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"Real Estate Valuation Updates – the essential guide forward".

Considering the growing importance of Property Valuations especially in the Capital Markets regarding the asset value of a quoted public company, as outlined in the EC directives to conform with the International Accounting Standards (IAS), the Kamra tal-Periti has felt it opportune to organise a Seminar on the above theme towards the end of January 2004.

Financial markets throughout the world are experiencing significant structural change, driven by the process of globilisation. In turn this process has been fuelled by the liberalisation of international capital movements, by widespread financial deregulation and by advances in information and communication technologies. One response has been a concerted drive to establish international standards in areas such as accounting, auditing, banking regulation and valuation.

As financial markets are now international, the European Commission has chosen to build on international standards in areas which are key to real estate valuation, rather than to develop regional European standards. This will force change on national real estate valuation standards and practices across Europe.

In the case of accounting standards the EU has decided not to develop "European" accounting standards, but has set upon a course of adopting International Accounting Standards (IAS) for all listed companies within the EU. Once finally through the EU political machinery, the Regulation on the use of IAS by all EU listed companies, including banks and insurance companies, takes direct effect in EU member states without the need to be transposed into national legislation. The Regulation calls for the use of the IAS by 2005 at the latest. In some cases adoption will be even earlier: for example, IAS must be used as from 2004 by companies listed on Euronext.

As the Reporting Group of Ernst & Young says, "*by adopting IAS, Europe is embracing a vision for financial reporting that is not necessarily that widely known or understood. It is a vision that considers fair value measurement to be paramount, and rejects historical costs, accruals and the realisation principle as irrelevant'.*

Asset valuations are an option under IAS 16, property, plant and equipment (alternative measurement basis), IAS 40, investment property (fair value model although even if the cost model is chosen, the fair value should be disclosed), and IAS 20, Government Grants (grant of non-monetary assets). Asset valuations are required under IAS 22, business combinations (initial measurement of acquired identifiable assets). IAS 19, employee benefits (assets held by a long term-term employee benefit fund) and IAS 36, impairment of assets (net selling price).

The proposal to make compulsory the use of IAS by all EU listed companies represents a huge market opportunity for the valuation profession. Valuation standards need to cover a range of issues; generic valuation issues such as the common bases of valuation; valuation process issues, such as the acceptance of instructions and the contents of reports; conduct and ethical issues; and subject specific issues such as valuations for secured lending and financial reporting. It is not possible for all these issues to be covered by one single set of standards, either international or European, for all purposes in all countries. There are still a large number of nationally specific issues which place requirements on valuers to do particular things in a given country. It is acknowledged that in an era of globalisation, global standards and guidelines are increasingly important. But they do need the support of standards incorporating regional specific issues, with regional standards in need needing the support of national standards

Recent events in the USA in the wake of the collapse of Enron, WorldCom, Marconi, amongst others have highlighted problems that corporate governance should address. There is increasing interest in the European Union in the role that corporate governance plays in business and particularly in the capital markets. Adherence to good corporate governance practices helps improve the confidence of investors, may reduce the cost of capital and ultimately induce more stable sources of capital.

On a macroeconomic level valuation standards based on principles of transparency and accountability are an essential part of a framework of corporate governance and the integrity of the capital markets. On a microeconomic level valuers need to know how corporate governance may affect their fiduciary and audit responsibilities to clients' organisations as well as to other stakeholders and how far it may involve an adjustment of existing valuation protocols.

Reliable valuations are basic corporate governance provisions that will influence a company's ability to mobilise capital. Economic growth is stimulated by the ability to use real estate as collateral to back investment facilitated by the adoption of soundly based valuation standards.

The phenomenon of market shock is being given greater prominence by the events of the 11th September. The valuer used to formulating a market value as at a specific date with evidence based on hard transactions has to further provide advice on the impact of market shock. The shock may arise from natural events (hurricanes, floods, earth tremors, etc), generalised manmade events (oil crisis, currency instability, fraud, environmental disasters, terrorism or war) or, like 11th September atrocities.

The role of property valuers is changing. Occupiers of business premises need property advice to inform their strategic and operational business decisions, based on value rather than cost. These include

Property asset rationalistion
Buy/sell and rent/own decisions
Asset efficiency monitoring
Tax implications

Many of these have become key business management decisions, driven by downsizing and new work practices. There are new opportunities for valuers to service a growing demand for property advice as businesses outsource more and more of their non-core functions.

