PRACTICE BRIEFING

A vision for valuation

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Abstract

Purpose – This paper aims to stimulate debate amongst valuers and users of valuations over what action is needed to ensure the provision of the valuation services that the modern economy requires.

Design/methodology/approach – This paper looks at developments and trends affecting the nature of and the need for valuation services around the world in the short to medium term.

Findings – There is a bright future for those valuers who understand the dynamics in their market and anticipate or always respond to change. The consequence of failing to respond is inevitable decline in the long term. More automated valuation processes and products have an important role to play in the future provision of valuation services. The valuation community must rise to the challenge of developing a professional class of valuers in emerging economies. Governments should insist on good quality valuation in their jurisdictions as they have a major role to play in consumer protection. The leading professional organisations in the world must ensure that collectively and individually they attract the best possible candidates into it.

Originality/value – Whatever the drivers of change in the valuation marketplace, it is fundamental for the survival of professional valuation services that the public interest is protected. This paper considers the challenges and opportunities in a range of areas brought about by these changes – a vision for valuation.

Keywords Valuation services, Valuers, Professional standards

Paper type General review

Why does valuation matter?

Property underpins a major proportion of financial decisions in mature economies. Failure to ensure assets are properly valued risks financial exposure for a wide range of stakeholders. For example:

- banks that use property as collateral for loans;
- shareholders that have invested in quoted companies and the companies themselves that become vulnerable to take-overs and asset stripping if the properties they own are not regularly and correctly valued in the balance sheet;
- house-buyers;

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- future pensioners whose savings are invested by funds; and
- whole economies that depend on stable banking systems.

A series of corporate financial crises around the world have proved that the dangers of wider financial collapse are real (see below):

The domino effect of poor valuation
RICS responded to the 1970s property crash in the UK by publishing the *Red Book*, setting out standards of valuation and professional conduct expected of valuers, while the Federal Government in the USA responded to the "savings and loan" crisis of the late-1980s by insisting on uniform appraisal standards and the licensing of valuers in each State. This led to State Certification of all valuers along with the adoption in each State of the annually revised Uniform Standards of Professional Appraisal Practice.

Sadly, the lessons learnt in the UK and in America generally were not applied elsewhere. Similar problems of poor standards and inadequately trained valuers contributed to the 1994 "Schneider affair" in Germany, the country's biggest property crash in fifty years. When Jürgen Schneider's businesses collapsed he owed DM5 billion to 40 banks and, in some cases, threatened their solvency (Grzesik, 2000).

Likewise, the Bangkok Bank of Commerce collapsed in 1997 under the weight of property loans, exposing weaknesses in other banks in Thailand. However, the risk was not contained. Globalisation has linked the world's economies more closely than ever before and the financial crisis in Thailand dragged down stock exchanges in South Korea, Malaysia and Indonesia, contributed to the Russian Government defaulting on rouble-backed bonds and almost halted the longest period of economic growth in American history.

The consequences of the Asian collapse are still being worked through. A 2002 report concluded that the growing burden of bad debt threatens Asia's banks and suggests that non-performing loans totalled a staggering $2 trillion – equivalent to almost 30 per cent of the region's GDP (Berger *et al.*, 2002).

Most of the national crises exposed wide variations in valuation approaches that led to vastly different, often unrealistic estimates of similar assets and the dangers of fraud or dishonest conduct where valuers were not properly trained or regulated.

The concern to avoid such collapses led to the emergence of valuation standards, first on a national and then on an international level. International valuation standards could make cross-border investment less risky and reduce the inherent instability of many stock exchanges by ensuring proper valuations of assets owned by quoted companies. This integrity would reduce the likelihood of a valuation-induced collapse in one financial centre potentially triggering a more global collapse.

There is a strong public interest in the integrity of the valuation process. Consistent and transparent standards in valuation are not only the responsibility of valuation professionals, but also that of governments and other stakeholders. The public who use valuation services expect valuers to meet fundamental standards and demonstrate independence (particularly of mind), integrity and objectivity.

Who provides valuation services?

Globalisation has led to a significant increase in use of international valuation standards, but a worldwide convergence towards adopting a single consistent basis for valuation services is a long way off. This is partly because of wide differences in entry to the profession, in the training of valuers or appraisers, in client or public perceptions of them and in the ability of valuers to contribute to wider financial or economic activity.

Becoming a valuer can mean little more than going through a relatively undemanding state licensing process in some countries. However, in other countries a much more rigorous approach is required involving a minimum standard of a university degree and period of supervised experience, further examinations and peer assessment.

In the USA, the licensing of appraisers is controlled on a state-by-state basis and the recognition of licences between states is very limited. Entry requirements are low. After a two to three year experience requirement, anybody who has passed the basic State-set test and submitted samples of their work product for approval by the State's Appraisal Board, can work as a certified appraiser in that state.

