

EUROPEAN MORTGAGE FEDERATION -EUROPEAN COVERED BOND COUNCIL (EMF-ECBC)

FINAL RESPONSE IVSC AGENDA CONSULTATION 2020

January 2021

II: Automated Valuation Models (AVMs)

Question 2.1: Do you consider AVMs to be a growing area and therefore something IVS needs to address? Please provide your reasoning for your answer as this will help the Board with their deliberations.

We consider AVMs to be a growing area, which should indeed be addressed by IVS. The majority of jurisdictions are observing an increase in their use, particularly for standardised properties such as single-family houses and apartments. The COVID-19 pandemic has further underlined the relevance and value of AVMs as in many countries physical inspections have been prohibited as a result of containment measures, requiring new ways of conducting valuation. In light of this, we consider it important to define the usability framework for AVMs. We believe that their advantages and disadvantages, as well as constraints that can be encountered when using these models should be addressed. Liability issues should also be considered. We also believe that it is necessary to consider other relevant aspects, including minimum requirements (type of real estate, minimum number of comparables, location etc.), model transparency and the role of the valuer when using them at an international level.

In some countries, efforts are being undertaken to create a legal environment for the application of simpler valuation methods in banking practice. Furthermore, in some European jurisdictions the introduction of AVMs is either underway or on the agenda and therefore a well-recognised standard for the use of AVMs could serve as the professional basis for forthcoming legislation.

As regards the European banking supervisory framework in particular, mortgage lending institutions would not be able to comply with all monitoring and revaluation requirements of property values without using automated valuation tools. This has recently also been recognised by the European Banking Authority (EBA) in its Guidelines on Loan Origination and Monitoring of 29 May 2020. We expect this evolution to prevail also on the global level beyond the European Union.

Question 2.2: Should AVMs be included/addressed within IVS? If you think AVMs should be outside IVS how should they be considered and what clarity valuers will require?

As indicated above, we believe that AVMs should be addressed within IVS for the following reasons:

- To react to the increasing use of AVMs;
- To react to the increasing focus of European legislators on AVMs (i.e. EBA Guidelines on Loan Origination & Monitoring);
- To set minimum quality requirements for underlying models and data bases;
- To define the scope of AVMs as opposed to manual valuations.

Question 2.3: Do you agree with the definition of AVM shown below. If no, please provide a suggested alternative definition together with a source for this definition.

We believe that further clarification regarding the definitions is needed as the separation between “AVM” and “Model” presented on page 12 could lead to misunderstandings. In our view it is sufficient to define AVM only, without specifying any model.

Furthermore, we believe that the discussion on definitions should be extended to advanced statistical models as is the case in the EBA Guidelines on Loan Origination & Monitoring.

Finally, we believe that a definition open to ongoing and future developments could be more interesting. With this in mind it could be relevant to capture the development of new and smarter technology which is enabling AVMs to provide more than “an indication of value”. Indeed, the reference to “indication of value” suggests that the result is not an estimate of value. AVMs merely indicating a value are essentially supporting tools, such as in the case of assisted valuations. In our view, where: (i) advanced statistical models are operated under the responsibility of qualified valuers, (ii) their quality is assessed and validated, including the input data which should be appropriate and sufficient and supervised and back tested on a regular basis, and (iii) there is oversight of these models, advanced statistical models could be considered as a standalone valuation mechanism. Indeed, for real estate in well-developed and mature property markets, where the conditions highlighted above are met, the use of advanced statistical models without oversight of the individual value by a valuer is currently the case in certain jurisdictions.

Question 2.4: Do you agree with the definition of Model shown below. If no, please provide a suggested alternative definition together with a source for this definition.

We believe further clarification is required as mentioned in 2.3.

Question 2.5: Should IVS consider Hybrid Valuations as illustrated in the diagram Key Categories of Valuation Methods. Please provide your reasoning together with any examples of Hybrid Valuations currently used in your market.

Hybrid valuations are relevant for lending purposes and should therefore be considered by IVS.

Hybrid valuations play a key role in less mature markets with less available data e.g. in the CEE and SEE region. In these regions, hybrid valuations as semi-automated desktop valuations exist and are used in many internal processes, though not for origination purposes. In markets where AVMs are not yet in full use, hybrid valuations could be the step between fully automated valuations conducted by AVMs and on-site valuations.

Furthermore, in the context of hybrid valuations, we would like to clarify that the physical or manual valuation element of the hybrid valuation should be able to be conducted by both internal and external valuers to the bank.

Finally, we would like to recall our view that in relation to AVMs or advanced statistical models more broadly and the role of the valuer, the use of advanced statistical models without oversight of the individual value by a valuer could be considered as possible where: (i) advanced statistical models are operated under the responsibility of qualified valuers, (ii) their quality is assessed and validated, including the input data which should be appropriate and sufficient and supervised and back tested on a regular basis, and (iii) there is oversight of these models.

III: Environmental, Social and Governance

Question 3.1: What role do you see IVS having in measuring the value of ESG? Please provide details and reasoning with your response.

