be overcome by universal adoption of the IVS definition.

There remains a clear disparity in the level of real estate market transparency and the quality or sources of data used to support the value determination across the four countries. Whilst the US and UK continue to lead the way on transparency and data availability the likes of Brazil and China have been making slow progress. However, there is evidence to suggest that within tier 1 cities the level of transparency is increasing and both countries are resolutely trying to rectify issues of enforcement, fraud, malpractice and data shortages in a real estate context. This process has been helped by the presence of ‘big brand’ real estate consultancies and a greater awareness of international investor requirements for institutional oversight and valuer consistency.
7.0 Conclusions

7.1 Introduction

This chapter outlines the key messages emanating from the earlier chapters of the report and summarises the respective positions of each case study country. Message boxes have been used to encapsulate the key conclusions with a discussion provided in the subsequent text.

7.2 Regulatory Environment

Key Messages

This section focuses on the key messages the report delivers in relation to the regulatory environment, including the importance of understanding the legal systems, the broad complementarity of local and international standards, the need to tighten valuation enforcement mechanisms, the need to avoid using standards as a means of protectionism and the increasing importance of public indemnity insurance and reducing valuer liability.

7.2.1 Key Message 1: There is a need for more international understanding of the local legislation and legal systems governing real estate

Real estate markets are often governed by complex legal systems and various local statutes which differ considerably from country to country. Failure to grasp these locally specific legal requirements can complicate and delay real estate investments and development as well as the procurement of valuation services.

It is clear that the four case study countries operate vastly different legal systems which establish the broad legal framework, in the form of local statutes governing real estate activities. These statutes influence the buying and selling of property, landlord and tenant responsibilities, the transfer of ownership or land use rights and the insertion of any specialised clauses into conveyancing documentation. The legal system also provides assurances to prospective buyers that recourse action can be taken in the event of breach of contracts or conditions. Given the substantial financial outlay involved in real estate transactions, there remains greater need to ensure due diligence in understanding the legal frameworks and local statutes operating in each jurisdiction. This could be aided by the local professional bodies through the preparation of an overview to conveyancing and real estate law for distribution amongst potential foreign investors to help alleviate any concerns or legal risks they might otherwise attach to a real estate investment in another country. It is therefore essential that real estate investors are able to access appropriate legal information to aid their decision-making process and ultimately ensure a smooth route to property ownership.
7.2.2 Key Message 2: There is a belief that international and local valuation standards can complement one another

Despite the existence of international and local valuation standards there was a shared belief by research participants that these tiers of standards could complement each other in both content and practical influence.

The IVS is recognised as the key international valuation standard which applies in many countries and often acts as the basis or foundation for all appraisal activity. Similarly, at a local level there often exists a further tier of standards which can operationalise the international standards in terms of content and practical influence. This broad complementarity between the two tiers of valuation standards was often cited by research participants. Their view was that international standards provide the underpinning valuation principles to be followed whereas the local standards add to these principles through illustrating practical application. The linkage between theory and practice is further articulated depending on the relative maturity of the market and the extent to which an open and transparent real estate market exists. In this regard, China and Brazil favour a more detailed local standard which is prescriptive in advising the valuer/appraiser on what they should do but contains less detail on the engagement process, ethics or valuer responsibilities. It is this latter element that enables the broad complementarity between the local and international standards as the IVS provides a detailed overview of the scope of work, terms of engagement and broad ethical arrangements. The local standards within these emerging markets on the other hand can continue to focus on the valuation process, report structure and articulation of the valuation methods. This complementarity is further evidenced in mature markets through the Red Book, which now replicates the IVS in its entirety, and USPAP which incorporates many IVS compliant principles.

7.2.3 Key Message 3: Enforcement procedures for non-compliance need to be tightened

The effectiveness of a regulatory enforcement method such as licenses or certification is diminished if not accompanied by regular checks for non-compliance with the standards or code of practice of the professional body.

Across all four case study countries there was some form of licence or certification system designed to measure and reward valuers/appraisers who have attained the necessary standards of knowledge and competency needed to act in the public interest. These systems are also designed to intervene if a valuer/appraiser is found to be acting in a way unbefitting of the profession or in not complying with the relevant valuation standards. However, across the four countries, whilst enforcement mechanisms and penalties for non-compliance exist, there was variable evidence of direct intervention or checks conducted to uphold professional integrity of the industry. It is therefore clear that a greater focus is needed to identify and penalise those found to be acting in a negligent or fraudulent way. There was a consensus across research participants that a falling market exposes bad practice and the importance of eliminating any malpractice or fraud. This should be based around ensuring the regulatory environment in which valuers practice is strong, well policed and subject to regular checks and audits.

