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NZIV Member Alert #4 - Coronavirus (COVID-19)

News (Category?Action=View&Category_id=175)



NZIV Member Alert #4 - Coronavirus (COVID-19)



27 March 2020

As mentioned in our Member Update #3 (https://propertyinstitute.nz/Story?Action=View&Story_id=2795) - The New Zealand Institute of Valuers (NZIV) Council has been seeking clarity on behalf of Members as to whether or not valuation is an essential service.

We have taken a deliberately cautious and responsible approach because of the seriousness of the situation.

A short time ago we received advice from the Ministry of Business Innovation & Employment (MBIE). This is what they have communicated to us:

"Based on the information provided, your business is considered non-essential. This is based on the decision that conveyancing is not essential and so very few people will be in a position to list new properties for sale during Alert Level 4.

Similarly, we expect banks to use alternative methods to ascertain property and asset values as needed.

If you are a business or worker in a non-essential business, you may still work – as long as this is from home. If you cannot work remotely, you must stay home."

We understand that members may be receiving contradictory information, however, at 2.21pm today the Ministry for Business, Innovation and Employment confirmed to NZIV that the above decision "should be considered final".

As previously suggested this is not 'business as normal' activities. The Government is now enforcing a lock down for public safety in an attempt to get New Zealand through the current crisis quickly, so we can all focus on the rebound.

Stay home, follow Government guidelines and plan for the rebound when it comes.

In conjunction with the Standards Board, NZIV Council has recently provided guidance on [Property Inspections](https://mcusercontent.com/90de70654f773d6800ff0e425/files/7ed3e1bf-038d-4d29-8423-6dffe58c867/Standards_Board_Member_Alert_Property_Inspections_March_25_2020.01.pdf) (https://mcusercontent.com/90de70654f773d6800ff0e425/files/7ed3e1bf-038d-4d29-8423-6dffe58c867/Standards_Board_Member_Alert_Property_Inspections_March_25_2020.01.pdf) during this time and [Valuation Uncertainty](https://mcusercontent.com/90de70654f773d6800ff0e425/files/6782dea5-9e45-43d5-8f39-6878b82f13c4/Standards_Board_Member_Alert_Valuation_Uncertainty_March_25_2020.01.pdf) (https://mcusercontent.com/90de70654f773d6800ff0e425/files/6782dea5-9e45-43d5-8f39-6878b82f13c4/Standards_Board_Member_Alert_Valuation_Uncertainty_March_25_2020.01.pdf).

We also reiterate the position we have consistently advocated:

1. [Follow Government Guidelines](https://covid19.govt.nz/) (https://covid19.govt.nz/) - including lock-down restrictions, and
2. Maintain the Health & Safety Policies you will be operating under

Regards

Jeff Alexander
President
New Zealand Institute of Valuers

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Standards Board Member Alert – Property Inspections

25 March 2020

New Zealand is moving into Level 4 Status under the COVID 19 pandemic. Do not breach social contact restrictions in undertaking banking essential services

Introduction

1. As we move through the pandemic cycle the message is the same. Communicate with your clients. We will be moving through this and as regions move to lower status Levels. Keep the communication relevant.

Status of Member Alerts

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3. Member alerts include all professional communities and relevant disciplines.

Preamble

4. In dealing with a COVID-19 (novel coronavirus) several members have made enquiries to PINZ on how they are able to meet Valuation Standards whilst also having restricted access to property for inspection purposes.

