The Valuation Profession in Australia: Profile, Analysis and Future Directions

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Abstract

Like many professions and industries the valuation profession is experiencing a more competitive environment. There is a need to establish where the valuation profession is going and, by definition, where it is now, for strategic planning purposes at both the profession and corporate level.

This paper analyses the issues facing the profession in Australia and uses Michael Porter's conceptual framework of "How Competitive Forces Shape Strategy." to better understand these issues and the direction the industry might take to succeed in an uncertain world. It is suggested that such an analysis could assist the strategic planning of major industry groups including API, RICS, as well as providing a basis for the Universities to consider the needs of the profession in the future.

Introduction

In recent years the property professions have had to address a number of significant issues including inter alia, the role of desktop valuations, the level of fees, the supply of qualified valuers, the impact of increasing professional indemnity insurance, the role of education and conflicts relating to professionalism in an increasingly competitive market. Fundamental questions regarding the future direction of the real estate valuation profession are being posed.

Questions about the future of the profession are, of course, not new as every profession needs to analyse and monitor its role and performance in the economy. Indeed the, question 'do appraisers have a future?' was the subject of a letter from McHolland R. to The Appraisal Journal as far back as October 1994 (v62,4 pg 638). He proposed that 'the appraisal industry is being left with clients who really do not care about what we can do. They have come to expect little from appraisers and are not willing to pay much for our services. It is a vicious downward spiral – as clients put downward pressure on appraisal fees, providers of appraisal services tend to do less. Clients become even more disenchanted and insist on paying less, get less and ad infinitum'. Valuers in Queensland, and undoubtedly throughout Australia, have been echoing these sentiments. The World valuation congress of July 2003 verified a wider concern about such issues and the general theme at that conference was 'is there a future for the valuation profession?'

It is not surprising, however, that valuers are recently preoccupied with the future of the profession considering the rapidly changing business environment of the last couple of decades of the twentieth century with the focus on cost minimisation. The business environment has become more competitive for valuers as with most knowledge based professional services. The global village and information exchange via the internet means that only the most competitive will prosper. There is no room for inefficiency and clients will not pay for services that do not add value to their function. If valuers are to survive, they must offer a competitive advantage and provide cost effective services that meet client objective. This is most succinctly put by Barry Gilbertson when he wrote *'There is agreement that the pace will accelerate the pace of change, the need for electronic and dynamic knowledge transfer, the degree of compulsion and the urgency to find a workable solution to reverse the greying of the profession'* (Gilbertson B 2003;345)

In order to address the many issues facing the profession, it is necessary to understand the relationships between the various drivers of change and to establish a framework for analysis. In many instances there is a tendency to consider the issues in ad hoc fashion to the detriment of understanding the big picture. There is a need to define the real estate valuation profession in the first instance and determine the dominant forces which are shaping its structure. From this platform, it is possible to more readily predict the future and therefore plan for its success. The first step in this process must be to establish the analytical framework upon which the issues facing the profession can be evaluated.

The Analytical Framework

Although this paper has so far referred to the term valuation profession, the terms real estate valuation profession and valuation industry can also be applied synonymously. It is reasonable to suggest, therefore, that the tools widely used by economists and other disciplines to analyse industries can equally be applied to the real estate valuation profession. One universally accepted framework for the organization of information about industries which enables a rigorous approach to industry analysis is the 'Five Forces that Drive Industry Competition' Model developed by Michael Porter and reproduced in Figure 1 below.