There is a perception that valuation is a standard service and valuations are commissioned for limited reasons. The challenge is to add value to the standard valuation. Business occupiers want property advice over and above an asset valuation. Rather than providing a snapshot of the market value of a property asset, in a consultancy role valuers can provide strategic advice over the long term in the form of worth appraisals and performance measurement, based on value rather than cost. Valuers have to move from the technical to the strategic role.

Valuations for operational reasons include:

Asset valuations for corporate disclosure
Market valuations for loan security and other financing arrangements
Property occupation or investment decisions such as acquisitions, disposals or development
Taxation and other statuory reasons

Valuations are also required for strategic reasons:

Stock exchange prospectuses and circulars
Takeovers, mergers and acquisition
Performance measurement
Lease/buy decisions
Company restructuring
Expansion, downsizing and relocation.

Further, planning instruments are being used for purposes wider than planning, with landowners carrying the costs of the increased infrastructure and services. Planning obligations are being regarded as a useful mechanism for extracting additional community benefit from developers. Planning obligations have, become a financial and hence a market orientated mechanism through which the social and environmental consequences of development can be determined and their costs met. This results in essentially financial matters being material to many planning decisions. Marketisation of the planning process places practitioners in a difficult position, with a possible lack of awareness amongst planners of the financial implications of development.

This seminar will be of interest to Periti, auditors, bankers, stock brokers, financial intermediateries, estate agents.

A sub-committee of the Kamra has over the past year produced a document on Valuation Standards based on The European Group of Valuers' Association (TEGoVA) and International Valuers' Standards (IVS), to be adopted by members.

Issues dwelt on relate to compliance issues, accredition for valuers, valuation reporting, forms of valuation, valuations for bank security purposes, valuation for investment – insurance companies, property unit trusts and pension funds, valuations based on operational performance of business trading properties, valuations of assets for development, agricultural property, and valuation of historical properties. As appenda are found standard method of measurement, together with a proforma valuation report for residential properties, relevant sections from the Agricultural Leases Act and the International Accounting Standards (IAS) are included. A historical outline of the Perit as a Valuer concludes the document.

This document will be launched during the above seminar. This should eventually lead to accredited Kamra Valuation members after having followed successfully a Continued Professional Development (CPD) course, to be organised after this Seminar. This outlines the necessity of a Property & Facilities Management stream being offered as an option in the faculty of Architecture & Civil Engineering, something that the Kamra has been seeking over the past years.

Perit Denis H. Camilleri
Conference co-ordinator
Kamra tal-Periti.

The above draws heavily on the monthly publication "European Alert" & " Fibre - findings in built and rural environments".

THE SUNDAY TIMES
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JANUARY 25, 2004

Real estate valuation updates

The essential guide forward

by **Denis H. Camilleri**

CONSIDERING THE growing importance of property valuations, especially in the capital markets regarding the asset value of a quoted public company, as outlined in the EC directives to conform with the International Accounting Standards (IAS), the Chamber of Architects has felt it opportune to organise a seminar on this subject.

It is being held on Thursday, February 5, at the Westin Dragonara and is sponsored by Bank of Valletta plc, HSBC Bank Malta plc, the Malta Financial Services Authority and Middlesea Valletta Life Assurance Co Ltd.

Financial markets throughout the world are experiencing significant structural change, driven by the process of globilisation. In turn this process has been fuelled by the liberalisation of international capital movements, by widespread financial deregulation and by advances in information and communication technologies. One response has been a concerted drive to establish international standards in areas such as accounting, auditing, banking regulation and valuation.

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It is not possible for all these issues to be covered by one single set of standards, either international or European, for all purposes in all countries. There are still a large number of nationally specific issues which place requirements on valuers to do particular things in a given country.

In this age of globalisation, global standards and guidelines are increasingly important. But they do need the support of standards incorporating regional specific issues, with regional standards needing the support of national standards.

Recent events in the USA in the wake of the collapse of Enron, WorldCom, Marconi and the recent Parmalat scandal in Italy, among others, have highlighted problems that corporate governance should address. There is increasing interest in the European Union in the role that corporate governance plays in business and particularly in the capital markets.

Adherence to good corporate governance practices helps improve the confidence of investors, may reduce the cost of capital and ultimately induce more stable sources of capital.

On a macro-economic level valuation standards based on principles of transparency and accountability are an essential part of a framework of corporate governance and the integrity of the capital markets. On a micro-economic level valuers need to know how corporate governance may affect their fiduciary and audit responsibilities to clients' organisations as well as to other stakeholders and how far it may involve an adjustment of existing valuation protocols.

