Mme NOUY

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Basel Committee on Banking Supervision
Bank for International Settlements
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Switzerland

Our Ref: RL

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Dear Sirs

The New Basel Capital Accord

Introduction

The European Group of Valuers' Associations (TEGoVA) is an international association under Belgian law comprising 38 professional associations representing property valuers from 27 European countries.

Since its establishment in 1977, its principal objective has been to agree and publish generally accepted real estate valuation and appraisal standards for adoption within both EU member states and the developing markets of Central and Eastern Europe. Such standards have become a key feature of European valuation practice in recent years and are the benchmark in accordance with which commercial property valuations should be reported to clients and against which competence can be assessed.

A copy of the Fourth edition of the European Valuation Standards (EVS), published in November 2000, is enclosed and parts thereof are referred to later in this submission.

Context of the TEGoVA submission

TEGoVA is aware that its sister organisation, the International Valuation Standards Committee (IVSC), has submitted comments on the proposed New Basel Capital Accord to the Basel Committee and TEGoVA supports the general principles outlined in its submission to which TEGOVA itself contributed. However, it wishes to take the opportunity to submit for consideration some additional comments.

Additional comments

- We question whether the proposals give sufficient attention to the role of real estate as collateral. Research (notably by the Economist Intelligence Unit in 1997 in its report for the Royal Institution of Chartered Surveyors, UK entitled "Global Direct Investment and the Importance of Real Estate") has shown that over 70% of corporate loans are secured against real estate assets. As far as retail loans are concerned residential mortgage lending probably forms the largest part. It is inherently safe. Commercial property lending as a first charge or lending secured against commercial property as collateral carries variable risk for the lender dependent upon its classification. In general it carries relatively less risk than project finance. Let investment grade property would carry low risk to the lender if other prudential banking procedures were followed. The example of the ECAIs is a basis on which TEGoVA and/or IVSC could establish with banks and rating agencies similar ratings for real estate as collateral;

- Standardised Approach to Credit Risk: the standard approach to commercial real estate lending allocates, in principle, a 100% risk weighting to commercial real estate. In practice the risk related to loans secured against commercial real estate varies in accordance with a number of factors. Unpublished research carried out for the European Commission in 1997 showed a pattern of default based more on the market stability sustained and reinforced by the structural framework, financial regulation, etc. Sound real estate lending is predicated on the effectiveness of banking loan protocols, valuation advice (and valuation standards) and the laws on mortgages, foreclosure, bankruptcy, lender priority in case of default, along with corporate finance structures and country risk. Financial stability is a major component in assessing capital adequacy. Mortgage regulations, insolvency laws and lending procedures in which loans were made are more significant than of any arbitrary across the board weighting. Arguably experience in Europe since the European Parliament and Council Directive 98/32/EC of 22 June 1998 amending Council Directive 89/647/EEC on a solvency ratio for credit institutions, and the publication and adoption of the 1997 European Valuation Standards has been of materially less volatility in property markets;

- Loan to value ratios: loan to value ratios have traditionally been used for real estate lending. As a measure on it own this may not be helpful. In periods where values have fallen banks have been protected where they have had equal regard to interest cover from rents/rental value or earnings before interest, tax, depreciation and amortisement (EBITDA) in the case of operational business units;

- Valuation Standards: valuation standards have now developed worldwide with standards in Europe existing since 1977. The third edition of EVS, published in 1997, was translated into 12 European languages. Valuation standards incorporating best practice in systems, procedures and methodology are an essential component of ensuring consistent and reliable valuations are available to banks

and equity investors. This has been recognised, inter alia, by the UN/Economic Commission for Europe (UN/ECE) with which we are working to introduce reliable and professional practices in Central and Eastern Europe. The most relevant European Valuation Standard is EVS 6 on *Valuations for Bank Security Purposes and In Relation to the Issue of Asset and/or Mortgage Backed Securities* on pages 71-82 of the enclosed;

- Certification of valuers: in response to direct pressure from Banks TEGoVA has developed a Certification programme on the basis of EN 45013. The objective is to establish a cadre of valuation experts who have undertaken a rigorous and continuously updated, on a five-year rolling cycle, programme of post-graduate training and examination. The focus has been on requirements in respect of the provision of informed advice related to secured lending, capital markets and other areas where specialist knowledge is required and the client-driven assurance of competence is a pre-requisite of efficient market operations. Launched in January 2000 Certification based on the TEGoVA model has been set up in Germany and at least 5 other European Countries are establishing similar programmes. The implementation of the programme will greatly enhance the capacity of banks operating in Europe to assess and mitigate risk in their loan portfolios. A brochure outlining the certification programme is enclosed;

- Transparency: the aim of valuation standards and certification is to create conditions where transparency is the norm and risk in secured property lending is minimised;

- Corporate governance: corporate governance and the fiduciary responsibility of the valuer is another area along with compulsory professional indemnity assurance which is emphasised by TEGoVA and endorsed by all the professional member associations;

- Market value definition: the IVSC has drawn attention to the definitions within International Valuation Standards. TEGoVA, albeit supporting this definition, has also recognised the adoption by the European Union in law (inter alia, in the Directive on the annual and consolidated accounts of insurance undertakings, the Directive 98/32/EC of 22 June 1998 amending Council Directive 89/647/EEC on a solvency ratio for credit institutions and in relation to competition law) of the definition referred to in the Basel Capital Accord. As such TEGoVA has amplified and provided guidance on the interpretation and implementation of the definition in the EVS;

- Mortgage lending value definition (MLV): TEGoVA welcomes the allowed exceptional treatment and the use of Mortgage Lending Value. Mortgage Lending Value is defined and further guidance and explanation of its use as a risk assessment procedure explained in the EVS. The TEGoVA definition is as follows:-

"Mortgage Lending Value shall mean the value of the property as *determined by a valuer making a prudent assessment of the future marketability of the property by taking into account long term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements may not be taken into account in the assessment of the Mortgage Lending Value. The Mortgage Lending Value shall be documented in a transparent and clear manner."*

- Commercial Real Estate (definitions): the definition of CRE must be consistent between the Standardised and Internal Rating Based Approaches so that rental-income-producing commercial property is included in the RBA. In addition, in the light of the need to classify real estate by relative risk categories, the risk-reducing impact of mortgage collateral must be recognised in the fundamental Rating Based Approach reflecting the robust security provided by mortgage collateral based on rigorous valuation standards; and

- Asset securitisation: a multi-disciplinary working party comprising valuers, bankers and representatives from the rating agencies has been formed by TEGoVA to review procedures and ensure standards are developed in Europe to enhance the due diligence process by which these instruments are rated.

We trust these comments are useful during the Committee's review of the submissions received on its proposals for a new Accord and TEGoVA remains at the disposal of the Committee to expand on the contents of this letter at any time.

Yours faithfully

Rebekah Lowe

Rebekah Lowe
Executive Director

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