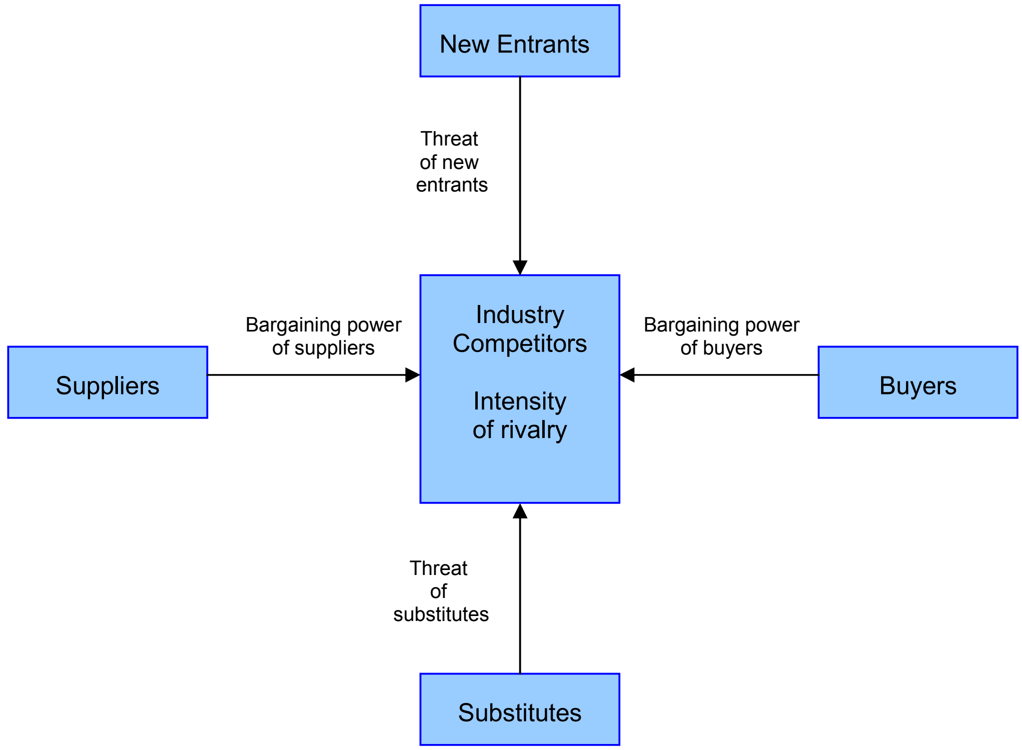

Figure 1 Porter's Five Forces Model

Porter's model assumes competition is the background to industry structure and a firm's performance. The model uses the widely accepted definition of industry as a collection of firms with the capacity to provide services which are close substitutes to each other. This definition can be readily applied to the real estate valuation industry of Australia which is thus defined in this paper as a collection of companies offering valuation services that satisfy the same basic customer need for real property appraisal. A real estate valuation company's closest competitors, its rivals, are considered to be those organisations that serve the same basic customer needs. To the extent that some public sector Government Departments are now operated within quasi private sector parameters and compete in the market for the commercial provision of valuation services, means that they to fall within this definition of competitors. As such, the immediate force of firm rivalry and intensity of competition within existing firms in the valuation industry is represented by the central box in Figure 1.

Aims and Objectives

Porter's model, as outlined above, provides a context to the issues facing the real estate valuation profession alluded to in the introduction and fulfils the objective of illustrating how they might be inter-related. This paper aims to provide a structural analysis of the real estate valuation industry and, in particular, to provide a platform for understanding the five fundamental forces of competition that have changed and will continue to change the nature of the valuation industry. In addition, the model or framework will enable a balanced and sound basis for discussing the future direction of the profession. This will enable senior players in the industry, along with the industry professional bodies, to plan for the future rather than react to problems as they arise. The model will provide the necessary context and employer skills basis that in turn will shape future academic programs in real estate, ensuring that new graduates are fully equipped to compete within the industry.

The Structural Analysis of the Real Estate Valuation Industry

The intensity of competition within the valuation industry, in terms of Porter's Model, is established by the generic five forces of competition shown diagrammatically in Figure 1 and listed below:

1. the bargaining power of suppliers
2. the bargaining power of buyers (clients)
3. the threat of new entrants
4. the threat of substitute services
5. the intensity of rivalry among existing firms

These significant forces to the valuation profession are, primarily, outside forces as they impinge on all firms within the valuation industry. The forces affect firms to different degrees as they have differing abilities to deal with each of them. This is the key to formulating future scenarios for the industry.

These forces should also be distinguished from the many short run factors that can affect competition and profitability (Porter 1980, p6). Such short run factors would include fluctuations in economic conditions over the business cycle leading to minor spurts in demand. It could be argued that the recent residential price bubble, and the consequent high rates of activity in the residential mortgage sector, has led to a shortage of property valuers to undertake the increased demand for mortgage valuations. This is a short term spurt rather than any long term factor associated with the five fundamental forces listed above and it can be readily seen that the situation is likely to rapidly return to the status quo.