Reliable valuations are basic corporate governance provisions that will influence a company's ability to mobilise capital. Economic growth is stimulated by the ability to use real estate as collateral to back investment facilitated by the adoption of soundly based valuation standards.

The phenomenon of market shock is being given greater prominence by the events of September 11, 2001. The valuer used to formulating a market value as at a specific date with evidence based on hard transactions has to further provide advice on the impact of market shock. The shock may arise from natural events (hurricanes, floods, earth tremors, etc.), generalised man-made events (oil crisis, currency instability, fraud, environmental disasters, terrorism or war) or, like September 11, atrocities.

The role of property valuers is changing. Occupiers of business premises need property advice to inform their strategic and operational business decisions, based on value rather than cost. These include property asset rationalisation; buy/sell and rent/own decisions; asset efficiency monitoring; and tax implications.

Many of these have become key business management decisions, driven by downsizing and new work practices. There are new opportunities for valuers to service a growing demand for property advice as businesses outsource more and more of their non-core functions.

There is a perception that valuation is a standard service and valuations are commissioned for limited reasons. The challenge is to add value to the standard valuation. Business occupiers want property advice over and above an asset valuation.

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Further, planning instruments are being used for purposes wider than planning, with landowners carrying the costs of the increased infrastructure and services. Planning obligations are being regarded as a useful mechanism for extracting additional community benefit from developers.

Planning obligations have become a financial, and hence a market oriented, mechanism through which the social and environmental consequences of development can be determined and their costs met.

This results in essentially financial matters being material to many planning decisions. Marketisation of the planning process places practitioners in a difficult position, with a possible lack of awareness among planners of the financial implications of development.

This seminar will thus be of interest to architects, auditors, bankers, stockbrokers, financial intermediaries, tax advisers, academics, estate agents, and students.

A sub-committee of the Chamber of Architects has over the past year produced a document on valuation standards based on the European Group of Valuers' Association (TEGoVA) and International Valuers' Standards (IVS), to be adopted by members.

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Further, as appendants are found, a standard method of measurement, together with a *pro forma* valuation report for residential properties, relevant sections from the Agricultural Leases Act and the International Accounting Standards (IAS) are included. A historical outline of the architect as a valuer, with the relevant legislation affecting valuations, concludes the document.

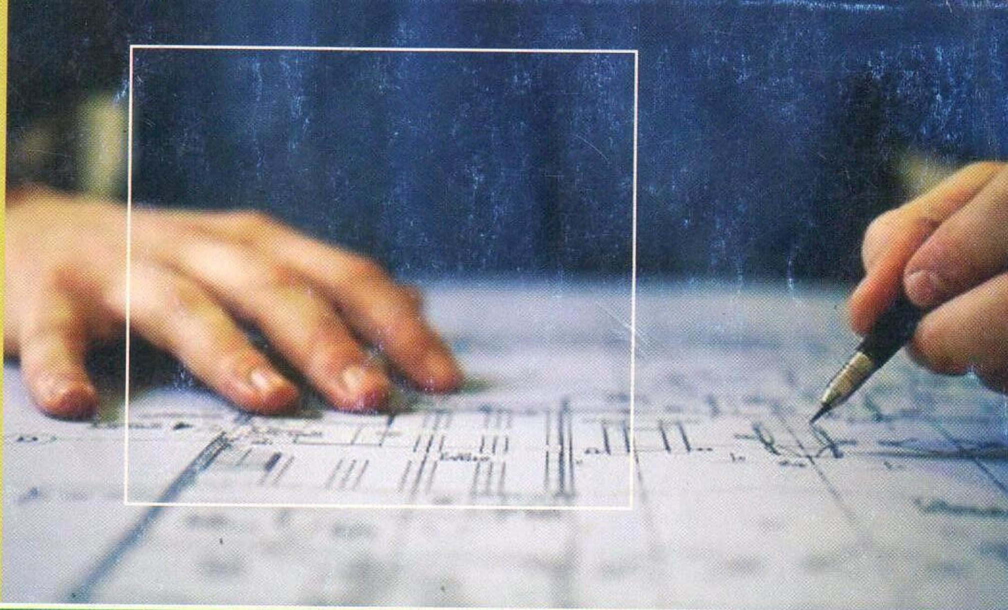
This document will be launched during the seminar on February 5. This should eventually lead to accredited Chamber of Architects valuation members after having followed successfully a Continued Professional Development (CPD) course, to be organised after this seminar.