Property Inspections - Member Alert

5. All members must as part of their agreed Scope of Works and preferably signed with the instructing party agree and detail under IVS 101 Scope of Works (i)
 - (i) The nature and extent of the valuers work and any limitations thereon: any limitations or restrictions on the inspection, enquiry and/or analysis in the valuation assignment must be identified (see IVS Framework, Paras 60.1–60.4) if relevant information is not available because the conditions of the assignment restrict the investigation, these restrictions and any necessary assumptions or special assumptions (see IVS 104 bases of value, Paras 200.1–200.5) made as a result of the restriction must be identified.
6. Valuation Ordering Panels (VOP) contracts require registered valuers signing the report to have inspected the property. It is recommended that members contact their VOP and obtain from them a departure to make assumptions on the property, if inspection is limited. Any departures should be clearly documented and agreed with the VOP.
7. We are of the view that it could be considered that the government's recommendation on travel and congregation is a regulatory requirement that will limit inspections. As COVID-19 is a pandemic, employers also have Health and Safety at Work Act 2015 considerations to make.
8. A regulatory requirement meets the departure definitions of IVS is as detailed below. (IVS Framework)

60. Departures

60.1. A “*departure*” is a circumstance where specific legislative, regulatory or other authoritative requirements *must* be followed that differ from some of the requirements within IVS. Departures are mandatory in that a *valuer must* comply with legislative, regulatory and other authoritative requirements appropriate to the *purpose* and *jurisdiction* of the *valuation* to be in compliance with IVS. A *valuer may* still state that the valuation was performed in accordance with IVS when there are departures in these circumstances.

60.2. The requirement to depart from IVS pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other IVS requirements.

60.3. As required by IVS 101 *Scope of Work*, para 20.3 (n) and IVS 103 *Reporting*, para 10.2 the nature of any departures *must* be identified (for example, identifying that the valuation was performed in accordance with IVS and local tax regulations). If there are any departures that *significantly* affect the nature of the procedures performed, inputs and assumptions used, and/or valuation conclusion(s), a *valuer must* also disclose the specific legislative, regulatory or other authoritative requirements and the *significant* ways in which they differ from the requirements of IVS (for example, identifying that the relevant *jurisdiction* requires the use of only a market approach in a circumstance where IVS would indicate that the income approach *should* be used).

60.4. Departure deviations from IVS that are not the result of legislative, regulatory or other authoritative requirements are not permitted in valuations performed in accordance with IVS.

5. When undertaking a property inspection, all members have a shared responsibility under the Health and Safety at Work Act 2015 and to minimise impact on themselves and others when dealing with COVID-19 and to follow Ministry of Health advice.

For COVID-19 health advice and information, contact the Healthline team (for free) on 0800 358 5453 or +64 9 358 5453 for international SIMS

Ends:

Standards Board

Member Alert – Valuation Uncertainty

25 March 2020

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4. In making a valuation of real property valuers rely on empirical data to assess value. The empirical data available today (24 March 2020) on which those valuation decisions are being made in most cases would not have been influenced by the current world events and the uncertainty created.
5. In the case of the sharemarket there is instant empirical data however real property decisions are generally made over a longer period of time with the reporting of sales not being as instant as the sharemarket.
6. This raises the question as to how accurate the valuer considers their assessment of value is and if this should be qualified or quantified. Valuation uncertainty is not a product of a restricted inspection it arises from the valuation process (valuation model or inputs) or events external COVID-19 (novel coronavirus).

Valuation Uncertainty - Member Alert

The Nature of Valuation Uncertainty

7. A valuation is not a fact; it is an estimate of the most probable range of possible outcomes based on the assumptions made in the valuation process. Market valuations are estimates of the most probable price that would be paid in a transaction on the valuation date. However, even where assets are identical and exchanged in

contemporaneous transactions, fluctuations in the prices agreed between different transactions can often be observed. These fluctuations can be caused by factors such as differences in the objectives, knowledge or motivation of the parties. Consequently, an element of uncertainty is inherent in most market valuations as there is rarely a single price with which the valuation can be compared.

Valuation Uncertainty (definition)

8. The possibility that the estimated value may differ from the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment.