Although there are some large, well known appraisal companies in North America, the market tends to be characterised by small firms (Appraisal Institute of Canada, 2002) with most appraisers working in only one or two states. Training is focused on appraisal and so even the big companies are unable to provide, or the market is unwilling to accept, the provision by valuers of wider property services like agency and investment. Indeed separate licences are required for brokerage services. Many commentators argue that state licensing in the USA has done little, if anything, to improve standards. Relatively low entry requirements, limited job prospects and a low opinion among graduates and school leavers about a career in appraisal have contributed to significant decline in recruitment in North America (Appraisal Institute of Canada, 2002). The profession is left an ageing profile (the so called "greying profession"), exacerbated in many States by restrictions placed on the number of trainees (typically only two) permitted under any one experienced supervisor.

Elsewhere the situation is very different. In the UK a regulatory framework is set by the leading professional body, RICS. Training is based on a broader university education in property, and valuation as a discipline tends to be more highly regarded by clients and institutions (Wyatt, 2001).

Arguably, the UK has one of the most developed markets in valuation services, partly because it has a highly developed commercial property market in which banks, pension funds and insurance companies invest heavily and a mature housing market with a high proportion of homeowners. Elsewhere, the slow development of a property market has held back the evolution of a valuation profession.

Pressures driving demand for a profession of valuers include:

- valuation induced financial crisis (e.g. Germany, Thailand) or the determination to avoid such a crisis (e.g. Poland);
- the move towards market economies (former Soviet bloc, developing countries); and
- property tax reform (e.g. Portugal).

While commercial property related valuation in mature markets has become an increasingly sophisticated process, there are parts of the world where demand is yet to start. Here, much valuation work is still generated by the state and may, for instance, arise from privatisation or be property tax related. In China, for example, where there is a very limited property market, valuers largely work for government departments.

A number of banks in mainland Europe are state owned or backed and have in-house valuation teams. The banks' desire to improve efficiency could well lead to a further trend towards outsourcing this valuation work to external valuers, which may in turn change the way the profession is organised.

In many countries valuation is a distinct profession, with valuers working either as sole practitioners or in firms of valuers. These valuation firms have generally developed separately from firms providing other real estate services. In some cases this is simply the result of the way the profession has evolved; in others, such as Spain, it results from a statutory requirement to separate out valuation services.

In the UK, however, few commercial firms offer valuation services alone. This means the market is dominated by multidisciplinary practices where valuation is often one of a package of services offered to clients, including other more lucrative property-related work. This model has been successfully exported by the large international practices across the world.

What are the dynamics of the valuation marketplace?

The basic purpose of valuation is to give an assessment of what a defined interest in an asset is likely to realise if sold on the open market or its value to the occupying business. Why clients need to know this information and what they want to do with it, influences the type of valuation and the professional service offered. However, in order for valuers to provide the best possible service, they must also understand the dynamic drivers of the marketplace, both in the commercial property and the residential property sectors.

Some of the drivers in the current market throw up potential new opportunities; some point towards an uncomfortable future for some valuers; and others threaten the credibility of valuation as a public interest profession. This part of the paper focuses on some of the biggest changes likely to affect the market for valuation services in the short to medium term.

1. Secured lending dynamics

The hallmark of a maturing market economy is wider property ownership and the greater use of property assets as security for loans. The asset is used to measure how much to lend and the risk of lending. It then serves as a hedge against the risk of the borrower defaulting.

The effectiveness of this safety valve makes security against property the most common basis for loans and the banks the biggest purchasers and users of valuations. However, it also means that changes in the type of information banks need, their use of such information and the way they perceive their exposure to risk, all have major implications for valuation services.

Basel II: capital adequacy for banks. A major driver of change in global banking is the Basel Accord, to which most internationally active banks and their regulators have signed up. It attempts to safeguard bank solvency by setting down the minimum amount of its own money a bank anywhere in the world should allocate to the loans it makes. Its impact is widespread precisely because secured lending forms such a significant proportion of financial activity and of the property market itself. The New Basel Accord, or Basel II, is due to be implemented by the end of 2006.

The required capital adequacy of a bank will be much more closely linked to its risks. The importance of real estate valuation as a risk management tool in secured lending is recognised in Basel II and becomes compulsory for the first time. The Accord considers some loans, like residential mortgages, less risky and so allows the bank to use a reduced risk weighting. However, there is a requirement to revalue both commercial and residential real estate every year, and this is likely to have an upward impact on the amount of valuation work needed by banks.

Basel II is likely to provide further impetus for the growth in international valuation standards. In the EU, where the Basel Accord is implemented through a binding directive on capital requirements for banks, the proposals use the internationally recognised definition of market value as defined by the International Valuation Standards Committee (IVSC).

One Basel objective – to enable comparisons to be made on the relative financial strength of banks – is only possible if banks value their property collateral on a consistent basis. Given the trend towards international standards in accounting and banking, it is likely that international valuation standards will become increasingly important.

Technology. Competition between lending banks in the provision of valuation services, particularly in a world where market evidence is increasingly freely available, is stimulating greater use of technology. Many of the objective elements involved in producing a valuation – collection, organisation, formatting of data – are ripe for automation and valuers are seeing a progressive shift towards automated processes.