This outlines the necessity of a property and facilities management stream being offered as an option in the faculty of Architecture and Civil Engineering, something that the Chamber of Architects has been seeking over the past years.

For further details phone 2131-2888, fax 2134-3002 or e-mail: *mfpb@maltanet.net.*

Architect Denis H. Camilleri is the conference co-ordinator.

The above draws heavily on the monthly publication European Alert *and* Fibre: findings in built and rural environments.



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"**KAMRA TAL-PERITI** VALUATION STANDARDS FOR ACCREDITED VALUERS" **2004**

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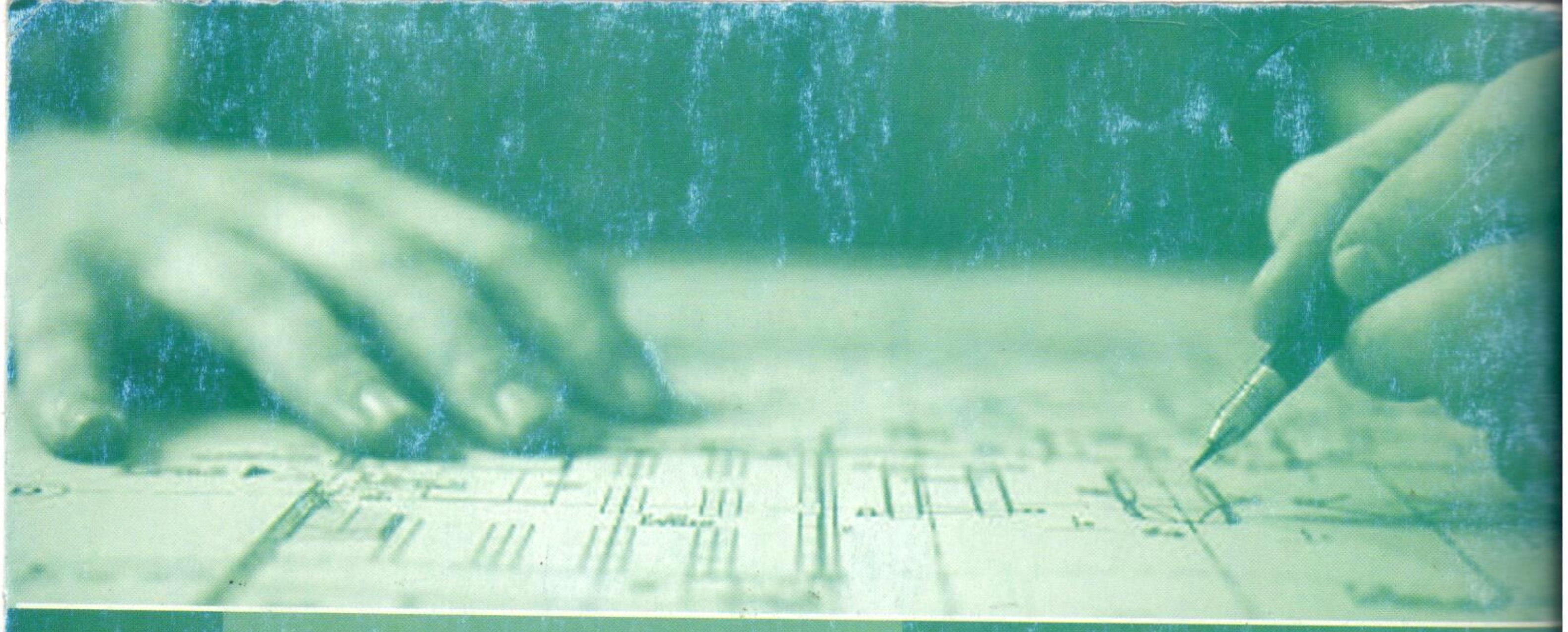

These Valuation Standards are to increase awareness in the role performed by the KAMRA'S ACCREDITED VALUERS
Their role is shifting from technical to the strategic.

Rather than providing a snapshot at the market value at the property asset, accredited valuers can provide strategic advice over the long term in the form of worth approvals and performance measurement based on value rather than cost.