Causes of Uncertainty

9. Material uncertainty can be caused by various factors. These are divided into the following categories in this Market Alert, market uncertainty, model uncertainty and input uncertainty. Model and input uncertainty arise from the valuation process, are closely related and may be measureable. Market uncertainty arises because of events external from the valuation process and is not normally measureable.
10. Model uncertainty and input uncertainty are not covered in this Member Alert

Market Uncertainty:

11. Market uncertainty arises when a market is disrupted at the valuation date by current or very recent events such as sudden economic, natural disaster or political crises. The disruption can manifest itself in a number of ways for example either through panic buying or selling or by a loss of liquidity due to a disinclination by market participants to trade. An outbreak of sudden trading activity in response to a crisis may cause rapid price changes that are not necessarily representative of those that would be agreed between parties acting "knowledgeably and prudently". Conversely, a loss of liquidity will mean fewer contemporaneous or relevant recent transactions which may impact on the reliability of the valuation.
12. Events causing market uncertainty may be macroeconomic, eg the terrorist attacks of September 11th 2001, the Lehman Brothers insolvency in 2008, and COVID 19 pandemic in 2020 or microeconomic, eg an unexpected change in the law disrupting a sector of the market or disruption to the supply chain of an industry.
13. Such events create valuation uncertainty, because the only inputs and metrics available for the valuation are likely to relate to the market before the event occurred and the impact of the event on prices will not be known until the market has stabilised.
14. Market uncertainty should not be confused with market risk. Market risk is the risk that an asset may lose value over time due to changes in market conditions that occur after the valuation date. The possibility of market conditions changing in the future and the potential for the price of an asset to be affected by those changes is something that is considered by market participants when negotiating a transaction and will be reflected in market prices

Materiality

15. IVS 103 *Reporting, para 10.2* requires the valuation report to set out a clear and accurate description of any material uncertainty that directly affects the valuation. As indicated in para 8 most valuations contain an element of uncertainty but it is only to be disclosed when it is “material” and has a direct effect on the valuation. A requirement to discuss and disclose uncertainty in all cases would over complicate the reporting of many valuations, and potentially raise unwarranted concern as to the reliability of the valuation opinion, which would not be helpful to users.
16. It is therefore necessary to consider whether uncertainty is material. Materiality should be considered from two aspects; first whether the impact on the valuation figure is significant and second whether it is of concern to a user of the valuation having regard to the purpose for which it is required.
17. In considering whether the impact of the uncertainty is significant, regard should be had to the impact on the overall potential profit or risk of loss to which either the owner of the asset or a third party relying on the valuation is exposed as a result of the uncertainty. This cannot be expressed in absolute terms but will vary depending on the purpose of the valuation and the nature of the asset.
18. Even if it is judged that the uncertainty could have a significant effect on the reported valuation, whether this is a matter of relevance to a user will vary depending factors such as:
 - whether the valuation is required for internal purposes by the commissioning party or whether it will be disclosed to and relied upon by third parties. The threshold of materiality is likely to be lower if the valuation is to be relied on by third parties;
 - whether it is the only asset in which the users of the valuation are interested or whether it is part of a portfolio in which the other assets are not affected;
 - whether the cause of the uncertainty was known to the commissioning party or a third party relying on it when the valuation was commissioned
 - whether the effect of the uncertainty could expose the commissioning party or a third party relying on the valuation to significant risk of loss.
19. When a valuation is being prepared for financial reporting, the relevant accounting standard often stipulates when an uncertainty disclosure is required. For example IFRS 13 Fair Value Measurements has extensive disclosure requirements. The most relevant to valuation uncertainty, although the term is not actually used, are in section 93:

IFRS 13 93

Specific Disclosures Required (inter-alia)

for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, the entity also provides a description of those

interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement

for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated

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20. IFRS 13 sets out a “fair value hierarchy” of Levels 1, 2 and 3. It will be noted that the disclosures required by IFRS 13 section 93 only apply where Level 3 inputs are used. These are “unobservable inputs” which are defined in the IFRS as inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.
21. Where Level 3 inputs have been used, the IFRS only requires a narrative description of the sensitivity of the valuation to changes in these inputs if this would result in a significantly higher or lower figure.
22. For financial instruments slightly different criteria need to be considered. Firstly the alternative inputs considered must be “reasonably possible”. If it is decided that these alternatives are reasonably possible and that they would result in a significant change to the value then it is necessary to calculate the effect of that alternative input. Significance is judged by reference to total assets and liabilities or to total equity.
23. For valuation purposes other than financial reporting under IFRS it is important to recognise that valuation uncertainty can and does affect valuations that use inputs that would be classified in either Level 1 or Level 2 in the IFRS 13 hierarchy and the fact that an explicit disclosure is not required for financial reporting does not mean that a disclosure may not be required to comply with IVS 103.
24. Whether a potential alternative input is “reasonably possible” can be a useful concept to help determine whether valuation uncertainty is material for purposes other than valuations under IFRS 13. The term is not defined in IFRS 13 and no specific quantitative probability level is implied. What is, or is not, reasonably possible will depend on the facts of each situation and requires judgement. From a valuation perspective a key consideration would be the distribution pattern and spread of potential alternative inputs. If the data follows a normal pattern of distribution, or bell curve, data in the tails could usually be safely disregarded as falling outside the range of being reasonably possible. However, other distribution patterns may mean that greater weight may need to be given to certain outliers.
25. Although model or input uncertainty is less likely to arise where the inputs would fall within Levels 1 or 2 if being undertaken for financial reporting under IFRS, any of the levels in the IFRS hierarchy could be affected by market uncertainty. For example a listed blue chip stock may still be affected by a sudden decrease in trading activity and abnormal levels of price volatility immediately following a market shock.

Nature of Disclosure

26. If valuation uncertainty is deemed to be material the next question to be addressed is whether the disclosure to it in the valuation report should be only qualitative, ie descriptive, or whether a quantitative, ie numeric, indication of the uncertainty should also be provided.

27. The requirement in IVS 103 is to provide “a clear and accurate description” of any material uncertainty. This indicates that a qualitative description should always be provided for all valuations for whatever purpose where any identified uncertainty meets the materiality criteria. This requirement is also consistent with IFRS 13. As can be seen from the extract above a narrative description of the sensitivity of the fair value measurement to changes in the inputs must be provided, for all valuations which meet the criteria listed.
28. A qualitative description of valuation uncertainty should explain the source of the uncertainty, the effect that this has on the market, the valuation process or both. In the case of market uncertainty it may be possible to comment on any consensus view on how long it may be until the effect of the event can be assimilated and stability returns to the market. In the case of model or input uncertainty a description of the reason why the selected models or inputs were used can be provided
29. The question of whether a numeric indication of the effect of the uncertainty should be also provided is more problematic. Valuation uncertainty often arises because of either a shortage or lack of empirical data inputs to support the valuation. Where this is the case, providing a quantitative statement of uncertainty may be unrealistic, as if the data needed to quantify the uncertainty is available then it could have been used to reduce the uncertainty in the valuation process.
30. A related potential problem in providing a quantitative measure of uncertainty is to avoid implying a false precision. While it may be possible to provide a quantitative measure by using an alternative input, by definition that input must be one considered to be less probable or relevant than the one used in the reported valuation. For this reason it is always appropriate to provide a verbal explanation of the uncertainty and any quantitative illustration of the possible effect of that uncertainty.
31. A simplistic expression of valuation uncertainty might be to provide a range within which the value is considered to fall. However, this is not recommended for the following reasons:
 - For many valuation purposes a single valuation figure is required and a range would not be acceptable
 - Determining the extremes of the range may also be unrealistic because the very factor that created the uncertainty in the first place is likely to mean that previously observed price fluctuations will no longer be relevant.
 - Users may assume that an equal probability attaches to any outcome within the range when this might not be the case.
32. Users may assume that there is no possibility of a valuation falling outside of the indicated range.

Measuring Uncertainty

33. While caution is required in presenting any numeric indication of uncertainty, there are circumstances where this can be reasonably provided and be useful to a user of the valuation. As discussed in paras above, model and input uncertainty may be measureable by observing the effect on the valuation of using either an alternative model or input.
34. The value of financial instruments is dependent upon the amount, timing and security of future cash flows between the counter parties. Variations in these mainly numeric

inputs over a fixed time horizon are more readily measurable than those that might be involved in the valuation of other types of tangible or intangible assets held for an indefinite period, such as the comparative quality or utility of the asset or its potential for an alternative use.