In many cases the complaints procedure relies on whistle blowers or random checks and this needs to be strengthened to ensure the appropriate financial resources are allocated in an effort to improve the reputation and competency of the valuation profession. If the enforcement procedures are not viewed as effective by industry professionals or the general public, the reputation of the valuation profession as a whole can quickly become affected, and confidence lost. The ability of the profession to self-regulate through its professional bodies or associated agencies could be called into question in the same way as the financial and accounting sectors before the introduction of the International Financial Reporting and International Accounting Standards. Such an intervention by governments would severely affect real estate operations and confidence in the industry as a whole. Therefore, initiating action to ensure the regulation and enforcement of those failing to meet the standards laid down by industry is more effective and efficient, and should help safeguard the self-regulatory environment under which real estate currently operates.

7.2.4 Key Message 4: There is a need to avoid using valuation standards as a form of local protectionism

There is evidence to suggest in some countries that local valuation standards, reinforced in some cases by local statutes, have been used as a form of protectionism for their local professionals against foreign valuers. This practice is not in the public interest given that valuation companies are supplying a public service.

The role of engineers and architects in delivering valuation services in Brazil as laid down by statute, the linkages between Chinese professional bodies and government in controlling valuation practice and the exacting standards laid down by the Appraisal Institute can be viewed as a form of protectionism as it makes it difficult for non-residents to qualify for a licence or certificate. This practice alongside the complex methodology driven standards which often focus on a science based approach make it difficult for foreign valuers to follow, necessitating a local partner with knowledge of local standards and practice. Whilst this is commendable from an employment perspective it means the market does not operate under free trade and competition principles and can therefore prevent the general public or wider real estate industry from getting the best price for the valuation services that they seek.
This practice is not in the public interest and therefore needs to be broken by looking towards international valuation practice as a means of introducing the common principles and the base competencies needed to operate as a property valuation professional.

7.2.5 Key Message 5: There will be continued growth in professional indemnity insurance and clauses to limit valuer liability within emerging markets

The practice of valuers being challenged through the Courts or Tribunals for failing to accurately reflect market shifts will become more prevalent in emerging markets. This will necessitate widespread professional indemnity insurance cover and the insertion of valuer liability clauses into the terms of engagement.

The emerging markets of Brazil and China have a limited culture of valuers being sued or their valuations being challenged through the courts. However, as the two markets mature and foreign investors become more predominant the need for professional indemnity insurance cover will become increasingly important. Similarly, local valuers also recognise the importance of limiting their liability to ensure that in the event of a client suing the valuer for an incorrect market value opinion that the claim does not put them out of business or that insurance premiums do not become punishing. This practice is common in the UK and US with liability clauses becoming widespread and PI insurance a necessity for all RICS regulated firms. The RICS in Brazil is already exploring the potential to introduce a collective industry policy which could be offered to their members similar to that in place in Brazil for professions such as dentistry. There is also increasing evidence that more valuers are being asked to sign confidentiality agreements which will prevent them from sharing information on the details or value of specific deals with any other market players. Such agreements will further reduce the availability of comparables and could reduce the confidence levels of valuers in reflecting the current market position and thereby increase the need for further liability clauses to be inserted into the terms of engagement.
7.3 Education and Training Key Messages

This section focuses on key messages relating to the education and training of professional valuers/appraisers across the case study countries. These messages centre on CPD activities, education backgrounds, wider investment and capital market interpretation and the need to improve the valuation professions image.

7.3.1 Key Message 6: There is a mutual interest in understanding each other’s local valuation practice

Despite a universal reluctance to change local valuation practice, each country felt they could benefit from understanding each other’s methods, approaches and reports to be in a better position to reflect international practice.

Each case study country remains deeply proud and protective of their local approaches to property valuation; however there is recognition that they cannot operate in isolation to the practices followed in other countries especially that accepted internationally. This is becoming more significant with the influx of foreign investors who often stipulate the use of IVS or Red Book standards or the production of internationally compliant valuation reports. Emerging markets such as Brazil and China are therefore recognising the importance of learning more about the IVS or Red Book standards, with some local professional bodies running courses to raise awareness. Likewise valuers in developed countries are seeking to become more aware of the local valuation practice and standards of developing countries. It is therefore important that as part of the training and education of new valuers/appraisers that more emphasis is placed on international valuation practice and gaining an understanding of how the valuation process is approached in other countries. This could be introduced as CPD short courses or through collaborative linkups between the local professional bodies and foreign firms.

