

The Time Is Right for **Global** *Standards*

What is the relevance of global issues to the real estate appraiser in Topeka, Kansas; Oswestry, England; Woolloomooloo, Australia; or Xian, People's Republic of China? Making the connection between traditional local markets and the e-driven global market is often difficult, but over time international events will affect national markets and, eventually, local markets.

Estimates of foreign direct investment (FDI) vary, but the annual figure may be in excess of \$1 trillion (U.S.). The U.K. Economist Intelligence Unit estimates that the property component, including both direct and indirect investment in real estate, might comprise 5 to 20 percent of total FDI. Thus, property is a significant factor in global business. It is often used as collateral in bank lending, and the occasional volatility of property markets in recent years has contributed to the economic turbulence of stock markets around the world.

Recent comments about the relevance of property asset valuation illustrate the need for uniform international standards:

“Interviews with large institutional investors... reveal the following areas where international disclosure practices are considered most wanting:... methods of asset valuation...” - Professor Frederic Choi, *Accounting and Business*

“I note there is broad support for the development of standards of best practice for other financial sectors, comparable to those the BIS has established for international banking...but we need new or strengthened standards for...asset valuation.” - Peter Sutherland, Chairman of Goldman Sachs, 1998 per Jacobsson Lecture.

“Widely accepted norms have not been developed for asset valuation despite its importance for financial stability.” - *G10 Working Party Report on Financial Stability in Emerging Market Economies*, 1997.

Many national valuation and appraisal societies are asking whether they can do anything to influence international events that could one day impact their members. Should they spend time and money attempting to influence global initiatives, or should they simply stand back and wait for change to happen?

International appraisal methodologies and standards will percolate down to national and local appraisal standards. The time is right for national standard-setting bodies to influence what is happening internationally before it is too late.

WHAT ARE STANDARDS?

Property is one of the basic factors of production and land and buildings are the most tangible (touchable) assets of property. Valuation is the skill of putting a price on property. Accuracy, consistency and transparency—the three cornerstones of reliable asset pricing—are needed to assess the value of property for owner occupation, investment, capital markets or loan security. This is a recurrent theme in countries where high-quality, comprehensive standards are already in place and in emerging nations finding their way in the capitalist system.

It is important to identify the difference between “standards” and valuation “methodology.” Standards should be constant, a benchmark of “good practice.”

Methodologies are dynamic, changing with need, fashion, demand and analytical techniques borrowed from other fields. Methodology belongs to the textbooks, on an academic level, and in the valuer’s tool box, on a practical level. Essentially, however, methods are derived from the marketplace. Valuers analyze transactions and apply the data to the appraisal of a property. The techniques applied reflect those used by the market.

Standards, on the other hand, are rules imposed by personal conscience, by national professional institutions or by law. These rules cover conduct, ethics and competency issues such as:

- The basis of valuation
- The stated purpose of the valuation
- Competency tests (i.e., relevant experience for that type of property in that location)
- The valuer’s responsibilities
- The extent of due diligence and inquiries
- Disclosure when accepting instructions
- Disclosure in the body of the report
- The reasonableness of limitations and stated assumptions
- Explicit coverage of the valuation process and rationale

THE “RED BOOK”

The development of USPAP and its application and limitations are familiar to U.S. appraisers. The development of standards in the United Kingdom came about in a similar way, born as a result of commercial and regulatory pressures. The Royal Institution of Chartered Surveyors (RICS) initiated the development of an improved set of standards in the U.K following the 1974 property crash.

Fueled by cheap money, the building boom of the preceding two years resulted in overdevelopment, which in turn led to the disappearance of occupier demand and created a free fall in property prices. The property market froze for nine months, and banks, investment trusts, property companies and speculators lost a lot of money. This precipitated a loss of credibility for the valuation profession.

The RICS commissioned a new set of rules, which was published in 1976

under the title “Guidance Notes on the Valuation of Assets.” This document became known as the “red book” and was endorsed by the Bank of England, the London Stock Exchange, the City Panel on Takeovers and Mergers, banking associations and others. The red book also was taken up by the Commonwealth countries, particularly in Africa and the Far East, and served as a template for national standards for many countries on those continents.