In the past it was market knowledge that set valuers apart from their competitors, but today it is what they do with that data that differentiates. This, along with the fact that access to enough highly comparable data is not available, is why using automated mass valuation technology is much more complex in the commercial property sector than in the residential sector.

Even though fully automated valuation products seem a long way off in the commercial sector, it is important to consider whether these outputs can really be seen as "valuations" if they are totally computer driven without the intuitive input of the valuer: what evidence to use, what assumptions to make and how to interpret the data. This is the subjective-objective balancing act in the process (Gilbertson, 2002) that acts as a safety mechanism that underpins sound valuation. Upsetting this balance opens the process to new risks, especially when new more automated methods are not accompanied by the same transparent standards (Appraisal Institute of Canada, 2002) that have governed traditional valuations.

Pressure on this balance is the greatest challenge in the residential sector where the move to more automated systems is being driven by increased competition between mortgage lenders and between valuers, and by the major cost, time and efficiency savings that increased computerisation can offer (Stimson, 2003).

The most advanced form of technology is automated valuation models (AVMs), which have been developed to allow for rapid, cost-effective, risk assessment and funding decisions. A user inputs the target address and property characteristics (e.g. number of bedrooms, age, etc.) into the computer model which will then return an estimated value based on the data available to the model. The fact that the valuer has little if any input is seen as a double-edged sword. It eliminates human error and bias but takes out of the equation not only the physical property inspection but also the skill, judgement and experience of the valuer.

Mortgage lenders and insurers in North America have found AVMs particularly appealing and they are now used in approximately 10 per cent of all mortgage originations in the USA (Standard & Poor's, 2004). However, to date the use of an AVM on its own for valuation purposes has generally been restricted to those loans with perceived low risk.

In British Columbia, Canada, some firms offer electronic valuations on-line for $29.95 and delivered within ten seconds (Hamilton, 2003). There has been little public debate about the consequences of moving from valuation to what is simply pricing. Consequently the public, particularly in Canada, appears to believe that mortgages are based on traditional valuations and traditional safeguards when this is no longer the case (Appraisal Institute of Canada, 2002). When the client does not understand the nature of the service, it should be of concern to valuers, their professional bodies and to governments, whose role it is to protect the public interest.

In the UK AVMs have only recently been available on the market but inexpensive on-line estimations of value already exist. The two major providers use hedonic valuation models which rely on a large database of property valuations and sales prices, and conduct an automated search for comparable properties with the target property (Standard & Poor's, 2004). Some form of indexation is generally used to bring the property values of the comparables up to date. However, lenders are particularly mindful of the fact that professional indemnity insurance losses for residential valuation in the early 1990s were significant and therefore take into account the appropriateness of relaxing controls.

Automated products giving pricing estimates do have an important, and growing, role to play in the marketplace. Standard & Poor's predicts that, as database sizes increase and new approaches are developed to predict valuation in heterogeneous residential areas, AVM performance will improve (Standard & Poor's, 2004). Currently, AVMs still have their critics even in the USA, where comparable sales data to populate the models are plentiful.

Yet here lies an opportunity for valuers. There is no way back from evolutions in technology. AVMs can be used as the sole determinant of value but in practice are only used for low loan to value lending propositions with good credit scores and depend on property type and geographic location. This is process-driven "valuation". However, AVMs have a range of uses, including as a quality control tool in the mortgage origination process, as a supplemental test for the reasonableness of other valuation methods and to help inform the valuer of his/her next step. They are also used widely in the USA for the mass appraisal of properties for tax assessment. If properly understood and used, they will become a valuable part of the valuation process rather than the process or the result itself.

The challenge will be learning to embrace this shift and to maximise the use of the technology where it is appropriate, for example to make residential valuation a more efficient and profitable business going forward. The greatest risk to the valuation profession is that commoditisation and automation creep up incrementally, ignored by reluctant professional valuers and unnoticed by those whose public interest is served by appropriate standards and the safeguards provided. There is no substitute for the skill of a competent and experienced valuer.

Valuation is a human process in which foresight enters (Fisher, 1930).

Those who choose the AVM approach need to be aware of the potential pitfalls: the automated process's inability to spot rogue figures and correct them before they influence the value of other property; the capacity for financial fraud; and lack of advice to the public. A computer-generated product gives an impression of certainty which could be misleading: an AVM, like a valuer, provides an assessment of value within a range. Yet these pitfalls could be avoided if data and output are analysed by appropriately trained valuers as part of what is essentially a risk management exercise.

The real danger remains that these automated products will be confused with traditional valuations when this is not the case. Valuation is a professional opinion and must be clearly distinguished, perhaps even with the use of different words. In this context, is it time to redefine valuation?

Securitisation. Further change for the valuation profession is being driven by securitisation, in the form either of debt pools such as mortgage-backed securities, or of tax transparent vehicles such as real estate investment trusts (REITs).