IVSC should consider what issues should be addressed in efforts to stop climate change. In the valuation practice, ESG risks are one category that should be considered. We believe that there is a tendency to delegate the entire responsibility for the recording and valuation of ESG risks to valuers. We therefore believe it is important to examine the role of the valuer in the recording and valuation of ESG risks and, above all, to narrow it down. We therefore recommend addressing the following questions: What are the ESG factors and ESG risks? Do the individual risks have an influence on values and how can this influence be reflected in the scope of the valuation? What data is required to capture ESG risks?

Question 3.2: How do you consider ESG within your valuation process? Please provide details of your country, specialism and as detailed an example as possible together with any data sources used, if applicable.

In many jurisdictions, the recording and, if necessary, valuation of ESG risks is still in its infancy. In many financial institutions, the extent to which the topic is addressed strategically and across departments is still low. Accordingly, data - e.g. on energy performance certificates - is still not collected systematically and comprehensively in many institutions. In addition, the lack of data and publicly accessible, transparent databases remains an obstacle.

We would like to take this opportunity to draw attention to the [Energy Efficient Mortgage Initiative's \(EEMI\) Valuation Checklist](#) drafted by the Royal Institution of Chartered Surveyors (RICS), which seeks to provide guidance to valuers on the identification of energy efficiency characteristics in buildings that could have an impact on their value. Against a background where ESG considerations are gaining in importance, this is intended to support the valuer community in this area and increase awareness amongst banks so that they can provide appropriate instructions to valuers in the context of the valuation of property for lending purposes.

Indeed, analysis of the correlation between building energy performance, property value and borrower probability of default conducted under the EEMI indicates a negative correlation in relation to both, underpinning the business case for banks in this area, as a result of the subsequent lower credit risk associated with energy efficient mortgages (EEM). It is therefore of utmost relevant that valuers take account of building energy performance characteristics in their valuations and that lenders instruct them to do so. This will deliver the preconditions to price these characteristics into the value on a consistent basis over time and support the creation of a robust value chain which can contribute to the financing of the EU's climate transition.

Finally, under the EEMI, in addition to valuation guidance, efforts have also been made to design a data infrastructure to address the lack of centralised, standardised and comparable data in relation to building energy performance. The resulting EEMI Master Template is intended to support banks in the collection of building energy performance data and integrate this information alongside other key data relevant for banks in credit decision-making. In turn, this Master Template underpins the recently launched EEM Label and its Harmonised Disclosure Template which is intended to provide a quality benchmark to ensure transparency in relation to EEM through data disclosure.

Question 3.3: What definitions and or framework do you currently use when considering ESG in your valuation work? Please provide the definition, framework and source.

Currently the situation is not fully standardised, there are in the market different initiatives and pieces of legislation in the context of ESG, not only at national level but also at the European one. It is difficult to identify only one framework as the attempts to define and group ESG related aspects

vary widely. In this sense and for the current time, in Europe the core piece of legislation is the EU Taxonomy Regulation which aims at implementing the Paris Agreement on Climate Change and steering investment towards environmentally sustainable economic activities. In addition, the ECB has published guidelines at European level as have national regulators, which formulate future supervisory expectations on how ESG risks are to be dealt with in the context of risk management. The possible mapping of these risks in the collateral values is also under discussion.

As indicated above, the EEMI has sought to define potential characteristics of energy efficient mortgage products, as well as providing guidance on the accompanying framework, including on property valuation.

Question 3.4: What are the demands from valuation stakeholders when considering ESG? Please provide details.

Banks are required to reflect ESG risks in their risk management processes and the effects on the collateral value must be presented accordingly. In the future, more data will be required for this purpose, some of which will have to be recorded by the valuer and - if possible - also taken into account in the valuation process. With regard to building-specific data, borrowers/real estate owners will have to provide much more information in the future, e.g. in terms of energy performance of the building, recyclability of building materials, water consumption, energy management systems and much more.

In some countries, when using “market value” in the valuation of real estate, the treatment of ESG factors by the market participants in their valuation is already of utmost relevance. In many real estate markets the EPC-label has already an effect on the market price as suggested above.

Furthermore, this correlates with the increasing recognition described above of the relevance of building energy performance for property value and therefore the importance of banks instructing valuers to assess these characteristics and of valuers having the necessary expertise to do so.

Question 3.5: As outlined above ESG can be subdivided into a number of issues. Can you separately account for any of these issues within the valuation process and if so please provide further details?

Data on ESG risks is not available in many contexts. There is a lack of central collection of data, public registers and provision by clients (if the data exists). Furthermore, where data is available, it is often not comparable, standardised/harmonised or transparent. As indicated above, the EEMI is seeking to address this in the area of EEM through a data infrastructure and EEM Label.

From a real estate perspective, the "E" is probably of the greatest relevance in terms of consideration and possible impact on values. It is almost impossible to single out the impact of each single ESG component on the value of assets.