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Australian Property Institute Limited

VALUATION PROTOCOL – SIGNIFICANT VALUATION UNCERTAINTY

Reference	Valuation Protocol – Significant Valuation Uncertainity
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Valuation Protocol – Significant Valuation Uncertainty

Purpose
This protocol deals with the concept of significant Valuation Uncertainty and is targeted at API Valuer Members (Valuers) who undertake valuations services, including for the avoidance of doubt rental assessments and restricted assessments of real property on behalf of clients.

This protocol includes:
1. What is Valuation Uncertainty?
2. What, in contrast is, significant Valuation Uncertainty?
3. How to assess significance or materiality
4. A sample interim COVID-19 significant Valuation Uncertainty limitation/warning disclosure statement

<u>What is Valuation Uncertainty?</u>

Most valuations will contain some element of uncertainty. Valuation Uncertainty can be defined as:

> *The possibility that the Valuer's professional opinion as to the Market Value of the asset may differ from the price that could be achieved in a transfer of the asset as at the valuation date, assuming all other market conditions and variables remain constant.*

There are three broad categories of Valuation Uncertainty: Market Uncertainty, Model Uncertainty and Input Uncertainty. For further explanation, please refer to Appendix 1, Explanatory Notes of this Protocol.

It is important for the Valuer to decide whether the valuation uncertainty is significant and therefore is required to be disclosed in the report/advice.

How do you Assess Significance or Materiality?

The IVS Glossary at 20.11 states:

"Assessing *significance* and *materiality* require professional judgement. However, that judgement *should* be made in the following context:

- Aspects of a *valuation* (including inputs, assumptions, special assumptions, and methods and approaches applied) are considered to be *significant/material* if their application and/or impact on the *valuation* could reasonably be expected to influence the economic or other decisions of users of the *valuation;* and judgements about *materiality* are made in light of the overall *valuation* engagement and are affected by the size and nature of the *subject* asset."

IVS Valuation Report Disclosure Requirement
In accordance with IVS 103 Reporting, para 10.2, the Valuer should include in any report or advice a clear and accurate description of any significant uncertainty that directly impacts the valuation and its outcome. This is a requirement under *IVS 103 Reporting* para 10.2 which states:

> "To provide useful information, the report *must* set out a clear and accurate description of the scope of the assignment, its *purpose* and *intended use* (including any limitations on that use) and disclosure of any assumptions, special assumptions (IVS 104 *Bases of Value*, para 200.4), *significant* uncertainty or limiting conditions that directly affect the *valuation*."

Given the unknown impact that the current COVID-19 outbreak will have on the Australian real estate market, the API considers that its Members should include a disclosure relating to significant Valuation Uncertainty in their valuation reports.

> *"The outbreak of the Novel Coronavirus (COVID-19) was declared as a 'Global Pandemic' by the World Health Organisation on 11 March 2020. We have seen global financial markets and travel restrictions and recommendations being implemented by many countries, including Australia.*
>
> *The real estate market is being impacted by the uncertainty that the COVID-19 outbreak has caused. Market conditions are changing daily at present. As at the date of valuation we consider that there is a significant market uncertainty.*
>
> *This valuation is current at the date of valuation only. The value assessed herein may change significantly and unexpectedly over a relatively short period of time (including as a result of factors that the Valuer could not reasonably have been aware of as at the date of valuation). We do not accept responsibility or liability for any losses arising from such subsequent changes in value.*
>
> *Given the valuation uncertainty noted, we recommend that the user(s) of this report review this valuation periodically."*

If there are any comments or feedback, please do not hesitate to contact the API via standards@api.org.au

The API is committed to the promotion of best practice within the property industry and welcomes feedback to help this goal be achieved.

Appendix 1 | Explanatory Notes

Causes of Valuation Uncertainty

There are several potential causes of valuation uncertainty. These explanatory notes will consider the following three broad categories.

1. Market Uncertainty,
2. Model Uncertainty, and
3. Input Uncertainty.

Model and Input Uncertainty arise from the valuation process and may be measurable. Market Uncertainty, on the other hand, arises as a result of events which are external to the valuation process and is not typically measurable at the valuation date.

1. Market Uncertainty

Market Uncertainty comes about when a market, as at the valuation date, is disrupted by current or very recent events such as sudden economic or political crises.

The event(s) that cause market uncertainty may be macroeconomic, for example the current COVID-19 outbreak, or microeconomic such as a change to a law or regulation which resets or disrupts a market sector.

In the real estate market, both macro or microeconomic event(s) may result in valuation uncertainty as the only evidence available to be considered by the Valuer is most likely to have taken place before the event occurred and the impact of which was not reflected in market evidence. The impact on sale prices and volumes will not be known until the market has stabilised and a new normal is in place.

Additionally, the API cautions Members in the use of desktop products based on potentially old AVM data during times of market uncertainty.

It is critical that market uncertainty is not confused with market risk. Market risk is the risk that an asset may experience a reduction in value over time as a result of changing market conditions after the valuation date.

Market uncertainty is not measurable as the uncertainty arises from the inability to observe and reconcile the impact of the event(s) on market prices as at the valuation date.

The extent of the impact is unknown at this time and is therefore considered to represent market uncertainty as at the date of preparation of this protocol (20 March 2020).

2. Model Uncertainty

Model Uncertainty arises from the actual valuation model (or methodology) utilised by the Valuer. There may be situations where different valuation models (methodologies) are used to provide an indication of value, and that the different models produce a different outcome. It is then incumbent on the Valuer to select the most appropriate model. This can result in model uncertainty as the selection of the most appropriate model may of itself be a source of uncertainty.

3. Input Uncertainty

Input uncertainty arises where there are a number of equally reasonable or feasible inputs or assumptions, that the Valuer can utilise, and their impact on the outcome of the valuation can be measured by applying reasonably alternative inputs. For example, if the inputs are based on historical data, then the assumptions and methods made to adjust the data to current market conditions applicable at the validation date can be a source of uncertainty.