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THE QUALITY OF VALUATION REPORTS IN AUSTRALIA: 1998

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INTRODUCTION

The issue of professional valuation standards and the quality of valuation reports has been the focus of considerable international attention in recent years. In the USA, the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989 had major implications for improving valuation standards (Colwell and Trefzger, 1992; Lahey et al, 1993). Similarly, in the UK, the RICS Mallinson Report in 1994 addressed a range of key issues regarding the quality of the valuation process and valuation reports (Mallinson, 1994).

In Australia, the Australian Property Institute (API; previously AIVLE) has also been particularly active in the following developments:

- development of specific written standards for a range of valuation procedures and property types
- establishment of the Australian Valuation Standards Board (1994)
- active promulgation of valuation standards and guidelines by eminent Australian valuers (Rothwell, 1990, 1991, 1994)
- active involvement in the International Valuation Standards Committee (IVSC) (McNamara, 1996, 1997).

With these developments in the areas of professional standards and valuation reports, it is particularly important that an assessment is performed as to whether external valuation client needs and expectations are being met. This important issue has received considerable attention in recent years in a number of countries, including:

- USA (Colwell and Trefzger, 1992; Dotzour and Le Compte, 1993; Knitter, 1993, 1994; Lahey et al, 1993; Rudolph, 1993; Shlaes, 1993)
- UK (Crosby et al, 1997)
- Australia (Barrett and Newell, 1990; Newell, 1995, 1997; Newell and Barrett, 1990; Rothwell, 1994; Smith, 1994)
- New Zealand (Hoyt and Croft, 1993).

This paper will present the results of a major survey on external users of valuation reports in Australia in 1998 to examine the client perceptions of the quality of valuation reports. A range of factors relating to the quality of valuation reports are critically assessed. The results are compared to previous surveys in 1989 and 1994 (Newell and Barrett, 1990; Newell, 1995) to assess the changing quality of valuation reports, the effectiveness of the introduction of valuation standards by the Australian Property Institute and user perceptions of valuation reports in different stages of the property market cycle.

SURVEY METHOD AND USER PROFILE

A survey designed to obtain information concerning the quality of valuation reports in the Australian property industry was conducted in September 1998. The survey was sent to 140 major external users of valuation reports (eg. insurance companies, superannuation funds, property trusts, property developers, banks and fund managers). 59 responses were received, with the resulting survey response rate being 42%. These respondents represented a total property portfolio of over AUS$57 billion, comprising 1359 properties and accounting for more than 1376 external valuations per year.

The main respondents to the survey were insurance companies (14%), property trusts (41%), superannuation funds (12%) and property developers (8%), with the total portfolio property types being office (41%), retail (32%), industrial (13%) and other (14%).

The frequency of valuation of individual properties by these external users of valuation reports varied considerably; the most frequent being every year (47%) and every two years (10%). Of those organisations surveyed, 100% employed outside valuers to conduct their valuations, with 97% of their total valuations being conducted by outside valuers. 93% of respondents used external valuers for all of their valuations.

Full details of the survey respondents are shown in Table 1. The questionnaire, response rate and respondent profile for this survey was consistent with that of the previous 1989 and 1994 surveys conducted by the author.

USE OF VALUATIONS

The most important reasons cited for using valuations in these organisations were for investment decisions (93% cited as "important" or "essential"), for legal requirements (89%) and for lending practices (79%). In many instances (42%, 48% and 42% respectively), valuations were indicated to be essential for the aforesaid reasons.

Given the major importance of valuations for the purpose of investment decisions, 97% of respondents indicated that valuations were relevant in the investment-related decisions of their firms, with 58% indicating that valuations were highly relevant in their property investment decision-making. This level of 58% was consistent with that seen in the previous surveys in 1989 and 1994.

In selecting outside valuers, 69% of respondents only used valuation firms/individuals that they knew from previous experience. While this level was down on that seen in the 1989 and 1994 surveys, the requesting of tenders (47%) was much higher than that seen previously, reflecting the more competitive valuation business environment in recent years.

Fewer organisations (68%) believed that there were significant differences in the quality and reliability of valuation reports among valuation firms/valuers available for their use than the level of 80% and 75% seen in 1994 and 1989 respectively.

USE OF DCF ANALYSIS

DCF analysis is now included in 84% of outside valuations. This is a significant increase on the level of 68% in 1994 and only 36% in 1989. 68% of respondents now require DCF analysis to be included in all valuation reports, increasing from only 50% of respondents in 1994.

QUALITY AND RELIABILITY OF VALUATION REPORTS

The users of valuation reports indicated that 96% of reports were at least adequate for their purposes. This level was consistent with the 97% level seen in 1994, and above the level of 88% seen in 1989. The level of client satisfaction with valuation report quality was high for each property type, being 91% for office property, 92% for retail property and 89% for industrial property. These levels of satisfaction were slightly above the 85-90% levels of client satisfaction seen in 1989 and 1994.

85% of valuation reports were considered to contain sufficient analytical detail to enable a reasoned judgement as to how market value estimates were derived. This was a major increase on the 70% level seen in the two previous surveys.