"**KAMRA TAL-PERITI** VALUATION STANDARDS FOR ACCREDITED VALUERS" **2004**

Constitution of Valuation Sub-Comittee Working Group:

Perit D.H. Camilleri	Chairman
Perit O. Camilleri Gaglione	Perit in Private Practice
Perit N. Sammut Tagliaferro	Kamra Tal-Periti
Perit J. Sciberras	Director General – Government Property
Perit A. Zammit	Perit in Private Practice, past lecturer in Valuation Theory

Corresponding Member:
Mr A. Mifsud (Director of Agriculture)

Secretaries to the Working Group:
Ms R. Gauci
Ms D. Spiteri

The compiling of this Valuation Standard has made considerable reference to European Valuation Standards (EVS) 2000, a publication by the European Group of Valuers' Association, TEGOVA (www.tegova.org) and we have obtained written consent from TEGOVA & the Estates Gazette for which we would like to express our gratitude.

Please note: References to the masculine, include where appropriate, the feminine.

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INDEX OF CONTENTS

PROPERTY IN A PORTFOLIO CONTEXT

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KAMRA TAL-PERITI CONFERENCE

February 2004

-“Real Estate Valuation Update”

- the essential guide forward

INVESTMENT YIELDS AND INFLATION 1950 - 2000

YEAR	ORDINARY SHARES	BANK RATE	RETAIL PRICE INFLATION	PRIME SHOPS	PRIME OFFICE	PRIME INDUSTRIAL
1950	5.5	2.0	2.4	5.5	6.5	N/A
1955	6.25	4.0	6.2	5.5	7.0	N/A
1960	5.0	6.0	1.8	5.5	7.0	10
1965	5.25	6.5	4.6	6.0	6.5	9.0
1970	5.0	7.5	7.9	7.5	7.5	9.0
1975	6.75	10.0	24.9	6.5	6.5	9.0
1980	6.45	15.0	15.1	4.5	5.5	7.5
1985	4.75	10.0	5.3	4.5	5.5	8.0
1990		12.0	4.0	4.5	5.5	7.5
1995		7.0	3.0	4.5	5.5	7.0
2000		6.5	2.4	4.5	5.5	7.0

CORRELATION BETWEEN ASSET CLASSES 1987-1995

	Property Direct	Property Companies	Gilts	Shares
Property Direct	1.0	-0.01	-0.38	-0.09
Property Companies		1.00	N/A	0.80
Gilts			1.0	0.78
Shares				1.00

Note: The correlation coefficient varies between 0 (not strong) and 1 (strong) and may be positively or negatively (- in table) correlated

Source: RICS (1997)

However, property companies exhibit high correlation with the stock market and low correlation with the direct property market, capturing only a small portion of direct property market returns.

FURTHER TO DIRECT & INDIRECT PROPERTY

On the other hand yearly valuation-based series for direct property as opposed to the indirect property markets subjected to continuous transaction-based property information, tends to indicate that the publicly-traded indirect property vehicles are more likely to reflect changes in property market fundamentals.

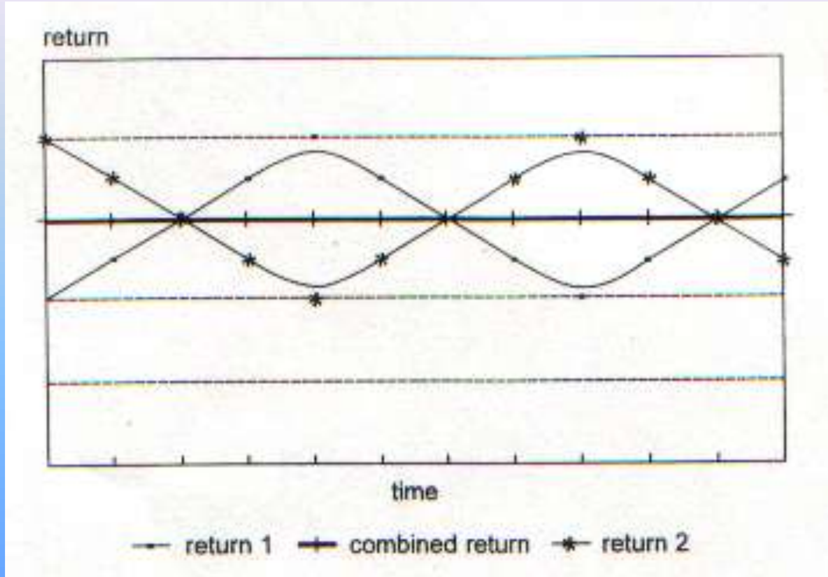
Studies have shown this time-lag could be up to one year with property companies leading direct property.

WHAT ARE THE IMPLICATIONS OF PROPERTY?

The Case for Property: Property is negatively related to equity & gilts. Therefore, including property will enhance portfolio returns & reduce risk.