7.3.2 Key Message 7: The prevalence and influence of valuer CPD activities differed greatly across countries

Continued Professional Development (CPD) activities should be made more valuer specific to ensure they keep abreast of new developments or changing valuation practice, especially the growing influence of IVS.

To help keep pace with the rapidly changing real estate industry and its impact on the valuation profession there is a stronger need for CPD activities to be tailored specifically to valuers. At present, the UK and the US through the RICS and the Appraisal Institute respectively ensure members undertake a specified number of CPD hours to demonstrate a commitment to on-going skills development. However, it is left to the discretion of the valuer to decide what courses to attend, with the only stipulation laid down by a professional body being the requirement of the Appraisal Institute for appraisers to undertake regular ethics training. Within emerging markets the requirement to undertake upskilling is even less defined. There is a need to ensure valuation/appraisal specific CPD activities are undertaken regularly as a means of renewing the knowledge of valuers to reflect increasingly important issues such as sustainability, valuation in a thin market or changes in the local or international standards.

7.3.3 Key Message 8: The educational backgrounds of valuers remain diverse and this in turn influences the valuation philosophy adopted in specific countries

In some countries the valuation profession is fed by non-cognate disciplines such as architecture, engineering, economics or business rather than dedicated real estate degrees. These academic disciplines therefore often influence the philosophy of local valuers in terms of their willingness to adopt a ‘science’ or ‘art’ based approach to valuation practice.

The nature of real estate and its broad business foundation enables many disciplines to provide graduates capable of understanding property market dynamics and undertaking property valuations/appraisals. Whilst this is an obvious strength of the industry it can also be a weakness especially if the underpinning fundamental principles of property valuation/appraisal are not properly understood. Often some of the broader technical focused disciplines such as engineering or architecture adopt a more objective and science based philosophy to valuation which can fail to mirror market performance. The adoption of this science based approach which follows prescriptive methods often impacts on the willingness of valuers/appraisers to employ judgement and consider market sentiment in determining value opinions. Market sentiment and valuer judgement belong more in the valuation art philosophy and are less evident in Brazil and China. Given that international practice places a continued emphasis on market sentiment and valuer judgements, there is a need for emerging markets to gain a better awareness of the art-based valuation philosophy. This is especially important in terms of understanding how investor sentiments start to reflect the initial signs of shifting market trends.

7.3.4 Key Message 9: Traditional valuer perceptions of real estate as bricks and mortar needs to change to reflect its increasing role as a financial asset which requires greater interpretation of capital markets and the wider economic climate
There was a wide variation across the case study countries on how much interpretation is included in valuation reports on market cycles, the capital market and the wider economic environment, particularly how this influences value.

Valuers should have a wider appreciation of how movements in bond yields and interest rates can influence real estate valuation and pricing. In this regard valuers should be capable of considering the role of real estate as a financial asset and how to interpret market cycles to provide a more detailed commentary on market trends within the valuation reports. A more in-depth market commentary section was welcomed by both the investment and banking sectors interviewed as part of this research as they felt valuers were ideally placed to provide advice on financial prudence and the economic context to the property market. This would necessitate an extension of the market context to fully reflect both macro and micro economic circumstances, wider capital market indicators and their impact on property values.

7.3.5 Key Message 10: There is a need to increase the number of young people choosing valuation/appraisal as a professional career through improving the image of the profession

Across all four case study countries there was a growing recognition that the valuation profession is ageing and that steps need to be taken to ensure real estate appeals to young graduates.