96% of valuers were considered to be competent in their professional activities, with this level being consistent with that seen among users of valuation reports in 1989 and 1994.

VALUATION STANDARDS AND GUIDELINES

Table 2 presents the perceived need for valuation standards and guidelines over 1989-98. The monitoring of valuation standards by an industry body remains the top priority over this 10-year period. The impact of the introduction of specific valuation standards by the API in recent years is amply reflected in the lesser perceived need for further valuation guidelines and the lesser perceived need to change current practice from the previous 1994 survey.

PERCEIVED WEAKNESSES IN VALUATION REPORTS

The users of valuation reports rated seven categories of weaknesses encountered in external valuations of their commercial properties, as shown in Table 3. "Failure to understand complexities and market position of particular project" and "inadequate market analysis" clearly remain the highest ranked of the perceived weaknesses, with the remaining five weaknesses retaining their same rank ordering as per the 1994 survey. The more stable property markets over 1994-98, compared to the volatility of the property markets over 1989-93 is a likely critical factor in this similar rank ordering in 1994 and 1998. In general, there was a user perception that these weaknesses were not as strongly evident in 1998 compared to the previous surveys in 1994 and 1989.

SUGGESTED SOLUTIONS TO WEAKNESSES

The external users of valuation reports also rated a number of possible solutions to the above perceived weaknesses. "Greater emphasis on current supply/demand situation" remains the top ranked solution. Rankings have not changed significantly since 1994, unlike the period of 1989-94 in which the priority ordering for these solutions was reversed.

The emphasis given to the solutions of "more use of analytical techniques" and "need for more detailed workings to be provided" were less in 1998. This clearly reflects the increased use of DCF and increase in analytical detail in valuation reports in the last four years, as evidenced in earlier results in this paper.

Similarly, the "need for valuation standards" remains the least favoured solution. This reflects the implementation of a range of valuation standards by the API in recent years.

GENERAL COMMENTS

In addition to the above specific analyses, the general comments provided by respondents showed some useful insights into the client perceptions of the quality of valuation reports. These general comments were in the key areas of:

- critical role of detailed instructions for valuer
- greater emphasis needed on market dynamics/future performance
- too much generalisation and unrealistic future projections
- lack of support for contentions with quality information.

CONCLUSION

This survey has clearly shown that the period of 1994-98 has been more focused on the consolidation of the quality of valuation reports in Australia. This is in marked contrast to the period of 1989-93 in which major improvements in the quality of valuation reports occurred, facilitated by the development of specific valuation standards by API.

Key highlights for the quality of valuation reports in Australia over the last four years have been:

- significant increase in use of DCF analysis
- significant increase in level of analytical detail in reports to enable reasonable judgement on how market value was derived
- lesser client perception of "weaknesses" in reports and need for "solutions".

Further developments in the area of valuation standards offer major property industry benefits to all parties, ensuring that both the client and valuer are fully aware and better informed of the expectations and requirements of valuation report content and standard.

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Table 1: Quality of valuation reports: user profile: 1998

Date of survey:	September 1998
Number of surveys distributed:	140
Number of responses:	59
Survey response rate:	42%
Value of property portfolio:	AUS $57.7 billion
Make-up of survey respondents:	
• Insurance company	14%
• Property trust	41%
• Superannuation fund	12%
• Property developer	8%
• Other (eg: hotel, bank, funds management, property syndication)	25%
Make-up of commercial property portfolio:	
• Office	41%
• Retail	32%
• Industrial	13%
• Other (eg: hotel, car park, rural, tourism, residential)	14%
Number of properties in portfolio:	1359
Number of outside valuations per annum:	1376
Frequency of valuations:	
• Monthly	0%
• Quarterly	5%
• 6-monthly	5%
• Annually	47%
• 18 months	2%
• 2 years	10%
• 3 years	9%
• Other (eg: as needed)	22%

Table 2: Valuation standards and guidelines

Question	Percentage responding "YES" 1998	1994	1989
Is there a need for:			
* monitoring of valuation standards by an industry body	82%	90%	78%
* standardised valuation guidelines	75%	82%	73%
* change to current practice	48%	69%	76%
* monitoring of valuation standards by a government regulatory body	30%	24%	10%

Table 3: Perceived weaknesses in valuation reports

Perceived Weakness	Percentage responding "highly important"	Ranking		
		1998	1994	1989
Failure to understand complexities and market position of particular project	68%	1	2	3
Inadequate market analysis	64%	2	1	1
Failure to comment upon likely market trends	52%	3	3	6
Lack of details and discussion of analytical aspects	49%	4	4	2
Limitations on assumptions and qualifications of valuation report	45%	5	5	7
Limited use of comparables	33%	6	6	5
Too much reliance on historic aspects of market performance	28%	7	7	4

Table 4: Suggested solutions to perceived valuation weaknesses

Solution	Percentage responding "highly important"	Ranking		
		1998	1994	1989
Greater emphasis on current supply/demand situation	56%	1	1	4
More use of analytical techniques (eg: DCF)	44%	2	3	3
Need for more detailed workings to be provided	40%	3	2	2
Need for valuation standards	33%	4	4	1