Comments on Valuation Uncertainty

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General Critique of the Discussion Paper

The IVSC Paper addresses the issue of market uncertainty by recommending that valuers admit to a level of inaccuracy via a self-imposed "reliability rating". This seems demeaning and unworkable. At best, admissions of incompetence endanger credibility; thus valuers will find it hard to honestly own up to being "uncertain".

At worst, the IVSC Paper promotes the notion (intentionally or not) that market uncertainty arises, at least in part, from inaccurate values. Uncertainty is embedded in markets. Uncertainty underlies risk. Without risk there is no market.

More recently, uncertainty has been exacerbated by an ever shifting array of new real estate "products", including creative interests and funding mechanisms. If the valuation is culpable in the uncertainty debate, it is because the rapid pace of innovation in global real estate markets far outpaces the valuation profession's ability to adjust and adapt to new methodologies. (e.g. today's instant availability of information and the ability of buyers, sellers, lenders, brokers, advisors, credit agencies, and traders in the diverse world of securitization, synthetic paper and credit swaps, to rapidly interact.)

The profession has barely begun to understand the impact of these forces of creative funding, securitization, asset allocations, derivatives and the interactive cross-border trading through listed and unlisted vehicles. Nor has the profession kept up with the IT and communications revolutions.

For example at the beginning of the recent crisis, this lack of knowledge about financial trading exposed a wide understanding-gap between real estate and financial markets. Residential valuers continued to submit opinions based on plentiful but flawed market data, thus supporting the theory that residential real estate values were on an unending upward spiral. Few sounded warnings that real estate and derivative markets were unsustainable. Those who did were ignored.

As a result valuers began to lose credibility as a reliable litmus test for a rapidly changing market. The scale and pace of the downturn overwhelmed the skills of many valuation practitioners and the profession found that its influence and respect in global capital markets had waned. It had shown itself powerless to act in the public interest and alleviate a subprime crisis that, while at first confined to California, became globally amplified by cross-border securitization and a vast array of synthetic credit products.

It was this understanding-gap that lead to the “valuation uncertainty” in the financial markets and ultimately brought into question the veracity of valuations for financial reporting.

Conclusion

We agree that because many users of valuation services already distrust a process that focuses only on a number, a concise explanatory statement of the market conditions and risks under which the value was conducted and a statement as to the availability and analysis of supportive evidence is warranted. It is up to the user then to determine whether or not, for his/her purposes, the valuation is reliable.

But user confidence and trust in the valuation process will not be improved by self-rated statements of reliability. What will improve this relationship is better communication of the market indicators examined during the valuation process and the expansion of the valuer’s toolkit to include more quantitative analysis of wider pools of market data, financial markets and the observable risks presented by market cycles. Education and continued innovations in reporting methods are the key.

Absolutely the IVSC needs to continue its work in uncertainty. But to promulgate valuation uncertainly as an internal problem within the profession without a full analysis of the wider external causes that lead to perceptions of valuation uncertainly, is counterproductive.

IVSC Discussion Paper Questions & Answers

1. **Do you agree that it is only when material, or abnormal, uncertainty attaches to a valuation on a specific time or date that that specific disclosure is necessary when the valuation is reported? If not please explain why you consider that an uncertainty statement should be provided in all cases.**

   Yes

2. **Do you believe that the Board has identified all major sources and types of material valuation uncertainty? If not please identify what additional causes of uncertainty exist and how often you encounter these in practice.**

   No, the Discussion Paper confuses the matter by correlating “stock market risks and the market for Rembrandts” with real property market risks.

3. **Do you agree with the Board's conclusion that an explanation of any abnormal uncertainty identified and an explanation of the impact this has on the valuation (a qualitative statement) is more helpful to users in understanding the valuation than a purely numeric expression of the range of possible values created by the uncertainty (a quantitative statement)?**

   Yes. The question remains how to get users of valuations services to actually read, understand and heed any such qualitative statement of market risk.

4. **Do you think the IVSB should include an explicit requirement in the proposed IVS 105, Valuation Reporting, to disclose any material uncertainty or is the principle that requires valuation reports not to be ambiguous or misleading sufficient?**

   No, valuation uncertainties are already covered in the current required disclosures. More emphasis should be placed on a fuller reporting of market risks.

5. **Do you consider that there are cases where a qualitative statement of the causes and impact of uncertainty on the valuation is inadequate and should be either augmented or replaced by a quantitative statement? If so please a. state the circumstances and assets classes where you believe that quantitative statements are more helpful to users and, b. provide a brief explanation or example of the type of quantitative statement that you believe would be useful.**

   No.

6. **Do you consider that it would be helpful if IVSC developed guidance on methods for making a quantitative disclosure of uncertainty under specific circumstances? If so please indicate the circumstances and any methods that you either use or encounter in your market.**

   No.

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