Valuation uncertainty at times of market unrest

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You will have a lot of questions…

• Check the Coronavirus Hub and listen to this webinar for the answer- our capacity to answer specific questions is extremely limited during or after webinars

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• We may also not know the answer- this is a fast-moving situation

• If you are unable to find the answer, please contact us:

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INTERNATIONAL VALUATION STANDARDS

BUILDING TRUST IN VALUATION

Dealing with valuation uncertainty at times of market unrest

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OUR MISSION

Working with our partners, including standard setters, regulators, valuation professional organisations, and professional services firms:

The IVSC’s goal is to build trust in valuation by establishing globally consistent, high-quality International Valuation Standards (IVS) across all asset classes, and by supporting the growth of the valuation profession.

In achieving this, the IVSC seeks to support business, strengthen financial markets and protect the public interest.
OUR ROLE

• The IVSC acts as the independent standard setter for the valuation profession.

• We develop, consult on, and set high-level, principles-based standards for the valuation of all asset types.

• The International Valuation Standards are adopted in the guidelines issued by Valuation Professional Bodies; by regulatory authorities; and by valuation service providers.

• The IVSC does not accredit or license valuation professionals. Our role, as an independent and not-for-profit organisation, is to ensure that valuers, and the valuation profession more broadly, have robust and transparent standards in place.
IVSC TECHNICAL BOARDS COVER

TANGIBLE ASSETS

BUSINESS VALUATION AND INTANGIBLES

FINANCIAL INSTRUMENTS
Dealing with valuation uncertainty at times of market unrest

Alexander Aronsohn
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Valuation Uncertainty

Elements of market uncertainty from Covid 19 crisis:

• Market volatility

• Limited transactions

• Uncertain future
IVS 103 ‘Reporting’ requires the valuation report to disclose a number of matters, including any significant uncertainty or limiting conditions that directly affect the valuation.
10.1. It is essential that the valuation report communicates the information necessary for proper understanding of the valuation or valuation review. A report must provide the intended users with a clear understanding of the valuation.
10.2. To provide useful information, the report must set out a clear and accurate description of the scope of the assignment, its purpose and intended use (including any limitations on that use) and disclosure of any assumptions, special assumptions (IVS 104 Bases of Value, para 200.4), significant uncertainty or limiting conditions that directly affect the valuation.”
Valuation is not a fact

One of the main issues when dealing with valuation uncertainty is that a valuation is not a fact, but it is an estimate of the most probable of a range of possible outcomes based on the assumptions made in the valuation process.

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 should not be confused with risk.

Examples include:

• for tangible assets reduction in market prices after the date of acquisition or valuation,
• a deterioration in the projected future income of a security,
• a loss of liquidity compared with other assets,
• costs for maintaining or developing an asset being higher than currently anticipated,
• the rate of an asset’s technical or physical obsolescence being higher than currently anticipated.
Valuation Uncertainty Vs. Market Risk

While risk may be thought of as a measure of future uncertainties that may result in an increase or decrease in the price or value of an asset, valuation uncertainty is concerned only with uncertainties that arise as part of the process of estimating value on a specific date.
Valuation uncertainty can be caused by various factors. These can be broadly divided into the following categories:

- *Market Disruption*
- *Input Availability*
- *Choice of Method or Model*
Market Disruption

Valuation uncertainty can arise when a market is disrupted at the valuation date by current, or very recent events, for example through panic buying or selling, or a loss of liquidity due to a disinclination of market participants to trade.
Market Disruption

In respect of the coronavirus, the market disruption could be seen as microeconomic, but in future this could also have some macroeconomic implications.
Market Disruption

If the valuation date coincides with economic or political crises or immediately follows such an event, significant valuation uncertainty arises because the only inputs and metrics available for the valuation are likely to relate to the market before the event occurred and therefore have limited relevance to the situation on the valuation date.
Input Availability

A lack of relevant input data will cause valuation uncertainty. This may be due to market disruption, but may also be due to the assets being unique or because the market for the asset is normally illiquid.
Input Availability

The use of extrapolation or unobservable inputs can be a source of uncertainty because of the difficulty of finding objective evidence to support either the adjustments or the assumptions made.
Input Availability

In some cases, the valuation uncertainty resulting from inconsistent or conflicting data can be estimated by the effect on the valuation of using possible alternative inputs.
For many asset types, more than one method or model may be commonly used to estimate value. However, those methods or models may not always produce the same outcome and therefore the selection of the most appropriate method may itself be a source of valuation uncertainty.
However, valuers should consider the use of multiple approaches and methods and more than one valuation approach or method should be considered and may be used to arrive at an indication of value, particularly when there are insufficient factual or observable inputs for a single method to produce a reliable conclusion. Where more than one approach and method is used, or even multiple methods within a single approach, the conclusion of value based on those multiple approaches and/or methods should be reasonable and the process of analysing and reconciling the differing values into a single conclusion, without averaging, should be described by the valuer in the report.
Significant Uncertainty