Securitisation is a way for businesses to release cash tied up in their often considerable property assets. Pooling various types of debt, usually loans, and repackaging it as bonds or loan notes means that it can then be sold to investors. These bonds are often called mortgage-backed securities (MBS) because the income from them is based on the value of the underlying assets. These assets can be commercial or residential property but the trade in these securitised notes is too risky unless the investor can be sure the underlying properties have been properly valued. The property value is an essential component in the credit analysis of each loan.

Securitisation is increasingly seen as an alternative mechanism for capital market financing, funding and risk-shifting, and consequently is likely to grow. Corporates, particularly the utilities sector, and government departments, are likely to be keen on using their property assets to raise finance in this way. Greater understanding of the mechanics and benefits of securitisation has led many countries to take steps to create a more hospitable environment for securitisation.

Debt securitisation is more prevalent in the residential property sector. Faced with increasing margin and cost pressures, mortgage lenders have been increasingly looking to the capital markets to finance their mortgage lending activities and possibly obtain capital relief by selling off their loan portfolios.

There is substantial interest from many lenders across Europe in how to make residential MBS (RMBS) transactions more efficient through standardisation. Most EU countries have already implemented national legislation on covered bonds and/or MBS, the best known success stories being German *Pfandbriefe* (Europe's biggest bond market), *Danish Realkreditobligationer*, Spanish *Cédulas* and French *Obligations Foncières*. However, the European Commission's expert Forum Group on Mortgage Credit (European Commission, 2004) has gone a step further by recommending that the EU develops a dynamic, liquid European-wide secondary market and removes any obstacles that prevent or hinder the pooling of mortgage collateral from different issuers based in different EU countries.

A consequence of any secondary market is that it leads to a standardisation of loan products to make them eligible for trading on the market. It is no real surprise, therefore, that increased interest in standardised data available in electronic format is coupled with a corresponding increase in interest and activity in AVMs.

Although financial rating agencies do assess the method of valuation for their rated securitisations, for RMBS transactions, they are unlikely to be concerned unless any particular valuation technique – whether physical, drive-by, desktop or AVM – results in consistent overvaluation. Individual overvaluations will rarely have a noticeable impact on the credit quality of the portfolio as a whole.

In the commercial property sector, however, where the quality of valuation is an element used to rate MBS or covered bonds, lenders will nearly always use a qualified valuer to verify the value of the property independently as part of their due diligence. Increasing standardisation within these portfolios is likely to bring with it a desire for transparency and comparability in valuation. A more systematic use of international valuation standards is at least part of the answer and should be encouraged.

REIT-style investments, which help to securitise otherwise non-liquid assets, are also growing. A REIT is a listed vehicle dedicated to acquiring, owning and managing income-producing real estate such as apartments, shopping centres and offices. Unlike traditional real estate, a REIT is highly liquid, offering investors a third way of participating in the property market alongside owning real estate directly or investing in a listed property company. Financial advisors have continued to favour REITs, even in a tough equities market, and they do not necessarily increase and decrease in value along with the broader market and they tend to pay yields in the form of dividends based on neutral income, no matter how the shares perform.

They were, for example, introduced in Hong Kong in the summer of 2003, bringing it in to the region's existing market alongside Singapore, Japan and South Korea. These markets are still small compared with the USA, where REITs began over 40 years ago, and Australia (around since the 1970s), where REITs have flourished as a tax effective investment for companies as well as investors.

In Europe, tax transparent vehicles are common in The Netherlands (the favoured vehicle is the *Fiscale Beleggingsinstelling* or FBI) and Belgium (*SICAFI/Vastgoedbevak*) and have recently been introduced in France. Discussions over Property Investment Funds are intensifying in the UK under pressure, not only from its neighbouring competitors but from the scheduled introduction of International Financial Reporting Standards in 2005.

It is clear that securitisation is revolutionising the way property is valued and traded. Valuers will increasingly be required to adapt to the needs and demands of the financial sector, and to develop and apply internationally agreed valuation standards and guidance to meet those needs.

2. Financial reporting dynamics

The world is seeing increasing amounts of cross-border financial activity, whether in investment or lending, and the capital markets have become increasingly international in their scope. Valuation is a key component in financial reporting.

Company accounts. An important element in the published accounts of a quoted company is the valuation of its assets. International investors want to compare not only the financial strength of banks but also to compare more easily the performance of companies cross-border. Currently, however, accounts in different countries are prepared in very different ways to different rules set by different financial regulators, making international comparisons virtually impossible.

This is set to change. The European Union has already made it compulsory for all listed companies in the EU to prepare their accounts in line with International Financial Reporting Standards (IFRS) by January 2005. IFRS are also being adopted in Australia, China, Russia, Thailand, Japan and parts of the Middle East and Africa. Others such as the USA, Canada, South Africa, Singapore, Turkey and Malaysia are committed to convergence with IFRS as an international benchmark.