Property offers more opportunities for active management than equity & gilts. The only way to improve performance on the latter 2 investments is to sell & purchase something else. With property you can restructure the lease, marriage value, refurbishment & finally re-development.

Perfect negative correlation of investment returns



Diversification in a two-asset portfolio:

Expected return:

Investment	Return			Average return	Standard deviation
	Optimistic	Average	Pessimistic		
A	12	10	8	10	1.63
B	20	10	0	10	8.16
C	0	10	20	10	8.16

Assume a two-asset portfolio with three investments to choose from. Investment A is a low-risk investment, B & C are both volatile. 50% of funds will be invested in each investment.

Combined portfolio:

Investment	Return			Average return	Standard deviation
	Optimistic	Average	Pessimistic		
$(A + B)/2$	16	10	4	10	4.89
$(A + C)/2$	6	10	14	10	3.26
$(B + C)/2$	10	10	10	10	0

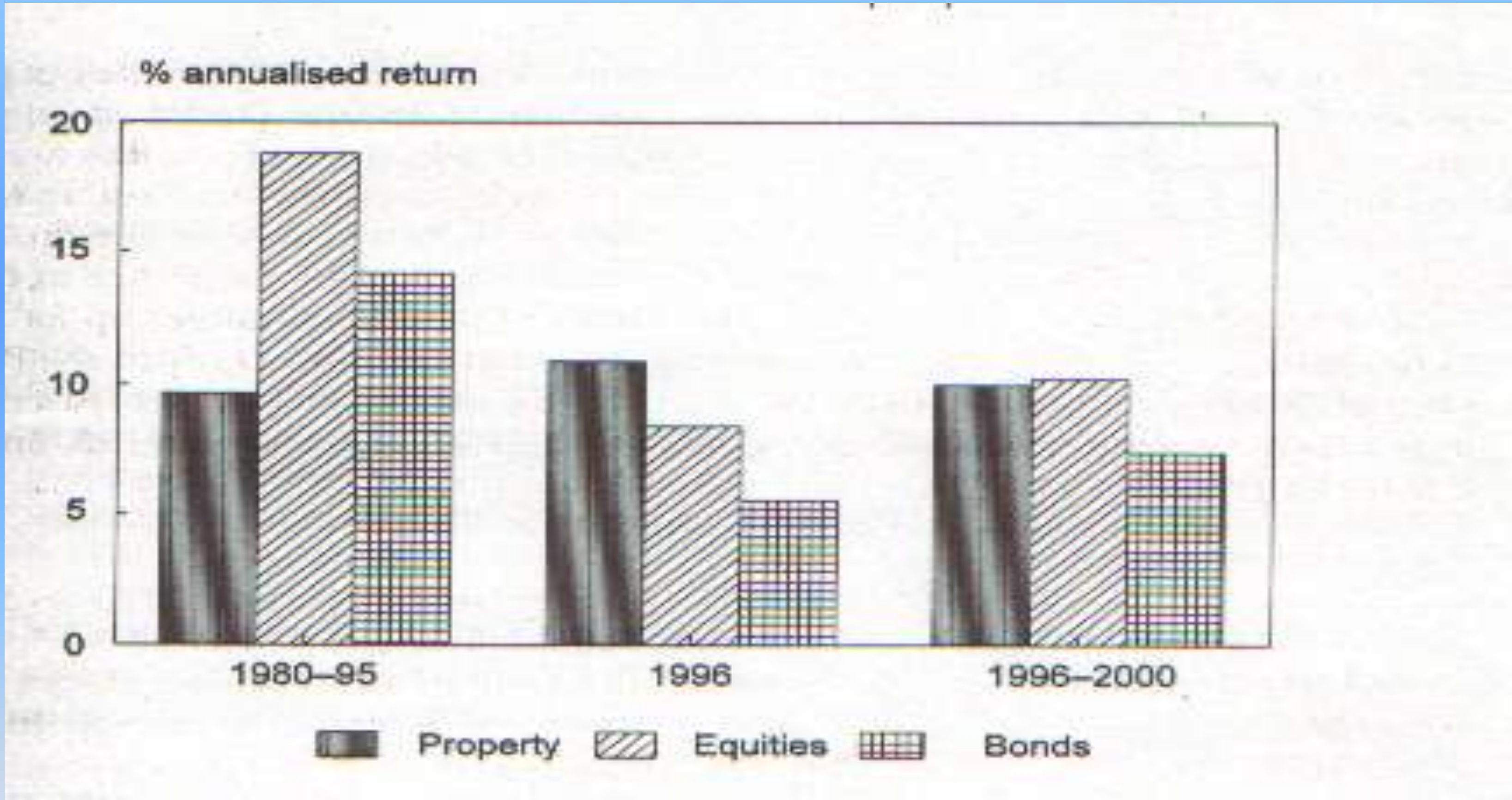
MEASURING RISK QUANTITATIVELY

(a) The standard deviation of series for return from property investment which shows the variability around the “average” return

(b) The correlations coefficient by which movements in returns of property are related to movements in returns of other assets, to show its risk reduction qualities in a mixed asset portfolio.

