

## TEGoVA

### Template for a country specific chapter on property valuation

The country specific chapter should reflect the specificities of national real estate markets and the respective principles of the valuation methodology. It should then provide an overview about the valuation profession and close with an outlook about potential future developments. Ideally, the chapter could be structured as follows:

#### 1. Real estate market

##### 1.1 the real estate market in its aggregate / macroeconomic context

In Italy, the real estate market has changed during the last five years quite significantly. In 1999 there has been the incorporation of the first real estate fund. Today, there are several types of real estate funds: (i) classic closed and listed (“fondo chiuso immobiliare”), (ii) reserved and closed (“fondo riservato immobiliare”), (iii) speculative and closed (“fondo speculativo immobiliare”) and (iv) listed and with yearly distribution of most of the income (“Siiq”, similar to the Reits).

All these real estate funds are closed, it means that the quota holder may ask for the liquidation of his portion only after a minimum period of time (usually 10 years).

The real estate market saw a booming in the price and in the volume of the transactions. The average size of the real estate projects increased considerably. The entire real estate market faced a new era.

The old style of doing real estate, through a limited partnership company with a restricted number of partners and a limited recourse to the credit, was not considered favourable.

The laws and the market awarded the funds and the listed structures with fiscal and credit incentives.

This may be repeated also for the valuation sector. Old style appraisal companies have been overwhelmed by new, more modern and more specialised appraiser companies, belonging also to international branches. Local and urbanistic knowledge has not always been considered as it should have been the case, also for valuations of the financial sector.

After September 2008 and the culmination of the financial crisis, the party is over and all starts to be fully reconsidered. The market does not know from where to start to rebuild its credibility and direct real estate investment is considered more safe than through investment vehicles.

The transparency is the key word of the Financial Stability Forum (in its report “Enhancing the Market and Institutional Resilience”) as well as of all the national authorities including the Bank of Italy (whose President, Mr. Mario Draghi, is the chief of Financial Stability Forum).

The non-equity market and, in particular, the US sub-prime markets have triggered the turmoil which spread out in all the rest of the market. But it was clear that all the market was already weakened by the insane extra credit of the recent years.

If the transparency is key of the free market, the valuation sector shall take the leadership regarding the assessment of the real estate assets which underlie the funds and non-equity securities (Mortgage Backed Securities-MBS, Collateralised Mortgage Obligation-CMO, Covered Bonds etc.).

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This is a big opportunity as well as a big responsibility. But it is our not easy and not friendly work.

It shall not happen again in the future that (i) the price of a MBS is much lower than the assessed value of its assets backed (this undermines also the respective valuation of the collateral) and/or (ii) the net asset value (NAV) of a listed real estate funds is ten times more the price of the quotas of such a fund as determined by the stock exchange (again, there is presumably something wrong with the respective backed valuation or there is totally lack of transparency information in the market).

The lucky thing is that often auditing companies had the lead in this field not the appraisal companies. In Italy, for example, the Asset Monitor of a Covered Bonds shall be only an auditing company. But since the auditing companies have not the capability to carry out an assessment of a real estate premises, they usually instruct valuers to do this job (by the way, at a very low price!!).

The real estate sector is vital for the financial sector, not the opposite. The financial sector needs mortgages (correctly assessed), the real estate sector may survive also without so much credit (as it did in the past).

The problem is that the valuers' society must take the lead (and not works underpaid behind the curtains).

If the valuer is responsible, the valuation is more prudent, the credit is calmed down and the economy is more sustainable and sound based.

The size of the valuation company shall grow to be deemed reliable by the market.

The average yearly revenues of a pan European lawfirm or of a pan European auditing company is 1,5 billion of euro. There is not still in the market a pure appraisal company of such size. This is one of the reasons that an auditing company is relaid by the market for being an asset monitor (and for subcontracting the job to the real, cheap and simple valuers!).

## 1.2 structure/s of the real estate market and its participants

Please refer also to the paragraph 1.1 above.