Valuers are in the eye of the global financial reporting storm as the move towards universal accounting standards has given a boost to the development of international valuation standards – a success story of the last few years. The International Accounting Standards Board (IASB), responsible for IFRS, is working closely with the IVSC to draw up compatible valuation principles:

> The demand for valuations prepared under International Valuation Standards is being driven by the rapid adoption around the world of International Accounting Standards, the growing influence of International Public Sector Accounting Standards, and the increasing need for users of valuation reports to have a consistent and comparable measurement of assets wherever they may be (IVSC, 2003).

The preference of both the IASB and the IVSC is for assets and liabilities to be presented in accounts at "fair value" rather than at historic cost as now or as in the past. On the face of it, this change should result in more work for valuers. In practice, however, it means that any rises or falls in value should appear in the profit and loss accounts. If revaluations at fair value negatively affect profits, the changes could act as a major disincentive for companies to revalue as long as it remains optional, rather than mandatory.

Investment. The desire to compare the performance of fund managers internationally has brought Global Investment Performance Standards (GIPS). Produced by the Association for Investment Management and Research, they are likely to come into force for real estate in 2005, providing a single global standard on which to calculate and report the performance of investment funds.

GIPS will mean that appropriate valuations must be done at least quarterly as changes to asset values are an essential element of investment performance and the aim is to ensure these changes are reported more frequently. Thus, GIPS is expected to lead to a dramatic increase in the number of routine valuations done for funds.

This is unlikely to have a major impact on the big property fund managers who already do valuations on a monthly basis. The biggest impact of GIPS is likely to be on the small pension and insurance funds, many of which have yet to move to quarterly valuations. It is also expected to affect a wider range of clients because of the diversification of the property market in recent years. This change has seen quoted property companies increasingly seek to split development from investment businesses, with the latter doing asset and value management based on capital provided from outside the company (Tuckett, 2002). Likewise, property consultants have also set up their funds to manage property. Both of these types of businesses are likely to adopt GIPS standards on fund management.

In terms of valuation services, GIPS requirements are likely to drive the commissioning of more work. However, standardised technology like GIPS or the Property Information Common Standard Exchange System (PICSES), which in the UK has set valuation software standards for the electronic transfer of data between unconnected systems, has made it easier for significant volumes of data to be moved between clients and valuers. The legal profession is now also exploring and developing data transfer systems based on PICSES.

Companies that are not used to regular valuations and who do not see the importance of them are likely to see more frequent commissioning as “grudge” purchases. Forced to pay for valuations they do not really want and under pressure to cut costs, these companies will resentfully seek out the cheapest provider, so exerting a downward pressure on fees and potentially a downward shift in quality.

This illustrates the difference between a commodity or “product” purchase and a professional service. Clients do not really want these products but they have to have them. In order to meet client demands and with the increasing power and capacity of technology, valuers are effectively packaging these products in a box like a product on a supermarket shelf. This is a totally cost-driven purchase and at times valuation firms even behave like supermarkets by using these valuations as loss leaders in the expectation of further instructions for other departments.

The challenge for valuers is how to manage the dynamic without debasing valuation and reducing it to a supermarket purchase. This would seem to be a case of professionalism coming into conflict with standards under the pressure of competition. To maintain trust and confidence with the public, quality of service must not be compromised.

3. New market dynamics: intangibles, personal property and businesses

Intangible assets like goodwill, brand names, trademarks, web addresses and customer lists are, by their nature, elusive and difficult to value. They lack well defined property rights, have a company specific nature, are associated with high levels of risk and uncertainty and have no organised markets in which they can be traded (RICS, 2003). They are also difficult to quantify and track.

These assets are major drivers of corporate value and growth. For some of the world’s biggest corporates like Coca-Cola and Microsoft, tangible assets are of only limited importance in the share price and in earnings growth (RICS, 2003). In other sectors, the only assets the company may have are its name, reputation and the ideas of its employees.

This means inadequate valuation of these assets can seriously expose investors and lenders to significant losses, as seen with the “dotcom” crash. That experience prompted calls for international accounting standards to set out how intangibles should be valued and how this valuation should appear on company balance sheets. There is a potential opportunity here for real estate valuers to adapt their existing skills to a new field of expertise.

In parts of Europe and in the USA, appraisers are recognised as professionals in the field of business valuations. Valuers in these countries carry out business valuations for mergers, acquisitions and disposals. That is, property advice is provided at a strategic level rather than in respect of individual properties. Even so, the valuation is an important part of that advice, so much so that in some countries the distinction between a property valuer and a business valuer is artificial (Wyatt, 2001).

The same tenets apply to the valuation of personal property. The education, experience and skills required to value personal property are beginning to be recognised as a legitimate part of the total valuation process, particularly in the field of plant and machinery (called FF&E, or "fixtures, fittings and equipment" in the USA). Although plant and machinery valuation is covered by the *Red Book* for RICS members, this skillset has not been adequately codified and regulated elsewhere primarily because personal property is typically a depreciating asset, not commonly a major component of collateral lending.

To take up the challenge and opportunity of these new and developing markets, valuers will need to acquire new knowledge on how companies work and how to take a multidisciplinary approach that will use external experts in patents, copyrights and intellectual and personal property. With the increasing diversity of the demands for services such as the valuation of businesses, personal property, brands and intangibles valuers are well placed to take advantage of expanding opportunities.

