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Lessons learned in the property crash

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Central Bank report highlights systemic failings and identifies areas where improvements can be made in the valuation process, writes EOIN McDERMOTT.

After the banking crisis of 2008/9, the Central Bank undertook to make lending institutions aware of the lessons that can be learned from that episode. Last December, as part of this process, it published a document entitled Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future.

There has been little reaction to date, but in my opinion the document is to be welcomed by all who are involved in commissioning, undertaking or interpreting property valuations for the purposes of secured lending.

The document is written for banks, credit unions and building societies, and offers guidance to ensure that credit risk management standards are appropriate for future demands. It identifies a number of failings by lending institutions and makes recommendations as to how these failings can be rectified. It also raises a number of questions that property valuers may wish to consider.

The following are, to my mind, the main findings of the report:

The Central Bank recognises the Royal Institution of Chartered Surveyors (RICS) asset valuation standards (colloquially known as the Red Book) as being consistent with the rules of international valuation standards. The Red Book contains mandatory rules, best practice guidance and related commentary for all chartered surveyors involved in asset valuations. It was first published in the 1970s, against a background of a property crash and a recession in the UK and has been updated many times since then. While the Red Book is the global valuation standard, the Irish standard is currently being finalised by the Society of Chartered Surveyors Ireland in association with the RICS.

Lenders should seek Red Book valuations from suitably qualified valuers when considering applications for loans or reviewing existing loans. In particular, the practice of using informal valuations is highlighted and criticised. These often took the form of a phone call to the original valuer and a question as to whether the property had increased or decreased since the previous valuation and if so, by how much in general percentage terms. The Central Bank report notes that in the past many valuation instructions were given verbally and were often vague. Compliance with Red Book procedures will require the valuer to confirm instructions in writing, which should minimise the potential for error.

Lenders and valuers are reminded that that there should be no conflicts of interest in preparing valuations. The Red Book states that the lender may specify that the valuer should have no previous, current or anticipated involvement with the borrower or property to be valued (or any other party connected with a transaction). The Central Bank recommendation is along similar lines.

The Central Bank urges lenders to ensure that their valuation panels are consistently monitored to ensure that the valuers have the skill set and experience to undertake particular assignments. It notes that panel appointees often had insufficient qualifications, may not have had appropriate experience for particular assignments and sometimes carried no professional indemnity insurance. The Central Bank also recommends that no one firm of valuers undertake more than 33 per cent of a lending institutions valuations. It also said that where the value of the loan was in excess of €25m, at least two full Red Book valuations should be sought. In addition, loans over € 3m or 5 per cent of the lender's own funds should be reviewed by an independent valuer every three years. Revised valuations should also be sought where there has been a material change to the property.

The report recommends that banks should ensure that their own staff have sufficient training and experience to be able to properly assess valuation reports. It also says that relationship managers and credit staff should be specifically trained in property valuation methods.

The document is written by the Central Bank for lenders and must be viewed in that light. How will the service providers, the property valuers, react?

I believe that the reaction will be very positive. The report addresses many of the issues that valuers have attempted to raise previously, although these have tended to fall upon deaf ears. It has highlighted systemic failings and identified areas where improvements can be made in a straightforward and easily understood approach. The Central Bank is to be congratulated on the production of this report.

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