

Australian Property Institute Limited
Property Institute of New Zealand
New Zealand Institute of Valuers

VALUATION PROTOCOL – SIGNIFICANT VALUATION UNCERTAINTY

Reference Valuation Protocol – Significant Valuation Uncertainty
Effective Date 1 July 2020
Owner Acting General Manager – Standards and Compliance

Valuation Protocol – Significant Valuation Uncertainty

Purpose

This valuation protocol deals with the concept of significant Valuation Uncertainty and is relevant to all API, PINZ and NZIV Members who undertake valuations (Valuers). It replaces the previous protocols published on 27 and 29 March 2020.

This protocol includes:

1. What is Valuation Uncertainty?
2. How do you assess significance or materiality?
3. Requirements to disclosure in accordance with IVS
4. A sample interim COVID-19 significant Valuation Uncertainty limitation/warning disclosure statement

Commencement

The effective date for this protocol is 1 July 2020. Early adoption is permitted and encouraged.

Status of this Valuation Protocol

This valuation protocol is not mandatory but is intended to provide guidance to Members. This valuation protocol does not constitute legal advice.

Reference Material

The IVSC paper “*Dealing with valuation uncertainty at times of market unrest*” is available at <https://www.ivsc.org/files/file/view/id/1719>

What is Valuation Uncertainty?

While market risk may be thought of as a measure of future uncertainties that may result in an increase or decrease in the price of an asset, valuation uncertainty is only concerned with uncertainties that arise as part of the process of estimating value on a specific date.

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:

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

For a further explanation of the above categories, please refer to Appendix 1, Explanatory Notes of this Protocol.

The valuation process, including the investigation and analysis of market evidence remains the same as for times when significant market uncertainty is not deemed to be present. It remains incumbent on the valuer to fully investigate and understand the prevailing market trends to support the assessment and reporting of market value as at the date of valuation.

As per IVS, Valuers must decide whether the Valuation Uncertainty is significant and therefore is required to be disclosed in the report/advice. Any significant uncertainty clause included in a report is a disclosure.

Re-issue or Assignment of Valuations during a Period of Market Uncertainty

Members are cautioned regarding risks of re-issuing or assignment of valuations during a period of Market Uncertainty given there may have been a material change of circumstances. If assigning or re-issuing a valuation Members should alert their clients to any material change in circumstances and recommend a revaluation if considered necessary.

Fair Value Assessments for Financial Reporting during a Period of Market Uncertainty

Users of valuations for financial reporting of fair value are encouraged to have revaluations undertaken so that issues such as impairment or changes in carrying values are appropriately considered.

How to Assess Significance or Materiality?

The Glossary of the IVS at paragraph 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.”

According to IVSC;

“The existence of significant uncertainty does not mean a valuation cannot be undertaken, but it does mean that significant assumptions within the valuation approach and methodology should be disclosed within the valuation report.”

Members are advised that different regions and sectors of markets may respond differently to major events. For example, as a consequence of COVID-19, there may be a significant decline in transactional activity in a particular asset class resulting in increased/significant market and hence valuation uncertainty, whereas in another asset class markets may continue to be active (albeit possibly at reduced transaction volumes). Some locations/regions may experience a contraction in market activity, but not markets in other locations/regions.

In those markets where the Valuer deems that the market continues to function, and where there are transactions which provide reliable evidence of value, significant market and valuation uncertainty may not exist.

Disclosure of market and valuation uncertainty is only required where it is significant and not normal market uncertainty.

Notwithstanding the above, Valuers should be aware of the requirements of their professional indemnity insurance policy which may require inclusion of certain clauses and disclosure statements.

IVS Valuation Report Disclosure Requirement

In accordance with IVS 103 Reporting, 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* paragraphs 10.1 and 10.2 which state:

“10.1 It is essential that the valuation report communicates the information necessary for a proper understanding of the valuation or valuation review. A report must provide the intended users with a clear understanding of the valuation.”

10.2 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.”

Sample Disclosure Statement for Valuation Reports

Where there is evidence of **significant** market uncertainty at the date of valuation, the API, PINZ and NZIV Members must include a disclosure relating to significant Valuation Uncertainty in their valuation reports.

A sample disclosure statement that could be included in valuation reports reflecting the COVID-19 impact is contained below.

Members should review any disclosure statements regularly to ensure that they reflect the prevailing conditions at the date of valuation and the specific circumstances relevant to the asset being valued.

“The market is being impacted by the uncertainty caused by the COVID-19 pandemic. As at the date of valuation we consider that there is market uncertainty resulting in significant valuation uncertainty.

This valuation is therefore reported on the basis of ‘significant valuation uncertainty’. As a result, less certainty exists than normal and a higher degree of caution should be attached to our valuation than normally would be the case. Given the unknown future impact that COVID-19 might have on markets, we recommend that the user(s) of this report review this valuation periodically.

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.”

Comments or Feedback

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

The API, PINZ and NZIV are 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.

These causes of valuation uncertainty are not mutually exclusive. For example, market disruption may affect the availability of relevant data which, in turn, may create uncertainty as to the most appropriate valuation methodology. Interdependence and correlation between the causes of uncertainty are therefore likely to exist and account should be taken of this during the valuation process.

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, political crises and natural disasters.

The event(s) that cause market uncertainty may be both macroeconomic and micro-economic. Macroeconomic would include the 2008 financial crisis. COVID-19 initially could be seen to be a health crisis but in time may have macroeconomic implications. Microeconomic disruption could include, for example, 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 Automated Valuation Models (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.

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.

The Valuers role is not to forecast the worst-case scenario. It is also not a stress test. The Valuer should, as far as reasonably possible, report on reasonable and likely alternative assumptions. The objective is not to provide a forecast of possible fluctuations in the reported value at future dates but to provide information about the variability of the value at the valuation date.

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 valuation date can be a source of uncertainty.