4. Taxation dynamics

Valuation-based property taxes are growing in popularity with governments around the world either as mass land tax systems or as top-up revenue raisers. The appeal lies in the significant increases in property values in market economies over the medium to long term. This means valuation-based forms of taxation can almost guarantee increased revenues for governments.

To ensure fairness, regular mass reassessments of property values need to be done to ensure assessed values are closer to market values and that government reallocates the tax burden according to property type and changes in value.

Options for conducting regular mass valuations or reassessments vary. It can be done every year, but this often only involves copying values from the previous year until the discrepancies between assessed and market values are too great and force a mass reappraisal. Alternatively, it can be done on a mass cycle at certain intervals laid down by law.

While the principle of this type of taxation is generally accepted, how it is calculated and implemented can be controversial. For instance, in Australia changes to the system of mass valuations has led to huge increases in assessments and in tax liabilities. In Queensland in 2003, valuations of shopping centres were up 800 per cent and there were reports of valuers writing down value of some big investments by 5-20 per cent because of tax liabilities (Perinotto, 2003).

The problem facing the former communist states is that they have only recently started compiling databases of land ownership, location, prices and rents. This means the move to mass land taxation is unlikely to happen until sufficient information has been collected. In the meantime, however, the city of Moscow has increased the number of city zones with the aim of calculating land tax more accurately. The revisions have increased the total valuation of the capital's land by 90 per cent (*Moscow Times*, 2003).

Other types of property related taxation exist, such as raising a supplement on existing property values as a means of securing additional funding for regeneration or infrastructure improvements. One such funding approach is the concept of Business Improvement Districts (BIDs) where a levy is raised on property within a specific geographic, or BID, location from local businesses and the funds directed back to improvements in the BID area.

It is estimated that over 1,500 BIDs have been set up in the USA and Canada, typically levying a rate of between 0.1 per cent and 0.3 per cent on the assessed value of properties. The Lincoln Square BID in New York City generates over US$1million per annum and is one of 40 such districts in New York State (Grimley, 2003).

5. Profitability dynamics

Valuation is more vulnerable to cost and efficiency pressures than most other property services because it operates on tighter profit margins. One of the biggest changes to the valuation profession has been the growth of competition between firms on price rather than on quality of service.

The professions that emerged in western Europe during the 1800s were based on the idea that educated people would be properly trained to provide specialist services to high professional standards, and that the price charged would reflect the quality of provision.

It is therefore anomalous that a public interest profession should find itself competing solely on price criteria: quality is bound to suffer in the long term. The idea of valuation as an unavoidable expense reduces it to a commodity which is devalued and begrudged by the purchaser, who is prompted to push down fees.

The auditing profession – once much maligned and begrudged for the same reasons – has seen a significant upturn in fortunes since the Enron and Parmalat (amongst others) auditing scandals. Now it seems that corporate governance pressures mean companies are prepared to pay, and to be seen to be paying, for a good quality service in auditing. Valuation needs to be regarded in the same way – as an element of good corporate governance and in the public interest – rather than as a grudge purchase.

Just like auditors and lawyers, valuers in the majority of developed markets are required by professional regulations and/or client requirements to hold professional indemnity insurance (PII). However, pressures in the global insurance market have led to a quadrupling of insurance costs over the past few years.

The value of the work involved in a particular instruction will affect PII premiums. However, higher PII costs cannot necessarily be offset by higher fees because cost conscious clients are unwilling to pay more and the market in valuation services is highly competitive. There are those who question whether valuers always charge a fee level high enough to meet the cost of their PII cover. If this is the case, it raises serious questions over the threat both to the public interest and to sound corporate governance practices.

This combination of increased work volumes, higher insurance costs and lower fees is driving many of the small practices out of valuation work. Larger firms may look to automation to cut their costs, although this brings its own dangers for the public interest and for the credibility of valuation.

A vision for valuation?

The problem for professionals is that the future of valuation is not altogether clear and a raft of issues is creating change, which is bringing mixed blessings. Valuers and their professional bodies are going to have to tackle these issues head on. Failure to do so, or a fudging of the issues, will only damage perceptions of valuation and leave valuers under-equipped to deal with changes in their market.

Increasingly exacting clients are demanding analysis, interpretation and application of property information, managed and delivered through technology.

Are valuers up to the job of meeting the challenges ahead? Are firms delivering the types of changing services that clients need? Do valuers have the expertise required by financial regulators, accountants and clients? Can the best work be provided at a fee that demonstrates its worth?

Polarisation of valuation service providers

Although client perceptions of valuers tend to be higher in the UK than they are in, say, the USA, a recent study revealed that clients have a narrow view of the role of valuers. It concludes that "despite valuers becoming increasingly involved in measuring corporate efficiency and valuations being used for this purpose, business occupiers do not recognise valuers in a strategic role. Instead, many firms see valuers as providing a single valuation service, the estimation of market value for purchase/sale decisions and corporate disclosure" (Wyatt, 2001).