Most valuations contain an element of uncertainty but IVS 103 only requires this to be disclosed when it is “significant”. However, the existence of significant uncertainty does not mean a valuation cannot be undertaken, but it does mean that significant assumptions within the valuation approach and methodology should be disclosed within the valuation report.
Significant Uncertainty

Even if the uncertainty can be quantified and appears to be significant, either as an absolute amount or as a percentage, whether it is significant also depends on its relevance, which has to be judged in the context of the purpose for which the valuation is required and the potential impact on all intended users of the valuation subsequently being shown to have been incorrect on the date it was provided.
Significant Uncertainty

Factors that it may be helpful to consider

• 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);

• the extent to which the value of a total portfolio is affected if the valuation uncertainty affects only certain assets within the portfolio (this may also involve considering correlation and interdependence between the individual assets);

• whether the cause of the uncertainty was known to the commissioning party or to 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.
Measuring Valuation Uncertainty

• Quantification of valuation uncertainty can be more relevant for some classes of asset than others.

• Where two or more alternative scenarios are possible the valuation should be based on the most likely scenario.
Measuring Valuation Uncertainty

A quantitative measure should always be accompanied with a narrative describing the cause and nature of the uncertainty
Measuring Valuation Uncertainty

- A purely numeric illustration will only confirm uncertainty, not explain it.
- Quantifying valuation uncertainty does not involve forecasting a worst-case scenario.
- The objective of any uncertainty analysis is not to provide a forecast of possible fluctuations in the reported value at future dates.
- When quantifying the impact of uncertainty, the interdependence or correlation between significant inputs needs to be considered when it is practical to do so.
Challenges arise, however, when considering assets that trade in less active markets and/or where there are significant differences between the assets providing the evidence and the asset being valued. In such circumstances the evidence available may not be directly comparable. It will therefore need to be analysed and reconciled in order for it to be used in the valuation.
Measuring Valuation Uncertainty - Comparable Evidence

Comparable evidence underpins the valuation of most traded assets. Provided the criteria below are met, it should provide an accurate indication of value:

- **comprehensive** – there should be several comparables rather than a single transaction or event
- **very similar or, if possible, identical to the item being valued**
- **recent, i.e. representative of the market on the date of valuation**
- **the result of an arm’s-length transaction in the market**
- **verifiable**
- **consistent with local market practice and**
- **the result of underlying demand, i.e. comparable transactions have taken place with enough potential bidders to create an active market.**
Valuers should be alert to whether the transactional information reflects the tone of value or is merely reflecting the needs of an individual buyer and/or seller, who could be seen as a Special purchaser. In this circumstance, the transaction may be proceeding at a figure to reflect the worth of the asset, taking into account the buyer and/or seller’s motivation to buy and sell but not at a figure that is reflective of the value of the asset.
Material Uncertainty Declarations

Where a material uncertainty declaration is being used, its purpose is to ensure that any client relying upon that specific valuation report understands that it has been prepared under extraordinary circumstances.

The term is not meant to suggest that the valuation cannot be relied upon; rather, it is used in order to be clear and transparent with all parties, in a professional manner that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. Indeed, with regard to the process itself, professional valuers will almost certainly have undertaken far more due diligence than normal, in order to arrive at their estimate of value.

Ben Elder FRICS. Chair of IVSC TAB
The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a “Global Pandemic” on 11 March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries.

Market activity is being impacted in many sectors. As at the valuation date, we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

Our valuation(s) is/are therefore reported on the basis of ‘material valuation uncertainty’ as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of [this property] under frequent review.
Material Valuation Uncertainty – Interface of IVS and RICS Global Standards – Valuation “Red Book”

- RICS Red Book denotes specific differences between general market uncertainty and material valuation uncertainty: ‘Markets can be disrupted by relatively unique factors. Such disruption can arise due to unforeseen financial, macro-economic, legal, political or even natural event...reduced level of certainty...due to inconsistent, or an absence of, empirical data, or...the valuer being faced with an unprecedented set of circumstances on which to base a judgment’ VPGA 10
- Definition and criteria at Red Book VPGA 10 and mandatory reporting requirement to ‘expressly signal’ material valuation uncertainty at VPS 3.
Additional Advice from IVS

• If you are unable to comply with all the requirements contained with due to existing government restrictions then this should be clearly stated within the scope of work, agreed with the client and clearly stated in the report.

• If the valuer considers that it is not possible to provide a valuation on a restricted basis, the instruction should be declined.

• Valuers should not apply pre-crisis criteria to their valuations as this approach is based on the potentially erroneous assumption that values will return to their pre-crisis levels and there is no way of predicting that this assumption is in fact correct.
Thank you.
Q&A

• ICAEW Coronavirus Hub:  www.icaew.com/coronavirus

• Direct enquiries:  www.icaew.com/contact-us/helplines-and-support

• Feedback / Insights:  https://r1.dotmailer-surveys.com/bb41f58a-914k8i13

• CABA:  www.caba.org.uk