The appeal of real estate and in particular valuation has been damaged by the 2007 global financial crisis and the outward negative perception that real estate and sub-prime mortgage lending and associated debt vehicles were central to this crash. This reduction in demand has been felt across many real estate programmes and is only now starting to stabilise as markets enter into recovery. There is also a clear disconnect between young students and how they perceive the valuation pathway as a career option which needs to be addressed in order to meet with international demand for valuers. This can be in part facilitated by the professional bodies engaging more with schools and colleges to publicise the profession and its diversity as well as illustrating the professionalism associated with the real estate industry. However, selling the career pathway to young people is often further hindered by negligent actions and unethical behaviour that sometimes exists and which needs to be regulated and brought under the professional code of conduct practised by the wider valuation community. Placing the full suite of real estate activities including agency, valuation and investment under the regulatory environment should ensure the professional status of the industry can be established to a level enjoyed by other professions such as lawyers, accountants and architects.
7.4 Valuation Definitions and Interpretation Key Messages

This section summarises the key messages arising from the use of various international and local definitions of value and how these often get re-interpreted within local contexts. In particular it focuses on the need for a common international valuation language, the role of market value as the preferred basis, the adoption of IVS and the limited understanding of fair value.

7.4.1 Key Message 11: International Common Valuation Language Needed

There was universal agreement on the need to introduce an international common valuation language that removed any interpretation differences in the use of terminology across countries.

Many research participants pointed to a lack of an international common language as one of the main reasons for different interpretation and application of the key valuation terms such as market value, yields, implicit or explicit growth etc. In this regard valuation terminology was often well understood within a country but much less so when applied from a cross border perspective. The subtle differences in valuation terminology that occur within countries are reinforced through local practice and soon become established norms but these local nuances may not have wider applicability when considered internationally. It is therefore imperative that the IVS and all local valuation professional bodies agree on an internationally accepted common valuation language which can eradicate any local nuances that would otherwise skew the valuation. This could mirror the approach being adopted in relation to measurement standards and the establishment of International Property Measurement Standards (IPMS) group which is supported by the RICS, the World Bank, BOMA and CoreNet Global amongst others. A similar move to internationalise valuation terminology would appear to gain widespread support.

7.4.2 Key Message 12: Market Value remains the preferred valuation basis but some local interpretation variations are evident

Market value remains the most common and preferred valuation basis across the four case study countries despite the number of alternative value definitions including fair value, investment value, forced sale value, mortgage lending value and liquidation value. However, the volatility of the market post 2007 has resulted in some alternative interpretations of market value.

Research participants were questioned on their preferred valuation base and were universal in their agreement that market value still provides the most appropriate basis upon which to formulate a value opinion. However, when valuers were queried about the impact of the global financial crisis on market value, some pointed to small pockets of valuers who in light of limited market comparables, would be reluctant to label the low values as market value. Instead, some valuers have incorrectly used the term forced sale value to denote the situation whereby market values are considerably lower than that which the market once traded at. In this regard there was a consensus that valuers across all four countries were relatively consistent at reflecting economic uncertainty within their cap rates but much slower in showing shifts in market rents to reflect the weaker occupational market. Valuers were not in favour of adopting the German mortgage lending value approach which smooth’s the real estate cycle, as they felt the actual value gets lost and the market no longer reflects market value. It is therefore important that more training is given to valuers of how to interpret market value in a thin market in which comparables are scarce and the wider economic evidence base is absent. The RICS issued some guidance but more information and checks are needed to ensure market distortions are not occurring.

7.4.3 Key Message 13: The role of the IVSC is becoming better understood but there remains limited full adoption of the IVS market value definition in local standards

Across all four case study countries there is increasing recognition given to the importance of the IVS and how this influences international practice. However only 2 out of the 7 local standards examined in this study have fully adopted the IVS definition of market value.

There is evidence to suggest that the IVS and the role played by the IVSC is gaining in support and awareness. However, this still does not translate into local valuation standards through the full adoption of the IVS market value definition and associated sub-components. Indeed, when the local standards were analysed there was further evidence that some standards leave the definition of market value quite vague and therefore open to loose interpretation. Furthermore, some local standards fail to fully define other bases of value which results in increasing use of informal definitions in industry which are inconsistently applied. There needs to be a renewed drive from the IVSC, supported by local professional bodies, to formalise all valuation terminology within local standards and ensure as far as possible that this is clear and transparent and not open to loose interpretation. Through the implementation of clear definitions the wider real estate industry can regain some public confidence that all valuers are practising under a rigorous quality assurance framework which is universally applied within a country.
7.4.4 Key Message 14: Limited understanding and reference to Fair Value across the local standards

Fair value since its introduction has remained a difficult concept for valuers to grasp and this lack of understanding is still evident with many valuers exercising the adoption of market value even when asked for the former. The role of a special purchaser therefore requires greater clarity to ensure fair value and market value inconsistencies are minimised.