Moreover, the market is split in two worlds which barely dialogue each other:

- (I) the corporate real estate where the investment banks or institutional investors have a central role and plan real estate acquisition, incorporation, re-structuring, finance and backed obligations. In this environmental, the valuers play a very little role. Sometime the valuation report is requested to be carry out by a valuation company for some purposes, but usually the appraisal is not a key element. Basically, they request it to simply support figures already determined with very limited power of the valuer/valuation company to have an independent view.

The market does not seem carrying about this pour role of the valuers.

However, specially in case of restructuring of debt, where the investment bank call for real independent judgement, a new type of approached is demanded. Not only the determination of the value is considered, but an integrated approach able to scout and balance the underlined risks of the real estate transaction including fiscal, legal and technical issues (the outcomes are Due Diligence, SWOT analysis and Property

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and Market Rating models depending on the circumstances). In this case, the real estate advisor (it is not usually named simply valuer) called for this job is always a company, never a single person, and has in home specialists capable to cover the different aspects of the submitted issues including specific market experts (for example residential, hotel, industrial etc.) as well as fiscal, technical and legal experts (sometimes fully licensed individuals). Sometime this role is played directly by the auditing companies which have inside tailored real estate division.

- (II) the non-corporate real estate which includes all the real estate transaction carried out by ordinary banks or investors. The main different from the previous category lies on the fact that this transaction are not directly or indirectly connected with the capital market or with auditing purposes. In this case, the role of the valuers is more defined, limited and almost always present at least for mortgage purposes. Sometimes the appraisal company is a parent company of the investment/bank/brokerage company which has instructed the deal. In this case, the valuations are carried out also by a single valuer (often brokers, architects, "geometri", engineers etc.).

### 1.3 relevant legislation and regulatory requirements

In Italy, there is not a specific state license for carrying out valuations. In any case in order to carry out valuations it is necessary to belong to a professional order that is connected with real estate and recognised by the Italian law, like the geometri, architects, engineers, brokers, industrial experts and agricultural experts.

Even the Italian Procedure Civil Code does not statutory require an assessment of the value of the mortgage in case of foreclosure, but simply a kind of due diligence (pursuant to article 568 of the Italian Civil Procedure Code). The value is determined by the laws; the judge may ask for a valuation but is not obliged to do it or even to stand the so obtained value.

### 1.4 market for residential property

In Italy, there is not a specific qualification for valuers with a specific experience in the valuations of the residential properties.

A part exceptions (primarily in the luxury residential sector or in the commercialisation of big project), the residential sector is very often of low profile with not outstanding professionalisms.

### 1.5 market for commercial properties

In Italy, there is not a specific and official qualification for valuers with a specific experience in the valuations of the commercial properties.

A part exceptions (primarily in the hotel, retail and logistics sector), the commercial sector is not distinguished from the residential one. In Italy, for example, the brokers profession does not have an official separation of industrial and residential branches. This is mostly historically motivated since during the past 20 years approx. 15 % of the transactions belonged to the industrial and commercial sector whilst about 85 % where purely residential.

### 1.6 other real estate markets

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The project finance, the eminent domain rights and public plan developments are some of the new real estate markets where the valuers are called to support and/or create business plan model.

#### 1.7 Main customer groups requesting valuation services (corporates, auditors, financial services industry)

Please refer to the paragraphs above too.

All the aforementioned group request for valuation services. Some of them (investment banks, auditing companies etc.) subcontracts the valuers in order to carry out directly a most complex engagement and therefore the single work of the valuer is merged in a bigger work and lost his identity.

##### 1.7.1 real estate finance / mortgage lending

The real estate finance / mortgage lending is an important source of business for the Italian valuers.

##### 1.7.2 volume of real estate finance

The volume of real estate finance is significantly increased during the last six years. Even due to the Basilea II scheme, the value of the mortgage was underestimated vis-a-vis the capacity of repayment of the borrower.

In the last six years, location, location and location – according to the words of the banks' representatives – shall have been substituted with cash flow, cash flow and cash flow.

Now that borrowers are often insolvents, the location of the properties has again some sense.

##### 1.7.3 supplier of real estate finance

The equity and non equity finance are the two source of the real estate finance.

Due to the fact that today the banks are not willing and/or are not in the condition to finance real estate projects; the joint venture between investors are become more common in order to pay back existing credit facilities to the banks.