The external forces of entry, threat of substitution, power of buyers and suppliers reflect the fact that competition in the valuation industry goes well beyond the established players and current competition. Customers, suppliers, potential entrants and substitute services are all competitors to existing valuation firms in the wider sense and each competitor or competitive force will vary in influence depending on the particular circumstances (ibid).

The weight and direction of these competitive forces will now be considered individually in more detail below:

The bargaining power of suppliers

Powerful suppliers to firms can increase the input costs into the valuation industry and put pressure on profits within the industry. In terms of measuring the power of the supplier, the question arises 'what fraction of a particular input to the valuation industry is supplied by a given vendor and what fraction of the supplier's output does the buyer (the valuation firm) use?'. In order to find the answer, the nature of the suppliers and, more particularly, the nature of the input and output has to be considered.

Within the real estate valuation industry, the standard input to a firm could be described as follows;

1. Labour
2. Office accommodation and equipment
3. Data relating to property markets
4. Intellectual property from other support services

In general, the power of suppliers is related to the number of suppliers and the specific inputs they provide. If there are few suppliers of a critical input then the power of the supplier as a competitive force is strong. With regard to the inputs outlined above, it could be argued that there is not any critical input factor in the hands of one or few suppliers.

Considering the inputs listed above in isolation, it could be said that the most critical input is professional labour which would typically form 50% or more of the total expenditure of a firm. Suppliers of this input, professional labour, are not necessarily restricted or collectively organized and it is therefore postulated that they are not a threat in terms of a competitive force. When there are boom times, it is to be expected there will be a shortage of experienced and professional staff and thus it might appear that the power of labour would be more significant in terms of costs to the firm. To compensate for this, however, it is probable that the extra costs would be offset to some extent by more revenue.

A more significant issue in terms of the supply of labour relates to a possible long term decline in the number of practising valuers as has been observed in New Zealand (Humphreys D Nov 2003). This does not appear to be the situation in Queensland. From Table 1 below, it can be seen that the numbers of registered valuers since 1999 has remained relatively constant. The number of registered valuers leaving or retiring from the industry is only a little above new graduate admissions. It should be noted that the relatively large number of valuers leaving the register in 2003, and the subsequent drop in total registrations, is thought to be attributable to the introduction of compulsory CPD requirements.

Table 1 Registered Valuers in Queensland

YEAR	1999	2000	2001	2002	2003
Number	1391	1393	1398	1417	1415
Less retired/removed	57	47	48	73	175
SUBTOTAL	1334	1346	1350	1344	1240
Reinstated	11	6	45	6	5
Graduate Admissions	36	34	44	36	42
Mutual Recognition	14	13	20	27	28
TOTAL	1393	1398	1417	1415	1318

It is estimated that 33% of registered valuers in Queensland are over the age of 50 with the future consequence of more valuers expected to retire than will be replaced by graduates seeking careers in real estate valuation. This is confirmed by a recent survey of registered valuers in Queensland. The results are exhibited in Table 2 below:

Table 2 Retirement Expectations

When do you intend to retire from full time practice		
	Number of respondents	% of total respondents(352)
By end of 2005	43	12%
By end of 2007	33	9%
By end of 2010	57	16%

The survey response rate to this question was 352 registered valuers out of a total of approximately 1318 registered valuers in Queensland. Assuming this result provides a reasonable representation of age profile and attitudes to retiring, then this would extrapolate to an estimated 480, or 36% of registered valuers retiring over the next five years. It can probably be argued though, that the expectancy of retirement age may well be optimistic and the above figures not so acute with respect to the future supply of registered valuers. Nevertheless, the retirement predictions, together with the long term projections for future economic and associated population growth in Queensland, suggests there could be problems in the supply of registered valuers unless steps are taken to address this potential shortfall. It is known from anecdotal evidence that some government departments are already experiencing recruitment difficulties. and are apprehensive for the future .
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Despite these possible trends, it is improbable that the force of the bargaining power of the labour supplier will change significantly in the future. Any shortfall in labour is unlikely to result in a significant shift in the force as it is probable that it will be matched over time by additional labour resources. Perhaps a more significant threat comes from the bargaining power of the buyers, which will now be considered.

The bargaining power of the buyer

As with powerful suppliers, buyers can also increase input costs into the valuation industry, and more importantly can force down prices for the services of the industry. As such buyers are competitors to existing valuation firms in the wider sense. It is suggested that the bargaining power of the buyers is presently a much more significant force in determining present and future valuation industry structure.