The research participants showed that there remains limited understanding of fair value as a valuation basis and how this differs from market value. This confusion is not helped by the fact there are two different definitions of Fair Value in the market. The first given by IASB through IFRS 13 more or less equates to market value whereas the IVSC definition in their IVS allows a special purchaser to be taken into account and therefore can produce a value greater than market value. Despite clarification papers issued by both the IVSC and RICS, the valuation profession as a whole have been slow to recognise the clear distinction which enables fair value to take into account the two parties and any special relationship. This may result in a higher value than that obtained using the market value definition where special relationships are to be ignored in favour of what the wider market would pay. Whilst in many cases the use of fair value and market value may amount to the same, there are an increasing number of special circumstances from a corporate perspective where fair value may command a different value. The failure of the market players, in particular property valuers to make this distinction diminishes the impact of fair value and its importance from a business valuation perspective.
7.5 Valuation Standards and Practice Key Messages

This section focuses on the key messages regarding valuation standards in operation and how these influence local practice. Specifically, it outlines the need for valuation consistency within countries, the existence of a 2-tier market, the lack of demand to standardise methodologies, value reconciliation training, reporting style and content differences, a summary valuation cover page and global improvements in data availability and market transparency.

7.5.1 Key Message 15: Valuation Consistency operates at two distinct levels i.e. within and across countries

The desire for valuation consistency is most prevalent within a country as this ensures the market is operating efficiently and is targeted by banks and local investors who expect valuers to respect local customs and traditions over international norms unless otherwise instructed to do so. However international investors remain concerned with consistency across country borders so that portfolios are valued on a similar basis, hence the use of large property consultancies to deal with investor activities.

It was evident from the research participants that valuation consistency was an issue that they were concerned about but often more from within a country perspective in terms of making sure that the same principles and methods were being applied to a local market. In this regard both banks and local investors gained confidence from the knowledge that the same approach and standards were being applied across all properties being valued in their country, so that the market was valued on the same basis with the same techniques. This ensures that there are no market distortions as a result of differing methods or the inclusion of different valuation variables. Concern on how valuation approaches could potentially differ across countries was reflected by international investors especially where the use of local methodologies could result in a different market perspective to that reflected in their own country. To avoid unfamiliar techniques being imposed on local valuers international investors seek the expertise of the large property consultancy firms. The acceptance of local methodologies to ensure local consistency within a country from a local valuation perspective further relegates the role of international standards to the broad underpinning principles and ensures that local standards remain the means by which valuations/appraisals become operationalised. Likewise cross country valuation consistency supports the need for professional bodies to continue the education process of local firms in the IVS/Red Book approach to enable them to compete with the international consultancies and narrow the gap between local and international companies as discussed in key message 16.

7.5.2 Key Message 16: A 2-tier market is evident with the leading international property consultancy companies dealing with international clients

Across the case study countries there is a clear dominance of ‘big brand’ property consultancies companies for international clients which can be traced back to the client demand for IVS or RICS Red Book standards to be used. This is further reflected in the market place with those properties capable of attracting international pension fund investment priced at higher market values than those appealing only to local investors.

Each of the case study countries has the presence of a number of the leading international property consultancy companies (e.g. CBRE, Colliers International, Cushman and Wakefield, DTZ, JLL, Knight Frank or Savills) who increasingly are commissioned by international clients seeking overseas investment opportunities. This in part ensures valuation consistency as discussed in key message 15, as well as promoting continuity in appraisal practice across a diverse property portfolio. This dominance by the leading large consultancy companies has created the 2-tier market situation whereby the local standards are applied by the local companies for local clients whereas international clients seek the reassurance of international norms through the employment of larger internationally branded companies. This position is altered somewhat in the emerging markets, by either the legal requirement for engineers and architects to apply local ABNT standards (Brazil) or the ranking of local firms according to their size, geographical remit, experience and expertise (China). In both instances, these additional requirements lessen the impact of the large consultancies and enables local firms to compete. It is also interesting to note that especially in a Brazilian context, where the local standards seek the adoption of a complex methodology, local firms are often sub-contracted by international companies to undertake the valuations. This clearly indicates that the quality of work undertaken by the local firms is at least equal to that of the international companies and in many instances the report merely gets rebranded under the international company’s corporate image. The comparability of local and international reports, in terms of quality and content, needs to be safeguarded to ensure that the gap between the practice of international and local companies continues to narrow, with training initiatives such as those undertaken by the RICS in Brazil starting to alter perceptions.
7.5.3 Key Message 17: There is no appetite to standardise the Valuation Methodological Approach

Each country is committed to learning more about international valuation practices but this does not translate into a desire to standardise the valuation methodologies applied in each country.