##### 1.7.4 types of real estate finance

The real estate finance is diversified as the other finance sector. The mortgage, senior, mezzanine, second lien and junior credit facilities were all used during the last six years to finance the real estate.

Today only the mortgage and the senior lines are sometime survived.

##### 1.7.5 capital markets / mortgage funding

The structured finance played a central role during the last six years. The main diffusion channel to finance the credit granted in the real estate sector was trough structured product markets in which mortgage and credits were securitised and sold by credit institutions.

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The lack of transparency in the underlined risk and, in particular, the lack of a Property and Market Rating analysis regarding the asset backed has cooperate to create a secondary (sometime third or fourth) non-equity market very instable and illiquid.

The today trends of the banks is to create MBS or Covered Bonds to be sold to the central banks in order to obtain funds. The danger is to repeat the same errors of the past and bring to the insolvency the same States and central banks.

In this sense, the valuers shall have much more room and independence to determine the Property and Market Rating and to monitor the value of the real estate collateralised assets.

## **2. Real estate valuation**

In Italy, the European valuations standards as well as the International valuations standards are considered in term of reference of good practice.

The EVS is considered more strict regarding the term and conditions of the engagement, including the disclosure of potential conflict of interest.

Moreover, the Guidance 14 of the EVS is considered by the Italian authorities useful to enhance the transparency of the structured finance non-equity market backed by the real estate assets.

### 2.1 terms of/for value

Please see the paragraph above

### 2.1 market value

Please see two paragraphs above

#### 2.1.1 non-market values (mortgage lending value, foreclosure value etc.)

Please see three paragraphs above

Moreover, according to article 568 of the Italian Civil Procedure Code, the value of the real estate properties subject for the foreclosure is determine according to their cadastral value pursuant to article 15 of the same Code.

This imply that an assessment is not formally requested. But the judge usually instruct an expert to carry out also a valuation of the property subject to the foreclosure.

#### 2.1.3 other terms of/for values

Please see four paragraphs above

## 2. valuation methodology

Please see five paragraphs above

### 2.2.1 methods applied for the calculation of market value

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Please see six paragraphs above

2.2.2 methods applied for the calculation of non market values (MLV etc.)

Please see seven paragraphs above

2.2.3 regulatory / non-regulatory methods (if applicable)

Please see eight paragraphs above

### **3. Types of real estate valuers**

3.1 organisation of the profession (organisations / associations of valuers)

There are several associations of valuers basically divided between engineers, economist and architects on one side and “geometri” on the other side.

3.2 certified valuers (ISO 17024)

There is still not any valuer certified, but there is a couple of valuation companies which are training some valuers pursuant the ISO 17024 standards.

The system of the certification is very well recognised in the industrial sector but in the professional one is not so encouraged. Lawyers, doctors, engineers and architects are not used to be certified. Moreover, the fact that it is the same valuation company to certify the valuers make the system not so proof from the conflict of interest.

Basically, the valuation company shall be directly responsible for the valuation and guarantee for the high standard education and practice of his valuers. A certification of the same valuation company has more sense. And for this reason many valuation company are certified pursuant to ISO 9000.

3.3 publicly appointed valuers

The Court may choose between the list of expert, but there is not a list specific for real estate valuers. According to article 13 of the provisions implementing the Italian Civil Procedure Code, the experts are divided in six categories: (i) doctor, (ii) industrial, (iii) commercial, (iv) agriculture and (v) bank and (vi) insurance.

To be inserted in the list of expert kept by the Court, it is requested to be member of a professional association connected with the real estate sector if the expert shall carry out property valuations. The process of registration in the list of expert is regulated by the Italian law.

Also the Chamber of Commerces, regulated by public law, hold list of experts for carrying out valuations. Also in this case the procedure to be registered within this lists is regulated by the law.

3.4 national specificities:

- public expert committees etc.

Not applicable.

3.5 further groups of valuers

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Not applicable.

#### **4. Outlook**

[to be completed]

#### **Requirements for all country specific reports:**

- extent for the country specific chapter: 10 - 15 pages maximum
  - the same structure (template) should be used by all countries represented at TEGoVA in order to achieve a wide ranging and comprehensive comparability for the reader/user
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