(c) The Beta coefficient of property i.e the slope of the regression line when returns from property are regressed against market returns, to show its relative sensitivity to market movements

COMPERATIVE PERFORMANCE OF INVESTMENTS



AVERAGE RETURNS & RISK FOR PROPERTY 1987 – 1995

SECTOR	AVERAGE RETURN %	STANDARD DEVIATION %
Direct Property Total	10	3.64
Offices	8.7	4.56
Retail	9.4	3.13
Industrial	14.2	4.17
Property Companies	13.3	23.57
Equities	15.7	18.71

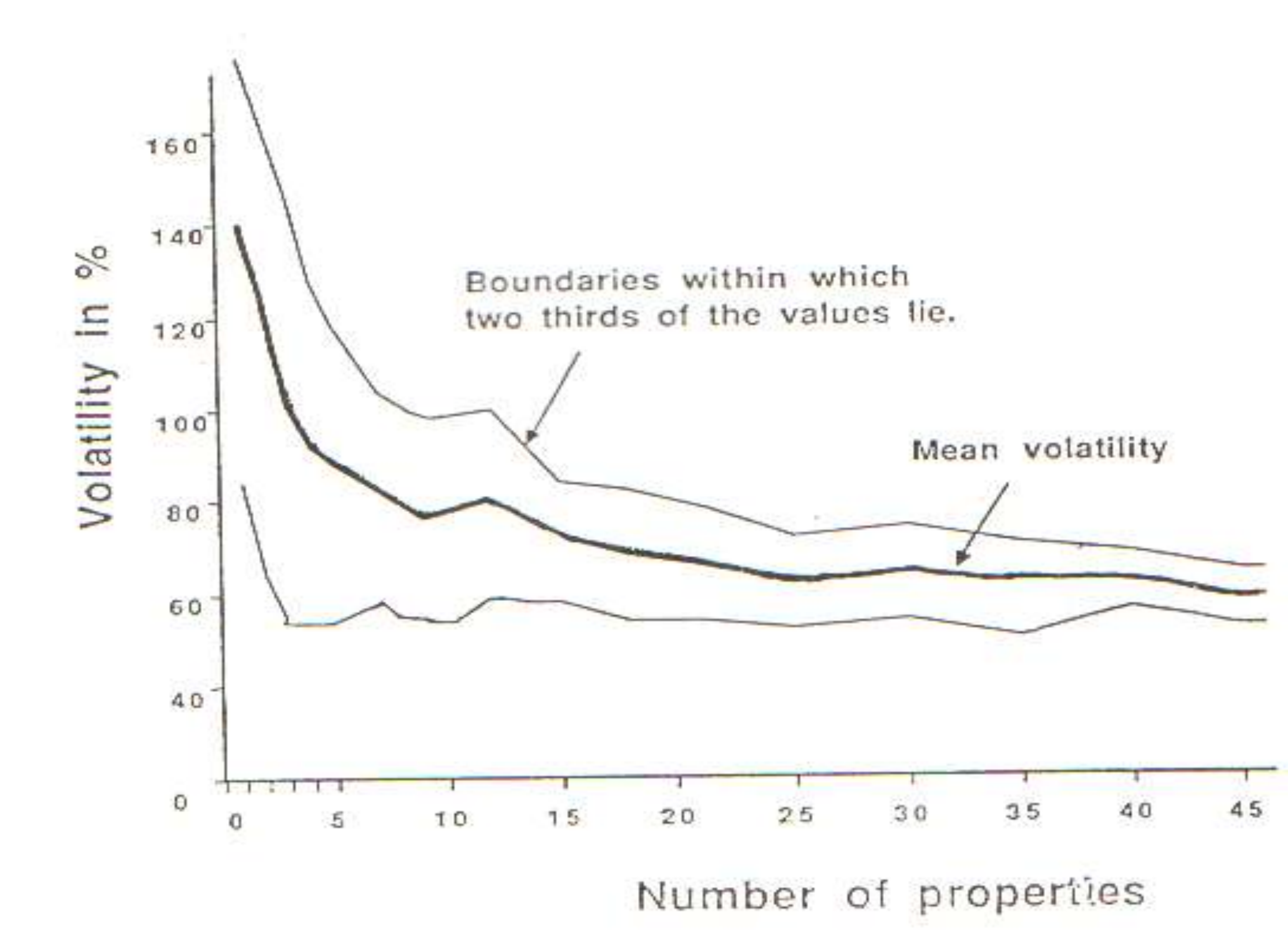
Expected Return on a Security = Risk-free Rate + beta (expected return on market portfolio – Risk-free rate)