The challenge for valuers, valuation firms and the professional bodies is to convince clients of the worth of those valuers with broad business skills that include strategic thinking and an awareness of business issues.

Boards of companies are concerned with managing their cost base but many lack a real estate strategy and apply no performance measures to their property. Real estate is increasingly on the boardroom agenda – as the second largest cost after employment, it should be – but often for the wrong reasons. Valuers have every opportunity to add value to the business through innovative property solutions.

Should professional valuation service providers be positioning themselves more with the business and financial world than the real estate world? RICS has recognised that if its members are to offer a wider suite of real estate services they need to have a broad-based understanding of business. Valuers in this market should be competing much more on standard of service, not simply on price. The price is what you pay; the value is what you receive.

There is certainly a need for top class property consulting services. A well educated professional valuer with the right training and experience, who is independent and acts according to recognised standards, will be able to provide a value-added advisory and analysis service. By providing the client with advice that goes beyond the scope of the original information requested, the valuer may actually be providing something of greater benefit than what was requested. This is about valuers helping their clients make the best possible property decisions. The more clients are aware that this service is available, the more they will be willing to pay a fair price for it.

> Quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for . . . Customers pay only for what is of use to them and gives them value (Peter Drucker).

While professionals offering financial or business skills are needed in one part of the valuation services market, those with a base of more technical skills are needed in another part. The profession will have to consider how to train more technicians equipped to handle more of the routine work and who are better able to compete on price. These valuers will need to be skilled to work on the design and implementation of software as well as in risk assessment of AVMs. More importantly, the professional bodies will need to maintain control of the educational and professional standards of these technicians.

Nevertheless it is vital for the public interest that quality across the spectrum is maintained and improved. Professional bodies are ideally placed to ensure quality control (see Figure 1).

Polarisation of approaches

Is there a serious case to be made for the multi-disciplinary approach? As business service providers aim to offer clients a "one stop shop" and where no individual can have all the skills required, it is increasingly likely that valuers will find themselves as part of a multidisciplinary team. This means that the valuer will need a broader based training to be able to understand fully the roles of the others in the team and how they interact.

What is clear is that those valuers and firms with training and experience in the broader property and business sector will be better able to diversify into other areas if markets and opportunities shift. The cost pressures on valuation are high. Those trained into a narrow valuation field may find their future too restricted.

However valuers organise themselves, the public interest remains key.

What needs to be done?

Clients are sending conflicting messages. Funds want quality of service but they do not want to pay for it; they want cheaper valuations but they do not want more automation. Mortgage lenders do want more automated processes to cut costs but have no desire to damage the interests of their borrowers.

Valuers

Valuers will have to negotiate their way through these conflicts, while ensuring that they provide the professional service the client wants. The danger is that valuers, resistant to change, try to impose on the client what they think is needed: the safe environment

Individual valuers will instead need to be forward thinking in assessing the future market for their training and skills so that they will be able to adapt, or retrain where necessary, to provide the services that the market requires: the challenging environment

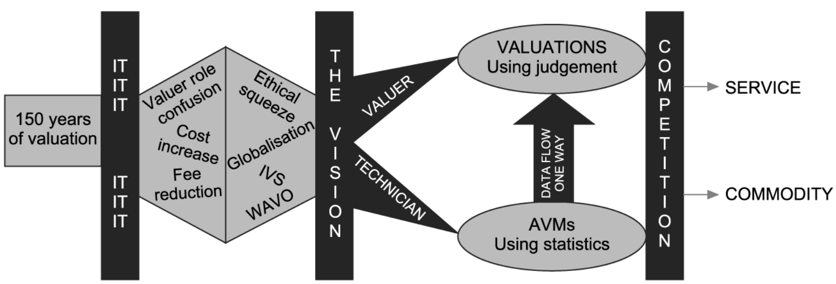

Figure 1.

Source: Barry Gilbertson (2003)

Firms
At one level this is something that individual firms will have to consider – where do they want to position themselves in the market? However, individually or in firms valuers will be unable to address all the issues raised by technological progress, market and regulatory forces or the image of valuation. Nor will they be able to adapt to challenges and to new opportunities on their own.

Education and training
Professional bodies have a crucial role to play in training and education. It may mean developing faculties in the universities to educate new valuers. The Appraisal Institute of Canada has outsourced its education component and is now working with selected universities to provide a broad-based property education that will enable a new generation of appraisers to work in a much wider property market.

Professional education, training and standards will be key given the considerable scope for expansion of valuation services into new geographical markets. Most developing countries now have a land code, some form of private ownership of land and are in the process of drawing up a register of valuation-based land taxes. However, valuation is in its infancy in many of the developing economies, although real estate is often the sole source of collateral available to bring about growth. Trained local valuers have a role to play as advisors on privatisations and disposals of government lands. Global investors will be looking to the valuation profession to help bring about much needed market transparency. The challenge in emerging economies is to develop a professional class of valuers equipped to meet the growing demand for valuation services in the future.