The recent survey of registered valuers in Queensland shows in Table 3 below that 53% of valuers surveyed are predominantly involved in residential property valuation and, of these, 25% of the respondents were employed in valuation practices that were almost entirely involved in residential valuation work.

Table 3 Principal Valuation Activity

What is the main valuation activity you are involved in?		
	Number of Respondents	% of Total
Residential	188	53
Commercial/Industrial	69	19.5
Retail	10	3
Statutory	71	20
Rural	17	5

Table 4 indicates that approximately 10% of valuers are involved in valuation practices that undertook a content of 40% or more of non residential work.

Table 4 Mixed Valuation Practice- % residential

If you are in a mixed valuation practice could you please estimate the % of residential sector work.		
	Number of Respondents	% of Total
100%	43	18%
90-99	41	18%
80-89	33	14%
70-79	18	8%
60-69	28	12%
50-59	20	9%
40-49	11	5%
30-39	7	3%
20-29	10	4%
10-19	9	4%
1-9	13	6%
Total	233	

It is also estimated from the survey results that approximately 60% of income sources of valuation firms comes from their panel contracts held with one or more banks or mortgage providers.

The residential mortgage market has changed significantly over the past couple of decades with the establishment of residential mortgage backed investment securities market and the consequential competition from these new lenders. This has had the affect of reducing the traditional bank lenders market share and led to much higher levels of price competition in the mortgage market. The buyers of valuation services have thus become larger and more powerful compared to the bargaining position of small valuation firms in a relatively fragmented industry. As a consequence it is to be expected that there has been a downward pressure on prices with respect to valuation services, especially in the high volume sector of residential mortgage valuations where lenders are seeking economies of scale. Large volume purchasers have the ability to apply purchasing pressure in terms of price. When the number of buyers is small, it is particularly hard for a valuation firm who looses a client to find an alternative market. Even the threat will often encourage a firm to offer discounts and other concessions to prevent a buyer from switching to a competitor. Accordingly, the figures in Tables 3 & 4 suggest that the competitive influence of the buyer of services has, and will continue to be, a significant force in shaping present and future industry structure.

Linked to this pressure is the ability of buyers to find substitute services to the traditional valuation report for residential property and this is now considered in more detail below.

Presence of substitute services

Substitute services restrict the potential returns of an industry by placing limits on the prices that firms in the industry can profitably charge. The real estate valuation industry has recently been experiencing the effect of substitute services in the residential sector. The principal substitute service has been the adoption of desktop valuations.

Desktop valuation models provide an assessment of the value of a property without the need for a physical inspection by utilizing desktop access to extensive real estate data bases. They are sometimes referred to as automated valuation models. A computer model is used to input the target address and property characteristics and return an estimated value for the subject property.

The two most common methods of automated valuation models (desktop valuations) are calculations based on weighted comparables and multiple regression analysis. The other type of desktop valuation is one that is not provided by an automated centralized process but on a bespoke basis by individual valuers (Standard and Poor's 2004). Whatever the type of desktop valuation, its distinguishing feature from the traditional valuation service is the lack of the on site inspection.

Desktop valuations are currently being trialled in Australia for 12 months by the Commonwealth Bank of Australia with some controversy in the press. It has been suggested that as the quality and reliability of computerized statistical models improve, it is conceivable that these techniques of valuation may become acceptable to the major financiers. (Downs, 2003).

Perhaps the most important feature in this trend is the underlying rationale for the substitute service of a desktop valuation. The buyers of desktop valuations, with respect to the residential sector, are seeking a service that will reduce their risk position, increase efficiency and reduce their costs in processing loans. As a result, they are looking for a standardised loan valuation process that reduces costs. (Feldman, 2004). The valuation industry is, in part, responsible for this trend as fee pressure on valuation services has sometimes been responded to with lower quality services, impacting upon valuation accuracy. The position is reached from a risk profiling perspective that, on average, the computer becomes as accurate as the valuer. It would appear that the automated valuation process will fulfil lender needs for a large percentage of their requirements. It has been suggested in the USA that by 2008, 17% of loans will be processed using automated valuation methods. Clearly, given the structure of the valuation industry and the significance of residential mortgage activity within the industry, this competitive force will continue to be an important influence on future directions for the valuation industry.