In contrast to key messages 1 and 2, there is no appetite to standardise valuation methodologies across countries. This can be traced back to the different art and science philosophical approaches adopted which reflect not only the level of maturity in the real estate markets but also the academic disciplines which feed the valuation/appraisal profession. It appears that the long established methodological history in each country reduces the aptitude to change, but perhaps of more significance is each country’s resolve that their valuation approach is ‘best’. Given that the education and training of valuers is reflective of local customs and methods then it remains unlikely that a change in valuation approach would be welcomed, especially as the main driver for change is to appease international investors and to ensure some form of comparability across real estate markets. In this regard, there is a danger that enforcing change on local valuers could lead to widespread confusion which may have the opposite from the desired impact of improving consistency and comparability. Instead it is hoped that a greater awareness of each other’s methods, cultivated through the recommendations in key messages 6 and 11 could improve consistency without the need to alter established methodologies. Furthermore, improving access to market data and establishing more rigorous interrogation and analysis of the values should result in further improvements in valuer consistency whilst working within the remit of present local valuation methodologies.

7.5.4 Key Message 18: Greater guidance needed on value reconciliation where more than one method has been used especially in thin markets

Some standards advocate the use of a minimum of 2 or more methods in determining the value judgement which then requires some form of value reconciliation to finalise the value presented in the report.

The US, Brazil and China valuation standards all specify the use of two or more methods to provide a means of checking the valuation being undertaken. However, there is limited guidance within the standards of how to reconcile these values in the event that they do not arrive at broadly the same figure. Given that the values could differ substantially it then becomes a skill and judgement issue for the valuer to determine which value best represents the market. Most standards give preference to using comparables to calculate market value, but during times of recession when there is limited transaction data or comparables it makes valuer judgements and assumptions even more important. The increasing number of court challenges that many valuers now face makes value reconciliation even more important to ensure a valuer/appraiser can defend their representation of the market position. There is therefore a need for the professional bodies in countries that propose the use of more than one method to provide more guidance on how these values should be evaluated against one another to justify what value is reported as the market value in the valuation report.

7.5.5 Key Message 19: The difference in reporting style and content across countries is narrowing

The level of sophistication and reasoning provided in valuation reports is growing across all case study countries to reflect both increasing data availability and market maturity.

The valuation reports produced in each case study country are reflective of the minimum content guidelines laid down in the local valuation standards. There is now much more commonality in terms of the broad content covered in valuation reports and the overall style adopted in presenting the information. This in part is down to client influences who actively seek more conformity across countries but also due to increased data availability and market maturity within the emerging economies. The US and UK appraisal reports are still the most detailed in terms of the amount of information that is presented and analysed, but the evidence collected through this research suggests that many reports produced by valuers in both Brazil and China are technically proficient and are capable of capturing the market position. As the emerging markets improve their data availability and quality further it is anticipated that reports could become more uniform and comprehensive in their style and content. Where these reports perhaps differ reflects the technical detail of the local standards with Brazil requiring appraisers to review their report and grade it according to its reliability, depth of data and overall impact and China requiring a points scoring review to determine if the report has compiled with the standards. There are also two styles of reports in operation across the US, Brazil and China which enables the material to be presented in both a summary and detailed style according to client demands.
7.5.6 Key Message 20: There is support for inclusion of a one-page summary to capture the value and underpinning assumptions

The sheer length and depth of detail in many valuation reports can result in key messages being lost in the content which could therefore benefit from a one-page summary at the beginning of the report.

The research participants in particular the users of valuation reports (banks and investors) felt that a one-page summary of the value determined and the underpinning assumptions made would be a useful addition to valuation reports. This would enable important information on the valuation base, methodology and assumptions to be summarised upfront so that these can be at the forefront of the reader’s mind as they make their way through the valuation report. Given that the assumptions made, whether they reflect special assumptions or not, are a vital influencing factor in the value determined, these are too often hidden in the report and not always transparent to the reader. Furthermore, many investors felt that their investment behaviour and decision-making was not fully understood from either a banking or valuer perspective, leading to incorrect assumptions being made in valuation reports. Therefore the one-page summary of the key assumptions and factors influencing the value determination could help ensure that the correct assumptions are recorded and that market values are not distorted.
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