Professional bodies
How can the wide range of valuation qualifications and training available around the world be made to work together? How will valuers service the global client? The professional bodies need to ask whether they really understand what qualifications and skills are needed in the new marketplace. Only then will they be able to equip valuers to adapt while strengthening the protection enshrined in sound valuation standards.

It is encouraging that there is an increasing collective will within the valuation profession worldwide, for example through the World Association of Valuation Organisations (WAVO), to promote the merits and benefits of valuation as a whole. The leading professional bodies globally are well placed to disseminate good practice from around the world and to promote international standards to governments, regulators, clients and to the public. These bodies also have a role to play in ensuring that the principles of sound valuation – protection, transparency and consistency – reach new markets and that the highest ethical standards are maintained worldwide.

Promotion of international valuation standards will help to improve perceptions of valuers and the services they provide, particularly as recognition grows in a number of countries of the need for professional valuers who are properly trained and regulated.

The collective strength of the leading professional bodies globally will greatly assist in providing current and future members with a sense of professional competence that will be recognised on a worldwide basis, raising the profile of the profession to a far higher level of worth and appreciation.

Professional bodies need to raise a debate among members, with the business community and in governments about the paradoxes that innovation and change is raising. They also need to remind themselves that governments have allowed the professions to regulate themselves as long as they continue to serve the public interest. The professional bodies will need to consider how market changes may enhance or undermine the public interest and be ready to defend threats to their public interest role.

Governments

Governments need to be involved in this awareness raising process so that they understand the advantages of good quality valuation and insist on it in their jurisdictions, particularly in new and growing areas of technological innovation such as automated valuation models.

Governments themselves also have extensive valuation requirements and they should lead by example. It is important that they influence the tone of the quality of valuation that should be expected. They have a major role to play in consumer protection – they should insist on a valuation system that has credibility. In some countries, the government devolves responsibility to a private body it can rely on, such as to RICS in the UK, but in others they may have to guarantee consumer and business protection themselves. One way that governments could protect business and investors is to make periodic rotation of valuers mandatory. Corporate governance pressures have put rotation of auditors high on the agenda in the same way.

In some parts of the world, laws preventing multidisciplinary practices need to be addressed. Valuation bodies and their clients should be lobbying governments to permit them to exist as they allow value to be added to the service. While statutory requirements have often been introduced to prevent potential conflicts of interest, there is clear evidence from many other countries that these conflicts can be and are successfully managed. The most important issue is maintaining quality.

The global community of valuation bodies must influence governments to take the issue of PII seriously. PII is a fundamental issue as it underpins the very status of professionals and is a worldwide problem across the professions, yet its cost must be managed to prevent the loss-leader approach.

Still a people business

To ensure that professional competence matches the expectations of the public and the users of valuation services, it is up to the leading professional organisations in the world to ensure that collectively and individually they attract into the profession the best possible candidates.

They must also retain the most talented people with the knowledge, skills, flexibility and ideas – the most valuable of the intangible assets. Loyalty can no longer be taken for granted and so businesses need to be encouraged to build cultures, financial and benefits packages and career paths for their people. Only by having the right people will the profession establish itself and grow on a worldwide basis.

A global profession with a clearly defined public role and reputation for quality, but which also has scope for development into new areas like capital markets, property financing and intangible assets, will excite young recruits. The challenge is for professional bodies to get this message out so that the best young people become tomorrow's valuers. A professional qualification, such as that provided by RICS, is increasingly becoming the "international passport" of choice for young graduates wanting to work across borders.

Conclusions

Market forces are putting pressure on valuation as we know it. Valuers cannot resist market forces: the consequence of failing to respond is inevitable decline in the long term. Some changes, like increased automation, bring new opportunities as well as threats, and the ability of the profession to capitalise on the opportunities depends largely on its ability to deal with the threats.

There is a bright future for the valuation profession as long as valuers and their professional bodies understand the market dynamics and do not shy away from change, even when it is uncomfortable or unwelcome. Keeping the status quo today is in reality going backwards. Is the valuation profession flexible enough to adapt to change and still meet its service delivery criteria? This is what it must do.

Valuation is a public interest profession. It needs to take care in how it handles the new challenges it faces to ensure that its integrity and independence are maintained. If it loses credibility, confidence in it will be damaged and the protection that sound valuation offers will be weakened. Automated valuation will be a key test. It is up to professional valuers and their professional bodies to define transparent and consistent standards in this area and then to lobby governments where necessary to adopt appropriate safeguards.

The valuation world needs to address three key questions. Failure to so will undermine the ability of the profession to face emerging opportunities and threats.

(1) How can valuers persuade policymakers to recognise the worth of good quality valuation?

(2) Are valuers listening to their clients and adapting in response to changing market circumstances?

(3) Do the valuers' professional bodies appreciate what they must do to meet the changing skillset requirements of their members?

However individual states organise their valuation professionals, whether self-regulated or state-regulated, and whatever the market dynamics, the quality of professional valuation should be key.

For valuation is a public interest profession – and every self-respecting country should have one.

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