However, complacency set in and some failed to realize that standards need to adapt to meet user expectations. A reprise of the 1970s boom-and-bust scenario unfolded in the late 1980s and the first half of the 1990s. Once again, valuers took the brunt of



criticism for banking losses and some high-profile litigation ensued.

One of the most heavily publicized disputes about valuation occurred with respect to the Queens Moat Hotels portfolio, which was valued in the early 1990s by one firm at about £2 billion and, a year later under similar market conditions, at about £800 million. A Department of Trade & Industry enquiry followed, the results of which have been held back pending the outcome of litigation on related matters.

The RICS, aware that the red book was either deficient or that valuers were not adhering to its rules, commissioned

The International Valuation Standards Committee (IVSC) was founded in 1981 and is an NGO (Non-Government-Organization) member of the United Nations. The organization works cooperatively with member States, organizations such as the World Bank, OECD, International Federation of Accountants, International Accounting Standards Committee, and others including more than 50 valuation societies throughout the world to harmonize and promote agreement and understanding of valuation standards. IVSC's international headquarters is in London, England. Its operational headquarters is customarily located in the offices of the IVSC Chairman. A new Chairman is elected every three years. The current chairman, Greg McNamara, is from Australia. Financial matters and orders are handled at the Committee's international financial bureau in Canberra, Australia. (www.ivsc.org)

The European Group of Valuers Associations (TEGoVA) represents the interests of professionally qualified valuers of land, buildings and plant and machinery in Europe.

TEGoVA is comprised of 37 professional bodies from 26 countries. Among the purposes of the organization are to write and promote valuation standards for application across Europe; recommend a standard approach to valuation methodology; transmit views to the International Valuation Standards Committee (IVSC) on issues of common interest; and encourage enhanced education of valuers in Europe. (www.tegova.org)

Royal Institution of Chartered Surveyors The RICS is one of the largest professional associations in the world, with a membership of some 100,000 comprising 75,000 chartered surveyors and 5,000 technical surveyors as well as 20,000 students and probationers. Members are based in over 100 countries and are represented in as many as 50 countries through locally organized units. The RICS has four main responsibilities to the public and its members: ensuring high standards of education and training; the maintenance of standards and conduct; professional advice to governments; and the provision of information to and about the profession itself. (<http://www.rics.org.uk/>)

the Mallinson Report. It was commended by the Bank of England as the best report produced on any profession's standards in modern times. The report cited 43 key points, which might be summarized as follows:

- Understand the client and his needs.
- Precise, written instructions are necessary.
- Clarity of valuation bases are required.
- Explicit methodologies are needed.
- The valuation needs to be explained.
- Any uncertainty or other concerns should be stated.

In response to the Mallinson Report, the red book was rewritten, supplemented, amplified and republished in 1995. The practice statements are now mandatory for member valuers, while the guidance notes are advisory only. The new red book is an impressive tome weighing 12 lbs.

THE "BLUE BOOK"

The red book serves the needs of U.K. valuers very adequately, but it has become less relevant to users in other countries, including those in continental Europe. Europe is clearly problematic due to its variety of languages, cultures, histories, currencies, legal frameworks, economic development and general fragmentation.

In 1981, The European Group of

Valuers Associations (TEGoVA) developed its own valuation standards and guidance, known as the "Guide Bleu" or "blue book." Originally based almost word-for-word on the RICS red book, the blue book is now truly an amalgam of trans-European influences designed to comply with EC rules and regulations. The Guide Bleu currently contains approximately 100 pages of standards and guidance.

UNIFIED INTERNATIONAL STANDARDS

At about the same time that European standards were being developed, international standards were also initiated and first published in 1985. Again, these standards were based closely on the U.K. red book concepts and definitions. A complete redraft of international standards was published in 1994 by the International Valuation Standards Committee (IVSC). This draft reflects the needs and requirements of the broad membership of member states, with particular emphasis on North America.

These standards are now being further extended and developed to form a single benchmark that meets the needs of users, capital markets, regulators, national valuation and appraisal institutes and individual members throughout the world.