A beta of 2 makes for an aggressive market since security twice as risky as market, whilst a beta less than 1 goes for a defensive market

Estimated betas for each sector measured relative to the property market (1978-83)

Sector	**Beta**
Office	0.943
Retail	1.041
Industrial	0.850

PORTFOLIO CONSTRUCTION - I



This shows that the number of properties necessary to remove the majority of specific risk is in the order of 30 to 45 equally sized investments. In the equities market note that 10 to 20 randomly selected shares would diversify away 90% of the non-market risk.

CORRELATION MATRIX BETWEEN SECTOR

	Industrial	Offices
OFFICES	0.9	0.82
RETAIL	0.82	

PORTFOLIO CONSTRUCTION II

DIVERSIFICATION ACROSS SECTORS - This could vary from

UK	35% offices	50% retail	15% Industrial	
UK	40% offices	40% retail	20% Industrial	
USA	30% offices	25% retail	10% Industrial	35% apartments

HOW MUCH PROPERTY IN THE PORTFOLIO

Empirical studies to date have shown that asset allocation models choose very high weightings in property, typically in excess of 50%, based on historical performance evidence.

Many investors will not accept this result, not least because they are suspicious of the core data that is fed in and that they do not believe that property is as risk free as this data would suggest. Studies in America have shown that models will still select high weightings in property, again in excess of 20%.

COMPUTER SPREADSHEET TECHNIQUES

Computer software known as an Optimiser can calculate how much of each asset should be held in order to achieve an efficiently diversified portfolio.

Inputs required are expected return on each asset, the uncertainly of this return (SD) and the extent of co-variance of pair of assets measured by correlation coefficient.

CORPORATE REAL ESTATE

- RETURN ON REAL ESTATE IS GENERALLY LOWER THAN RETURN ON CORE BUSINESS
- SPECIFIC NATURE OR LOCATION negative influence return on Corporate REAL ESTATE
- Most Corporations are more than happy when they realise a revenue growth from 3% to 7%
- Image of their buildings in marketing campaigns with savings in marketing expenses, may even offset constructions costs
- Relocation of premises may occur for employee satisfaction

PERCEPTIONS OF PROPERTY RISK

1. The most important reasons for including property in a portfolio were the long term return and the low level term risk. The next most important reason was the need to diversity the portfolio.
2. 85% said that they considered the lack of short term volatility of property an advantage.
3. The most important disadvantage of property was illiquidity. Only 19% were neutral to this feature.
4. High units costs were a severe problem to 22% and minor problem to 44% but for large investors this was perceived to be a key advantage.
5. 40% were neutral to management costs. They were seen as recoverable and active management was viewed as an opportunity for increasing return not a burden.
6. The specialist knowledge needed to investing in property was seen as a further disadvantage.

MARKET EFFICIENCY

Access to property market information is more restricted thus leading to more inefficiency.

There is thus a greater likelihood of dealers earning abnormal returns.

Efficiency of the market is difficult to test with valuation models based on the comparison method, as no indication is given whether property is under or over-priced.

VALUERS TO SHIFT FROM THE TECHNICAL TO THE STATEGIC ROLE

The use of ‘appraisal’ rather than ‘transaction’ date in portfolio analysis taking into account the risk involved leads onto ‘Market Worth’ which is the price at which an investment trades where buyers and sellers use, in an efficient manner, all available information.

TYPES OF INVESTORS

- **Risk Averse** – actions involving high risk or large monetary loss are avoided.
- **Risk Neutral** – typical of owners of enormous wealth.
- **Risk taker** – takes the possibility of achieving the maximum reward from even the most dangerous gamble.

EPILOGUE

- Clients are return orientated
- Client is not happy to hover around the bottom of the performance table because he has a commensurately low level of risk.
- Competition will not be removed from the market – therefore RETURN will always be KING.