The competitive force of potential new entrants

The threat of entry into an industry depends on the barriers to entry that are present, coupled with the reactions from existing competitors. If the barriers are high and/or the newcomer can expect sharp retaliation from competition, the threat of entry to an industry is low.(Porter 1980)

The major barriers to entry to the real estate valuation industry can be summarized as government policy through regulation and licensing of professionals, the costs of professional indemnity insurance and customer loyalty. These barriers can be considered as relatively minor, particularly as governments are removing the anticompetitive licensing requirements. It is postulated that the nature of these barriers are unlikely to change in substance in the foreseeable future. In this respect, this competitive force is probably of minor importance as far as changing future industry structure.

Rivalry among competing firms in the industry

The profile of the valuation industry is generally of a fragmented nature. Fragmented industries are common within the service sector of the economy. It is argued ‘smaller firms are often more efficient where personal service is the key business. The quality of the personal service and the customer’s perception that individualized, responsive service is being provided often seem to decline with the size of the firm once a threshold is reached. Also where a local image and local contacts are keys to the business, the small firm often has an advantage in terms of contact building.’ (Porter 1980)

Valuation practices have their strength in local knowledge, contact building, personal services and an ability to be responsive. These strengths are the underlying economic reasons for its fragmented nature. Despite what appears to be some recent trends of amalgamation of firms in the real estate sector, it is suggested that the fundamental economic basis of the valuation sector will not change and will continue to cause an industry which is fragmented in nature.

However it would be reasonable to argue that the intensity of rivalry between competing firms will differ according to the nature of their markets. Those firms that are largely involved in residential mortgage work will continue operating in an increasingly competitive business environment, in terms of price and market share, whereas those involved in more diverse markets will be less affected by pressure on prices for their services.

Summary and Implications

The nature of the real estate valuation industry means that it will continue to be impacted upon by the bargaining power of the buyer and the threat of substitute services. This is particularly so in some sectors of professional practice where economic pressures are at there greatest. Large volume buyers of residential valuation services will continue to explore ways of achieving the same or better levels of lending risk at lower costs in order to gain market advantage for their mortgage product. The advances in GIS technology, the availability of more comprehensive and rigorous market data and developing risk management approaches to the mortgage market, render statistical valuation methodologies more accurate and it is easy to speculate that desktop valuations will fulfil the demands of many of the clients in the residential mortgage business in the future.

With the almost inevitable growth of desktop valuations for residential mortgage lending, if valuers and the firms providing valuation services are to prosper, they need to be part of the solution rather than part of the problem. In other words, they need to utilise new technologies to enhance their valuation services. If desktop valuation services add value to the valuation industry's clients, then the provision of the service is inevitable and is best provided by qualified valuers capable of identifying possible valuation anomalies and interpreting market trends. The skills of the valuer, in terms of local knowledge, together with market and property analysis are essential if the risk position of clients is to be reduced and the valuer, as a property professional, is better placed than anyone to provide a desktop service which is both efficient and effective. It is important not to lose sight of the client's objectives in obtaining valuation advice as a risk management measure. The nature of the risk in recent years, with rapidly increasing residential values, has largely provided a buffer against valuation discrepancies. This could change. As rises in property values decline, the accuracy of valuation becomes more critical both to the lender and the mortgagor.

It can be argued that these key forces will also influence other areas of valuation activity, although to a lesser degree. However, the strength of real estate valuation as a function is that it will always be a balance between the subjective and objective, as property markets are imperfect in nature and hence there will always be a need for professionally trained valuers with the appropriate set of skills.

Given the importance of these forces, there are a number of implications for the valuation profession.

1. Issues relating to ethics and guidelines to good valuation practice

2. Need for education providers to embrace new technologies such as GIS and to ensure that graduates entering the profession are fully equipped to work with these technologies.

3. Need to understand the process of desktop valuation and to research and evaluate the limitations of the practice.

4. The need to educate lenders and the broader public of the changes in valuation and lending practice if desktop risk based valuation is used.

As valuers, members of professional bodies and educators, we must embrace changes that technology and economic advances bring to our professional lives. We must lift the professionalism of the valuation practice to more than simple mass production of valuations at lowest cost, to a service which clients see as adding to the business process and for which they are prepared to pay a fee worthy of the expertise of the property professional.

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