Pressure for international standards is coming from a number of different sources, including:

- 1 The requirement of governments for valuations of publicly owned assets. To this end, the IVSC has contributed to the International Federation of Accountants' exposure draft standard on "Property, Plant and Machinery," with particular reference to those troublesome categories of property—heritage assets, infrastructure and military facilities.
- 2 The trend toward the privatization of government enterprises. There is no reason to differentiate between property assets in the public and private sectors, although the concept of "public interest value," community value or social value is one that currently defies the sort of measurement that auditors would consider adequately reliable for accounting purposes.
- 3 The development of international accounting standards. The IVSC is part of the International Accounting Standards Committee Consultative Group, advising in particular on IAS 16 "Property, Plant and Machinery," IAS 17 "Leases," and ED 64 "Investment Property."
- 4 The move towards a fair value accounting model, certainly for all

Color Key to Standards Worldwide

The Red Book: Standards developed by the Royal Institution of Chartered Surveyors and more formally known as “Guidance Notes on the Valuation of Assets.” Widely recognized and relied upon by valuers in the United Kingdom and Commonwealth countries.

The Blue Book. The “Guide Bleu” was developed by the European Group of Valuers Associations and is used in most European countries.

The White Book. A compilation of standards that has just been introduced under the auspices of the International Valuation Standards Committee. The Appraisal Institute was represented in this effort by Joseph Vella, MAI. The document is being officially introduced at Valuation 2000 in Las Vegas in July.

investment property and at the lender's discretion with respect to owner-occupied property. This model will increasingly demand the services of external or independent valuers who can satisfy those accounting requirements by assessing the market value of property assets.

- 5 Emerging economies with no established skill or depth in real estate appraisal.
- 6 The GATT Agreements, designed to balance world trade practices, which led to establishment of the World Trade Organization in 1995. The IVSC recognizes that the agreed-upon valuation standards should reflect the role of real estate across global markets.
- 7 The United Nations Conference on Trade and Development, which is working towards the harmonization of accounting and other professional practices.
- 8 The need to measure property, portfolio and company management performance for both real estate investments

and owner-occupied property. Common indices of pooled property data exist in some countries, and the prospects for similar databases elsewhere establish the need for common performance measures based on common standards.

What investors, regulators and users of valuation require is consistency, clarity, reliability and transparency in valuation reporting worldwide. The evolution and creation of a set of standards for any field is far from straightforward. A single international standard has to encompass or recognize property laws, tenures, accepted rules of conduct, languages, concepts and “best practice” benchmarks. Trying to accommodate all views and perspectives would result in a bland, multi-optional conglomeration lacking definition, incisiveness or adequate direction. The view from 60,000 feet may be all-encompassing, but is of limited relevance to the valuer with his feet on the ground.

The Appraisal Foundation's Uniform Standards of Professional Appraisal Practice (USPAP) are also gaining recognition in a number of developing economies. The key concern is for consistency among standards. To achieve that, we must improve communication and work toward a common set of objectives.

To illustrate the developing relationship between national and international standards, note that in certain circumstances U.K. valuers may be directed by a client to follow the guidance of the TEGoVA blue book when appraising in Europe for EU regulatory purposes or of the International Valuation Standards Committee (IVSC), rather than the RICS red book.

The development of international standards is both a bottom-up and a top-down process. The best national stan-

dards can contribute to a single global standard which, in turn, can be adopted and assimilated by those nations with a less-established standard-setting model. Inevitably, a hierarchy will emerge that places international standards at the top of the pile, regional standards next (where necessary, e.g., European Union, through regulation), and, below that, national standards.

THE “WHITE BOOK”

The IVSC standards, newly named the “white book,” are currently being heavily promoted. When it is introduced, the white book will be a culmination of the efforts of the IVSC's editorial board, its executive director and its co-opted writers, led by Michael Milgrim of the U.S. with support from both Europe and Australia. The standards will continue to be a living document, subject to continuing adjustment, updating, and correction.

Both the IVSC and the leading institutes of more than 50 member nations appreciate the opportunity to present the white book at the Valuation 2000 Conference for scrutiny, comment and, hopefully, approval. The IVSC will continue to upgrade and add to the white book over the coming months, adhering to the existing framework and format and maintaining a single, concise writing style. The IVSC Web site is www.ivsc.org. Appraisers are encouraged to review the standards and pass on their comments to their respective organizations through the usual channels.

All these challenges offer a real opportunity for more work for valuers and appraisers. When individual national institutions align behind a common international document that has the quality and content to earn universal recognition, the profile of the entire profession and all those associated with it is raised. ▲

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