35. Where the value of a financial instrument is uncertain because there is no market data available for an identical or similar instrument it is necessary to make an estimate of certain inputs into the valuation based on the assumptions that a market participant might make. In these circumstances it is more likely that two or more alternative figures that could be reasonably be chosen for a key input into the calculation. Where this occurs it is recommended that the reported valuation is based on the most likely of these outcomes, but a sensitivity analysis is provided showing the effect of the range possible outcomes on the reported value.
36. The principle of quantifying uncertainty by the use of a sensitivity analysis can also be applied to assets other than financial instruments where there were a number of reasonably possible alternative numeric inputs that could have been selected on the valuation date.
37. To establish what might be considered a reasonably possible alternative input, statistical techniques may be used, although if there is market uncertainty at the valuation date the relevance of input ranges based on previous fluctuations may be of limited relevance.
38. If a quantitative measure of valuation uncertainty is to be provided, the following principles should be considered and applied as appropriate:
 - A quantitative measure should always be accompanied with a narrative describing the cause and nature of the uncertainty. A purely numeric illustration will only confirm uncertainty, not explain it. There is no useful purpose served by providing such a quantitative expression of uncertainty if this will not result in a better understanding of the valuation by the user.
 - Quantifying valuation uncertainty does not involve forecasting a worst case scenario. The objective is not to stress test a valuation to an extreme case. Any test of valuation uncertainty should address the impact on the reported value of reasonable and likely alternative assumptions. When choosing alternative assumptions to measure uncertainty, selection needs to be made among possibilities that are not located in the tail of the distributions (where events are very unlikely to happen) but rather in their central areas (where events are likely to occur).
 - The objective of any uncertainty analysis is not to provide a forecast of possible fluctuations in the reported value at future dates but to provide information about the variability of fair value measurement at the specific valuation date.
 - When quantifying the impact of uncertainty the interdependence or correlation between significant inputs needs to be considered when it is practical to do so. Incorporating correlation analysis is technically and operationally challenging and potentially costly; but an analysis that does not consider interdependence provides less relevant information to users. When uncertainty is measured without proper correlation of interdependent inputs the degree of uncertainty may be overestimated.

- When measuring a portfolio of financial instruments, interdependence and potential netting effects across products should be considered. However, such analysis should complement, rather than be a substitute for, a disaggregated asset by asset uncertainty measurement. The reason is that potential netting effects across assets are only relevant when a transaction of all the products of the portfolio takes place at the same time.

Interim COVID-19 significant valuation uncertainty sample statement

39. Given the unknown impact that the current COVID-19 outbreak will have on the New Zealand real estate market, NZIV considers that Valuers should include a disclosure relating to valuation uncertainty.
40. A disclosure to the following effect should be included during this uncertain market period:

The outbreak of the Novel Coronavirus (COVID-19) was declared as a 'Global Pandemic' by the World Health Organisation on 11 March 2020. We have seen global financial markets and travel restrictions and recommendations being implemented by many countries, including New Zealand.

The local/regional/national/international (delete those that are not relevant) real estate market that the subject property is transacted in is being impacted by the uncertainty that the COVID-19 outbreak has caused. The landscape and market conditions are changing daily at present. As at the date of valuation we consider that there is a significant market uncertainty.

This valuation is current at the date of valuation only. The value assessed herein may change significantly and unexpectedly over a relatively short period of time (including as a result of factors that the Valuer could not reasonably have been aware of as at the date of valuation). We do not accept responsibility or liability for any losses arising from such subsequent changes in value.

Given the valuation uncertainty noted, we recommend that the user(s) of this report review this valuation periodically.

41. If there are any comments or feedback, please do not hesitate to contact PINZ via standards@property.org.nz

Ends: