



Survey results

Residential valuation practices by ADIs and LMIs

23 May 2005



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Glossary

ADI	Authorised deposit-taking institution under the <i>Banking Act 1959</i>
API	Australian Property Institute
APRA	Australian Prudential Regulation Authority
Back testing	The process whereby, when considering new valuation methods, existing valuations are tested against the new methodology to ensure appropriate outcomes are achieved.
Captives	LMIs established by ADIs whose sole purpose is to meet the mortgage insurance requirements of the said ADI.
Electronic valuation	Otherwise referred to as a database valuation, where statistical sales data are used to assess the value of specific properties. This information is commonly provided by Residex, Australian Property Monitors (APM) etc.
Full external valuation	Includes full property description, full market analysis, valuation rationale and individual memorandum.
Hindsight review	Review of valuation reports by registered valuers, typically on a sample basis and post funding, to ensure valuation reports are being completed in a satisfactory manner. This usually involves some form of check valuation, with the process handled internally (if there are suitably qualified staff) or externally.
Internal valuation	Valuation undertaken by staff internal to the organisation; includes valuations undertaken by non-registered valuers and registered valuers.
LMI	Lenders mortgage insurer
LVR	Loan-to-valuation ratio
Open policy or delegated underwriting authority (DUA)	Legal arrangement whereby an ADI is given direct underwriting control for mortgage insurance policies without reference to the LMI. This is subject to the transaction meeting certain underwriting requirements.
PI	Professional indemnity insurance
Restricted valuations	Also commonly referred to as 'kerbsides'. No internal inspection of the property is undertaken.
Service level agreement	An agreement detailing the commercial arrangements between a valuer and an ADI.
Short form valuation	Concise summary report designed to be read in conjunction with a separate memorandum already provided/agreed with the ADI.
Valuer-General's assessment	Refers to State Government valuation assessments for rate payment purposes. Some states assess on a land only basis, others provide a value based on an assessment of the capital improvements (capital value).

Executive summary

This paper presents the results and analysis of the surveys of 96 authorised deposit-taking institutions (ADIs) and eight lenders mortgage insurers (LMIs) into residential valuation practices, undertaken in the last quarter of 2004. The surveys were completed by all ADIs with a mortgage book of greater than \$50 million or total net assets of greater than \$100 million. Only two of the participant LMIs may be viewed as being completely independent; the remaining six are owned by ADIs.

The key aims of the surveys were:

- to understand current industry practices in order to identify whether there is any trend towards the use of less rigorous valuation methodologies that might have a significant impact on the financial viability of ADIs and LMIs if there were to be a major property market downturn;
- to understand the interactions in valuation practices between LMIs and ADIs;
- to consider whether there has been any material relaxation in valuation practices; and
- to identify areas where ADIs and LMIs might improve their risk management practices.

Current industry practices

The main conclusion reached is that there have been changes to valuation methodologies in recent years that could potentially increase the risk profile for ADIs and LMIs. However, the control framework implemented to mitigate these potential risks is critical in bringing them to a controllable level. It is important to note that the surveys did not focus on the rigour of the evaluation of new methodologies before they were introduced nor did it seek to identify whether senior management (or the board as appropriate) has approved the methodologies. APRA will be following up on these issues in the course of its regular visit program.

Some specific findings on current industry practices are as follows:

- All the ADIs surveyed use external valuers for at least some classes of residential property valuations. The percentage of valuations completed by external

valuers tends to vary according to the size of the ADI, with the larger ADIs seemingly more willing to explore alternative methodologies. For smaller ADIs, with some exceptions, the traditional full external valuation is still very much the norm.

- Some 94 per cent of valuations are undertaken by sources external to the ADI. This comprises 72 per cent by way of full/short form valuation/restricted valuation (i.e. a valuer actually inspects the property) and 22 per cent by way of electronic valuation/contract of sale or Valuer-General's valuation.
- Internal valuation assessments comprise six per cent of total valuations. Four ADIs undertake internal valuations by registered valuers on their staff and a further eight by non-registered valuers. The primary methods of assessment are restricted or short form valuation.
- There has been an increased willingness on the part of ADIs over the last three years to consider the use of alternative valuation methodologies and this trend is likely to continue over the next three years.
- While the movement away from a total reliance on the full external valuation might be seen as a relaxation in credit risk management practices, this does not necessarily follow. Much depends on the control framework surrounding the use of alternative methodologies. Clearly it is one thing to use more streamlined methodologies for relatively low-risk situations, where the LVR might be 60 per cent. It is another thing to use them for higher-risk loans with an LVR of, say, 95 per cent.

For loans with LVRs over 80 per cent (which are typically mortgage insured), risks in valuation are generally shared with the LMIs and valuation methodologies for these loans have changed. It is now common practice for LMIs to accept contract of sale and restricted valuations, although subject in many instances to controls on loan size, LVRs and property location. Internal valuations by non-registered valuers are not generally accepted by LMIs, with one exception. Acceptance by LMIs of these changed practices has clearly impacted on the way higher LVR loan securities are valued. These practices need not give rise to increased credit risk provided

that appropriate controls are in place. It must be emphasised, however, that ADIs and LMIs should not be using alternative valuation methodologies as a complete replacement for full valuations, especially for high LVR loans, large loans or where the property is in a location where it would be difficult to use the alternative methodologies.

APRA views the current risk management arrangements for ADIs and LMIs as having a number of strengths:

- most ADIs have a documented valuer appointment process where the credit risk management area is usually involved;
- in most instances the valuation report is available to the decision maker, who more often than not is located in the credit risk management area. Not surprisingly, valuations will be questioned from time to time;
- valuer panels tend to be fairly stable;
- many institutions have a Service Level Agreement with their valuers;
- whilst brokers and mortgage managers can often recommend particular valuers there is little evidence of their involvement in the appointment process;
- in all instances, valuations are addressed to the ADI, its LMI or the securitisation vehicle, if the relevant mortgage is to be securitised;
- most ADIs do check on valuer Professional Indemnity (PI) insurance on an annual basis;
- disputes between ADIs, LMIs and individual valuers rarely become litigious although there is no guarantee that this would remain the case in a property downturn and a less benign credit environment;
- decline rates due to valuation concerns are typically low for most LMIs;
- LMIs have established guidelines for the appointment of valuers to ADI panels; and
- risk-based sampling is an established part of the audit process, particularly for those entities operating under 'open policy' or delegated underwriting authority (DUA) from LMIs.

Interaction between LMIs and ADIs

LMIs do not actively involve themselves in ADI valuer selection and ongoing management processes. It appears that LMIs take the view that these issues are not their responsibility since they are insurers and not bankers. Furthermore, such involvement would limit their freedom of action when it comes to assessing claims: it would be harder to refuse a claim for valuation reasons if the LMI had been actively involved in the valuer management process.

That said, LMIs can play a significant role in rigorously evaluating changes in ADI valuation practices. This is not only in their own commercial interest but would act as a discipline on ADIs adopting new valuation practices. During APRA's on-site visits, it will be examining the extent to which LMIs already do this.

Prudential issues in valuation practices

The surveys have identified that residential valuation practices have undergone a significant change over recent years, particularly for the larger ADIs. Whereas previously a full external valuation, including an internal inspection of the property, was the most common valuation technique, this is now not the case; some institutions physically inspect less than 50 per cent of their security properties.

Alternative valuation methodologies can pose additional risks since they do not typically involve an internal inspection of the property by an appropriately qualified valuer. APRA is conscious of the pressures on ADIs to reduce valuation expenses and that this could, in turn, see a further reduction in the number of properties subject to external valuation. APRA is concerned that these new methodologies have not been tested during a period of property price declines and it will be closely monitoring developments in residential valuation practices. In particular, APRA will be assessing how the new valuation methods were researched, and subsequently monitored, in the regular visits to ADIs and LMIs.

Weaknesses were identified in the valuation practices of some institutions, which APRA is taking up with the institutions concerned. There were also some institutions whose practices differ from those of their peers and give rise to potential for increased risk.

Aspects which have been identified as requiring attention are as follows:

- appropriate risk control parameters for the use of alternative methodologies are not always as clear as they might be;
- some (usually smaller) ADIs do not have a valuer appointment or performance review process;
- Service Level Agreements with valuers are not always in place;
- in some instances, there is no formal process for decision-making when a valuation suggests that the ADI's credit risk might be higher than would normally be accepted. Decisions are then taken on an 'ad hoc' basis which can lead to inconsistency;

- a majority of ADIs do not formally hindsight review their valuations; and
- some ADIs do not check valuers' PI cover on an annual basis.

APRA's expectations for a prudent risk management environment for valuations are detailed in the relevant chapters of this document and summarised in Chapter 6.

In revisions to the capital adequacy framework for residential mortgage lending, announced in September 2004, APRA outlined requirements that ADIs must meet where they do not require a formal (full external) valuation of a residential property.

Chapter 1 – Background to surveys

Objectives

The key aims of the surveys were:

- to understand current industry practices in order to identify whether there is any trend towards the use of less rigorous valuation methodologies that might have a significant impact on the financial viability of ADIs and LMIs if there were to be a major property market downturn;
- to understand the interactions in valuation practices between LMIs and ADIs;
- to consider whether there has been any material relaxation in valuation practices; and
- to identify areas where ADIs and LMIs might improve their risk management practices.

While the surveys sought to identify the valuation methodologies in use and whether an external valuation was required in all instances, they did not cover issues such as the internal controls surrounding the use of particular methodologies, validation of databases or the basis for adopting new methodologies. These matters will be covered during regular APRA visits to ADIs and LMIs.

Survey sample and design

In August 2004, surveys were sent to 96 ADIs and eight LMIs, including six entities owned by ADIs. The ADI survey contained 38 questions and the LMI survey 23 questions. The surveys covered the following:

- external valuer selection and the valuation process;
- credit approval (not part of the LMI survey);
- monitoring; and
- disputes.

The total value of ADI residential lending for the period of the survey (July 2003 to June 2004) was \$233 billion, for which banks accounted for over 90 per cent.

The results of the ADI survey are summarised in Tables 1 to 5 and Charts 1 to 3 and the LMI survey in Tables 6 to 9, which are attached to the end of this report.

The surveys and their analysis were conducted by John Jones and Michael Blacker, Supervisory Support Division of APRA.

Alternative valuation methodologies

The term 'alternative valuation methodologies' in this report is used to describe various valuation practices that do not involve an internal inspection of the security property, the most common valuation technique. The valuations captured by this term include:

- restricted (or kerbside);
- electronic;
- contract of sale; and
- Valuer-General's assessments.

Restricted valuations involve some 'in office' assessment of a property's values, typically with reference to comparable sales. In APRA's view, this practice is more appropriate for lower LVR and/or loan amounts. APRA would view with concern the use of restrictive valuations (particularly if they lack supporting comparable sales data) for high LVR lending in tandem with large loan amounts.

Some valuers are now developing electronic systems that enable ADIs to access much more information about property values and provide an auditable process around the valuation. These systems rely on sales data from a number of sources, overlaid with valuer knowledge, to determine the valuation of individual properties. These valuations are typically completed remotely although there is scope for a full valuation if the ADI or valuer determines this to be appropriate. APRA is monitoring the use of these new systems and will be discussing with individual ADIs the results of various trials.

Many ADIs have relied on a recent contract of sale as the basis for determining value. With appropriate controls, this is an established valuation technique. The trend more recently, however, has been to use 'older' contracts of sale (perhaps some years older) and then apply a model of average growth to this original figure. The reliability of this blended approach

depends upon the age of the original contract of sale and the appropriateness of the growth assumptions. One approach is to apply 'average growth rates by postcode'. However, ADIs' risks are to individual properties, not whole suburbs, and this approach provides no mechanism to take into account property-specific factors, which may have a significant effect on the property valuation. In APRA's view, the use of dated contracts of sale is not an effective method of valuation and needs to be viewed with caution.

Valuer-General assessments made for council rating purposes are also not property-specific and are generally assessed on a suburb-by-suburb basis. In addition, the information may not be timely (some review cycles are three years).

ADI valuation practices

In aggregate, 94 per cent of valuations are undertaken via external sources, comprising full or short form valuations, restricted valuations, electronic valuations (i.e. Residex and the like) or use of contract of sale or Valuer-General assessment.

The larger ADIs surveyed have tended to be more willing to explore different valuation methodologies such as contract of sale, Valuer-General assessments or restricted valuations, whereas the smaller ADIs still rely heavily on full external valuations. The highest proportion of internal valuations for an ADI is 45 per cent, restricted valuations 36 per cent, electronic 22 per cent and contract of sale 60 per cent.

Some 38 per cent of the ADIs surveyed have made changes to their valuation policies over the past three years. The most common changes have revolved around the contract of sale as a valuation source in its own right or as part of a new valuation methodology. It is also interesting to note that, over the same period, some ADIs have actually chosen to pull back from the use of alternative methodologies such as contract of sale or restricted valuations.

Only 16 per cent of ADIs expected significant changes in valuation practices within the next three years and these tended to be the larger ADIs. These changes are most likely to result in a further reduction in the number of external valuations undertaken by external valuers, driven by cost and competitive pressures.

APRA expects ADIs that choose to use alternative valuation methodologies to undertake a formal review process. This should include back testing to ensure the appropriateness of any new system, establishment of specific parameters for the use of these methodologies (for example, excluding their use for particular products such as 'low doc' loans, as well as limits based on LVR, loan size or property location) and hindsight sampling.

LMIs appear to have accepted some of the changes to valuation policies and, typically, no longer require an external valuation for loans up to \$300,000 and an LVR of up to 90 per cent, subject to certain parameters.

A number of ADIs have set specific parameters—in terms of LVR, loan size and location (e.g. metropolitan only)—which govern where particular valuation methodologies should be used. APRA expects that these sorts of parameters would be established for all valuation methodologies used.

Acceptable valuation methodologies can vary from state to state. This is particularly evident in the use of Valuer-General assessments where state-based factors are relevant. In states where a capital value is provided (as opposed to a land only value) Valuer-General assessments tend to be more widely used. South Australia is a case in point.

All ADIs indicated that valuations are addressed to the ADI, its securitisation vehicle or LMI. There was no evidence to suggest that valuations were 'addressed' to homeowners or their agents, such as mortgage managers and brokers. This said, APRA's on-site reviews have identified occasions where brokers have arranged the valuation and sent it directly to the relevant ADI. Generally, however, there is no evidence of significant broker involvement in the area of valuations.

A number of ADIs use a blended approach to valuations in certain circumstances. That is, the purchase price from the contract of sale may be accompanied by an electronic or restricted valuation. The aim is to obtain the most accurate figure without the expense of a full valuation.

The number of valuers on the panel varies significantly from ADI to ADI. APRA observes that the larger the

panel the more difficult it is to manage and control. ADIs should ensure the valuer panel is sufficient to meet their needs.

LMI valuation practices

Half of the LMIs surveyed required external valuations in all instances. Whilst this survey did not address what other valuation methodologies are accepted when an external valuation is not required, it is apparent from the separate ADI survey that the contract of sale and restricted valuations are now being accepted by some LMIs in determining property values.

Some 63 per cent of LMIs offer open policy or DUA arrangements. However, not all ADI-owned entities operate on this basis, suggesting that there is some degree of independence in some entities. Only the two independent LMIs offer open policy or DUA to more than one institution.

LMIs will normally have an audit process where open policy or DUA is in place. Not all LMIs indicated the percentage of files reviewed during the audit process

although this can be up to 10 per cent. Where the transactions are individually underwritten by the LMI there is typically no audit process.

Two LMIs had transaction decline rates at more than one per cent, but the rest had lower rates. As a generality, LMIs indicated that transactions were declined because of concerns about the nature of the security offered rather than because of any issues arising out of valuations per se. This said, the three most significant valuation issues LMIs see on a regular basis are property sale comparisons (i.e. use of dated sales or properties that are not directly comparable), zoning or assessment of property condition (i.e. rural zoning) and property risk ratings (i.e. the valuer has assessed marketability risk to be higher than normal).

No LMI maintains a register of unacceptable valuers, primarily as a result of concerns relating to privacy or possible defamation.

The API valuation format is generally the preferred method for both ADIs and LMIs although it is apparent that some of the larger ADIs have moved away from this format.

Chapter 2 – External valuer selection

ADI survey

A number of ADIs indicated that they do not have a formal valuer appointment process. APRA expects all ADIs to have a documented appointment process which, amongst other things, identifies who is responsible for valuer appointment and, if necessary, removal. Where the decision is made to outsource the valuation process, the ADI should be able to demonstrate there has been adequate due diligence of the outsourcing decision.

Overall, only 39 per cent of surveyed entities have a Service Level Agreement (SLA) with their panel valuers. This is an important tool in setting out the contractual relationship with valuers and ADIs should consider implementing an SLA or, alternatively, document the reasons why an SLA is not necessary for their organisation.

Some 45 per cent of the ADIs surveyed do not have documented policies and procedures for dealing with higher risk properties as determined by the risk ratings assigned by valuers. APRA expects all ADIs to have policies and procedures for dealing with valuations evidencing higher risk, be it in terms of the maximum LVR, authority level for approval or other relevant factors.

One ADI indicated that it contracts directly with individual valuers rather than valuation firms. This approach may have implications for individuals working for large valuation firms in that the valuation firms may themselves be responsible for the PI cover rather than the individual.

Overall, 45 per cent of ADIs indicated they have a documented conflict of interest policy. APRA expects that ADIs should at least consider the issue of conflict of interest and that it would normally form part of the appointment process. Whether it is appropriate to establish a formal policy in this area, with detailed parameters, is a matter for senior management of the ADI.

LMI survey

LMIs have a limited involvement in the appointment of valuers to ADI panels. Any input is likely to be informal, at a business relationship as opposed to a risk management level.

However, there are some broad general principles that LMIs insist must be followed. For example, valuers are usually required to have API membership and acceptable PI insurance. Individual firms or valuers are generally not vetted by the LMI providers prior to their inclusion on the ADI panels. Not surprisingly, those LMIs owned by ADIs rely on the ADI valuer policies and procedures.

Chapter 3–Credit approval

For the most part, the ADI survey confirmed that credit decisions are made with a valuation report provided to the decision-maker. Some ADIs do not provide the valuation report to the decision-maker initially, but do so if required.

In 86 per cent of ADIs, the credit risk management function is responsible for following up any anomalies identified in the valuation report. Sales personnel are involved in the balance of situations.

Only a small number of ADIs identified recurring anomalies in the valuation assessment process.

The issues mentioned include the adequacy of comparable sales figures, valuer risk ratings and the actual valuation figure.

Where an automated decision-making tool such as credit scoring is used in the credit assessment process, the same person is usually responsible for identifying any anomalies in the valuation report, as would be the case with a non-automated decision. In consequence, there does not appear to be any difference in the way the valuation is reviewed.

Chapter 4—Monitoring

ADI survey

Only 41 per cent of ADIs surveyed have an annual review process for valuers. There appears to be a correlation between the size and sophistication of an institution and the existence of a review process. In general, the larger the panel the more likely it is that a process is in place. APRA considers a documented review process to be important in managing valuation risks and should be undertaken by all ADIs. The review process should document who is responsible for undertaking the review, and APRA would expect that the risk management function has an involvement.

Two approaches were identified to reviewing valuations: a review at the time of application and a later hindsight review. While all ADIs indicated that they review valuation reports at the time of application, only 23 per cent have a hindsight review process where some sampling of valuation reports is undertaken. Only eight per cent of ADIs review more than five per cent of valuations. APRA believes a strong hindsight review process is important in monitoring valuer performance and all ADIs should consider implementing such a process.

There tends to be little movement in the composition of valuer panels. Only 26 per cent of ADIs in the sample have removed a valuer within the last twelve months. The most common reasons for removal are cessation of business or retirement. A low 11 per cent suggested that they had issues with service or pricing. This said, it is quite likely that ADIs do not want to

waste time on disputes with valuers who are perceived to be performing poorly, and these valuers are simply not given future business.

Some 69 per cent of ADIs monitor the renewal of panel valuer PI cover on an annual basis. APRA believes that all ADIs should have a process for monitoring the PI cover of their panel valuers.

A large number of the ADIs surveyed do not monitor the level of business being undertaken by each firm or valuer and this may limit an ADI's ability to determine any undue concentration risks. APRA would suggest that ADIs consider monitoring the level of business being undertaken by each of their valuers.

LMI survey

The review process for most LMIs is undertaken on an exception basis and, in limited circumstances, some valuation checks are ordered. The review process is typically left to the ADIs to manage, including the review of PI cover.

No LMI has declared a valuer unacceptable over the past 12 months, reflecting privacy and possible defamation issues. LMIs typically do not formally reject valuers, although in rare circumstances this can occur.

LMIs argue that these are issues for the ADI and that they would wish to maintain their freedom of action. Nonetheless, APRA believes that LMIs should carry out some due diligence on the introduction of new valuation methodologies by ADIs as part of prudent risk management.

Chapter 5–Disputes

Only 25 per cent of ADIs have a formal valuer dispute resolution process. There is a general feeling that a formal process is not necessary at present, but APRA believes that ADIs should at least consider the creation of a formal disputes process to simplify matters if there were to be an increase in disputes in the future.

The ADI survey identified that there have only been seven claims against valuer firms over the survey period (July 2003 to June 2004), which probably reflected the buoyant property market and benign credit conditions over that period. Three involved

legal action. Alternatively, some 75 per cent of the LMIs have pursued a valuer through the legal process over the same period.

ADIs and LMIs have indicated they do not involve the API in any dispute resolution process.

LMIs do not currently make a claim adjustment for inadequate valuer performance, unless there has been fraud in which the ADI has been culpable in some way. In most cases, once a payout has been made, the LMI is left to pursue the valuer should there be a case for so doing.

Chapter 6—Findings and conclusions

A main conclusion from the surveys is that the larger ADIs are becoming more willing to adopt alternative valuation methodologies in an effort to minimise costs and respond to competitive pressures. LMIs have also been prepared to accept these alternative valuation methodologies, particularly contract of sale and restricted valuations.

As a generality, the smaller the institution the more likely it is to rely on a full external valuation. At the same time, larger ADIs tend to be better organised when it comes to the appointment and subsequent management of valuer relationships.

At this stage, it is too early to determine whether the alternative valuation methodologies adopted by ADIs have resulted in an increased credit risk profile. To a large extent, this depends on the controls around these methodologies, such as limits on their use according to LVR, loan size, property location or product type. In general, APRA would expect such methodologies to be used only for lower risk lending, where there is benefit in minimising costs without significantly adding to risk. Clearly, an institution using contract of sale valuations for high LVR loans would, prima facie, be assuming more risk.

In its on-site reviews, APRA will be seeking to satisfy itself that alternative methodologies have been appropriately researched and approved at senior levels in the institution, with a suitable level of subsequent back-testing. From a prudential perspective, the key issue is whether an acceptable level of due diligence is undertaken prior to the introduction of these alternative methodologies.

With regard to the particular findings from the surveys:

- The trend in alternative methodologies is towards the use of computer-based databases, which may or may not be blended with the use of valuer expertise. Whilst this may be perceived as a less rigorous process, it depends largely on the characteristics of the loan.
- That said, in some instances ADIs did not appear to have considered establishing appropriate parameters for different valuation methodologies. Good practice would involve limits being set on LVR levels and loan size for each valuation methodology in use. Without these controls, too much discretion is given to the individual credit decision-maker.
- While many ADIs have a documented appointment process for valuers, APRA believes that all ADIs should do so, with senior management actively involved in the process.
- Similarly, not all ADIs have SLAs with valuers. APRA recommends that all ADIs should consider using SLAs, although such agreements may not be necessary for a small ADI with, say, only one or two valuers.
- The majority of ADIs surveyed do not have a valuer review process. Good management practice would suggest there be a reasonable level of valuation review by suitably qualified professionals, conducted on a firm-specific basis.
- APRA expects all ADIs to have policies and procedures for dealing with valuations of potentially higher risk loans, be it in terms of the maximum LVR, loan size, location, authority level for approval or other relevant factors.
- APRA also expects all ADIs to consider the issue of conflict of interest, presumably as part of the valuer appointment process. The decision as to whether it is appropriate to establish detailed procedures for doing so is a matter for the senior management of the ADI.
- APRA believes that all ADIs should be checking, on an annual basis, that panel valuers continue to have adequate PI cover.
- The LMIs generally leave valuer selection and ongoing relationship management to the ADIs. LMIs tend to see this as an issue for lenders and have no wish to compromise their own position in relation to any ADI or valuer should a claim be made. APRA believes that LMIs should carry out some due diligence on the introduction of new valuation methodologies by ADIs as part of prudent risk management.
- There have been very few ADI/LMI disputes in recent years, to which the benign credit environment and strong property market have undoubtedly contributed.

In September 2004, APRA announced revisions to the capital adequacy framework for residential mortgage lending. *AGN 112.1, Attachment C, Eligible Residential Mortgages*, states that where an ADI accepts the purchase price (contract of sale), or other means of valuation, as being an indication of the value of the residential property offered as security for a loan (in lieu of a formal or full external valuation), the

ADI must detail the criteria used to justify this use in its lending/credit policy and procedures manual. The manual must include clear guidelines which detail the circumstances under which the purchase price (contract of sale) or other means of valuation are acceptable to the ADI as an indication of the property value as well as circumstances where a formal valuation of the property is required.

Table 1

ADI survey details/ background (Data estimated as at September 2004)	
	All
Number of surveys sent	96
Number of responses (% response rate)	96 (100%)
Number ADIs using external valuers	96 (100%)
Dollar value of residential mortgage lending between July 2003 and June 2004	\$233.3bn
Number of ADIs using registered internal valuers	4 (4%)
Number of ADIs undertaking internal valuations (excluding registered valuers)	8 (8%)
Number of ADIs using restricted valuations by external registered Valuers	11 (11%)
Number of ADIs using electronic valuations	11 (11%)
Number with significant change to external valuations practices over the last three years ¹	36 (38%)
Significant changes to policy over last three years	
Contract of sale acceptance or change to existing conditions ²	36 (38%)
Electronic valuations changes	10 (10%)
Restricted valuations changes	6 (6%)
Valuer-General changes	14 (15%)
Number with significant change expected to external valuations over next three years	15 (16%)
Number of valuers on panel	
Less than 50	70 (73%)
Between 51 and 150	14 (15%)
Greater than 150	8 (8%)
Valuation parameters for specific valuation methodologies	
Contract of sale – LVR limit and dollar limit	25 (26%)
Contract of sale – LVR < 80%	17 (18%)
Electronic valuations – LVR and dollar limit	5 (5%)
Electronic valuations – LVR < 80% and all others	6 (6%)
Restricted valuations – LVR and dollar limit	5 (5%)
Restricted valuations – LVR < 80% and all other	6 (6%)
Valuer-General's – LVR and dollar limit	4 (4%)
Valuer-General's – LVR limit and all others	50 (52%)

¹ In some instances, significant changes to ADI valuation policy did not correspond to any significant change to the number of external valuations. It is assumed that the identified changes to valuation policy would have altered the balance of external valuations and has been included in the latter measure.

² Includes ADIs that no longer use contract of sale as a valuation methodology.

Table 1a

ADI valuation methodology statistics (per cent of total valuations) ³	
External valuations	94
Internal valuations	6
External valuations	
Restricted valuations	8
Short form valuations	34
Full valuations	30
Contract of sale ⁴	18
Valuer-General assessments	2
Electronic valuations	4
Other ⁵	4
Internal valuations	
Restricted valuations	34
Short form valuations	60
Other	6

³ Responses have been weighted according to size of residential mortgage lending.

⁴ The majority of ADIs have reported contract of sale and Valuer-General assessments as external valuations; to ensure comparability these have been assumed to be an external process for all ADIs.

⁵ Other valuations include progress reports, estimated valuations and non-conforming valuation reports.

Table 2

ADI external valuer selection	
Number of ADIs that have an appointment process for the selection of external valuers	75 (78%)
Top four characteristics for selecting valuers ⁶	
Experience/qualifications	73 (76%)
Reputation	44 (46%)
Professional indemnity insurance	48 (50%)
Service delivery	28 (29%)
Number where senior management or board is responsible for removal or appointment of valuers ⁷	91 (95%)
Number where mortgage managers or brokers are involved in the appointment or instructing processes	8 (8%)
Number who have a standard Service Level Agreement	37 (39%)
Number where standard response time of 48 hours	55 (57%)
Number who mandate the API format	70 (73%)
Number where specific guidelines address the impact of the valuer-assigned risk rating on the lending criteria	53 (55%)
Number with conflict of interest policy or guidelines	43 (45%)

⁶ Some ADIs responded with their three most important characteristics, despite not currently having an appointment process.

⁷ Some ADIs responded that senior management would be involved in the appointment, despite not currently having an appointment process.

Table 3

ADI credit approval	
Number of ADIs who make a copy of the valuation report available to the approving officer	91 (95%)
Responsibility for addressing any identified anomalies	
Credit officer	83 (86%)
Sales officer	13 (14%)
Number who indicated some recurring anomalies	18 (19%)
Three common recurring anomalies	
Comparable sales	5 (5%)
Adverse risk ratings	5 (5%)
Valuation amount above or below expectations	7 (7%)

Table 4

ADI monitoring of valuers	
Number of ADIs with a documented review process ⁸	39 (41%)
Three characteristics of the review process (where described in detail)	
Sampling	20 (21%)
Professional Indemnity review	30 (31%)
Service delivery	18 (19%)
Number of ADIs where a hindsight review subsequent to the approval is undertaken⁹	
Hindsight review percentage > 5%	8 (8%)
Hindsight review percentage < 5%	10 (15%)
Number with risk management (including valuation team) responsible for the review ¹⁰	40 (42%)
Number of ADIs where this risk management/valuation area is also responsible for the day-to-day management of the valuer relationship	35 (36%)
Number of ADIs which question valuations during the review process ¹¹	45 (47%)
Four common reasons for questioning	
Adverse risk rating	15 (16%)
Comparable sales	23 (24%)
Valuer comments	16 (17%)
Valuation amount above or below expectations	18 (19%)
Number who monitor the proportion of lending associated with individual firms	33 (34%)
Number who have removed a valuer from their panel over the past 12 months	25 (26%)
Three most common reasons for removal of a valuer from the panel	
Service/pricing	11 (11%)
Poor valuation practices	11 (11%)
Retirement or cessation of business	14 (15%)
Number who monitor the renewal of professional indemnity insurance	66 (69%)

⁸ The question sought to understand the hindsight review process (if any). Where the sole purpose was a review of service delivery or where the valuation was only reviewed at the time of application, the processes were not considered a hindsight review.

⁹ ADIs that did not indicate the sample size were not included.

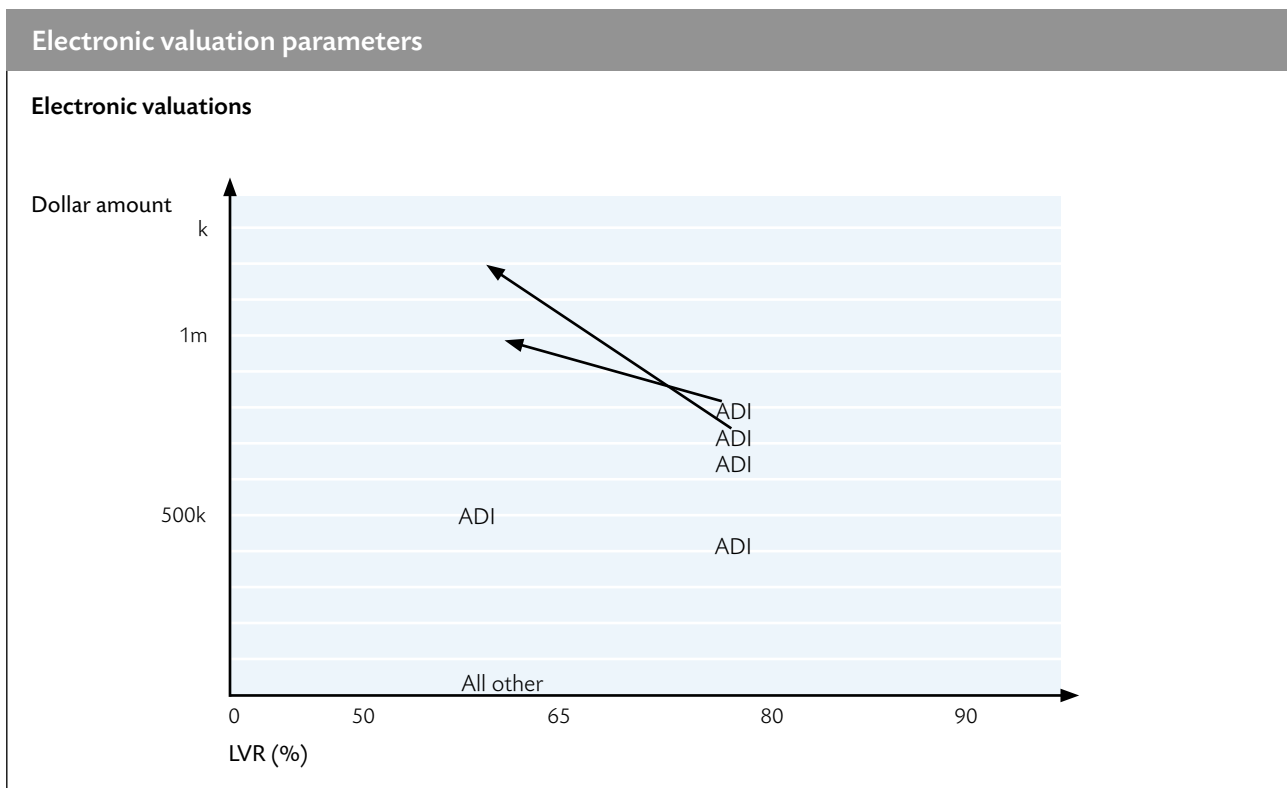
¹⁰ Some ADIs had no formal review process but indicated that the risk management function is/would be responsible for reviews.

¹¹ A number of ADIs indicated issues at time of approval rather than during the review process, and have been included.

Table 5

ADI disputes with valuers	
Number with a formal process for handling disputes	24 (25%)
Number of ADIs who have indicated they have made a compensation claim against a valuer firm over the past 12 months	7 (7%)
Claims involving legal action	3 (3%)
Number involving the API in the dispute resolution process	1 (1%)

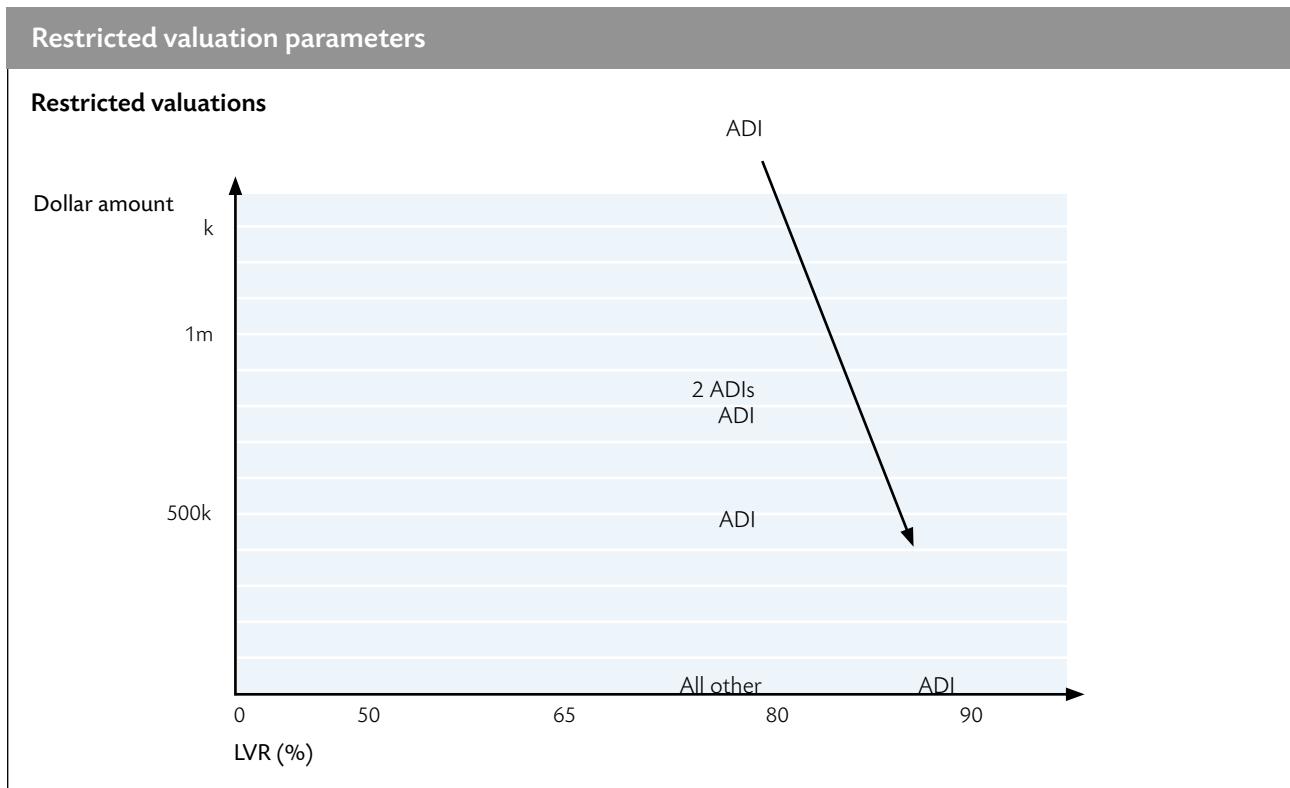
Chart 1



Notes:

- Arrows on graphs indicate that, as the loan amount increases or decreases so does the maximum LVR allowable under this valuation methodology.
- All other ADIs (6) have LVR guideline only.

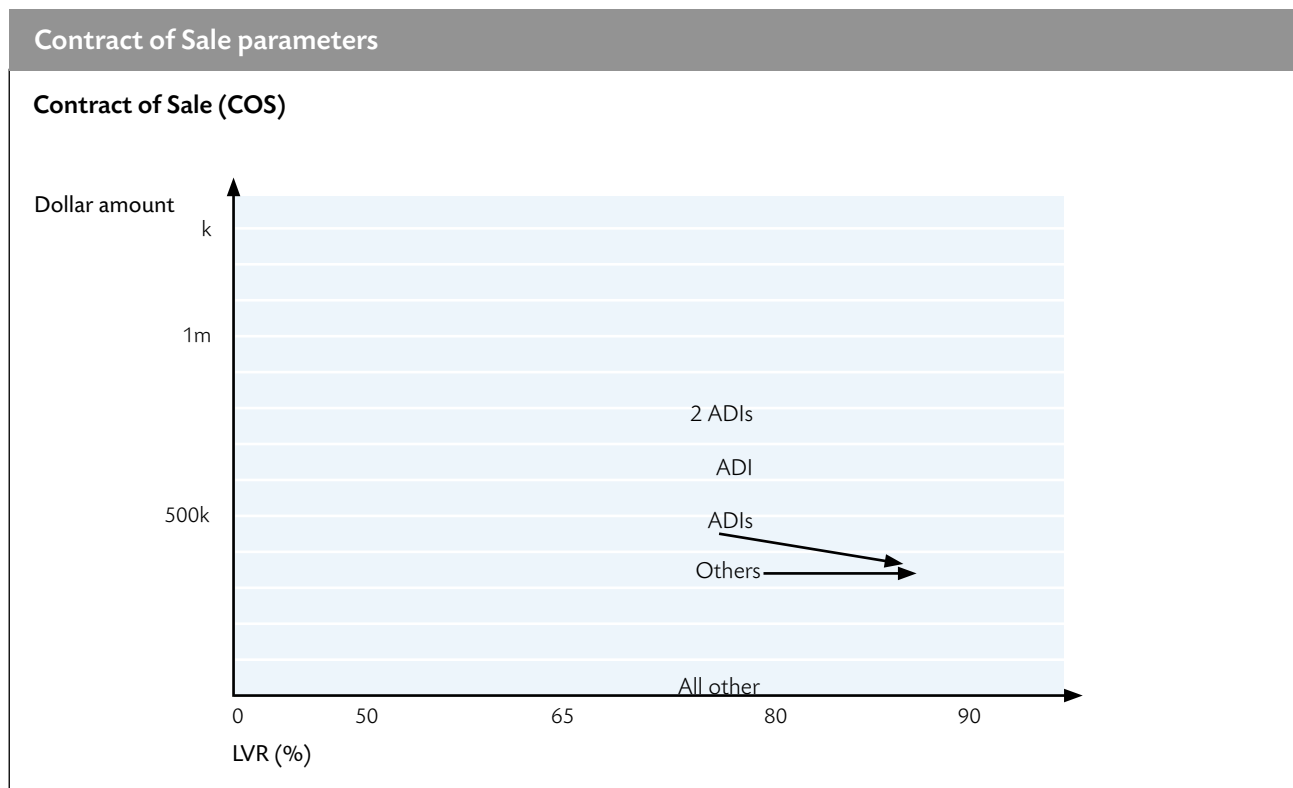
Chart 2



Notes:

1. All other ADIs (5) have LVR guideline only.

Chart 3



Notes:

1. 13 ADIs use COS up to \$500,000 and some acceptance of COS < 90% LVR for LMI purposes typically to \$300,000.
2. 8 ADIs use COS up to \$300,000 (also some acceptance of COS < 90% for LMI purposes).
3. All other ADIs (17) have LVR guideline only (no scope to use for LMI).

Table 6

LMI survey details/ background (Data estimated as at September 2004)	
Number of surveys sent	8
Percentage response rate	100%
Percentage where valuations by registered valuers are required for all issued policies	50%
Percentage who have open policy or delegated underwriting authorities	63%
Percentage who have audit process to determine whether transactions written under open policy have a valuation	50%
Review conducted at minimum quarterly for all institutions ¹²	50%
Less frequently than quarterly	13%
Percentage of sample size	
Less than 5%	25%
Greater than 5%	25%
Percentage of directly referred transactions that are declined due to valuation concerns	
Less than 1%	75%
Greater than 1%	25%
Three most common problems that are identified with valuation reports	
Assessment of property condition or improvements (risk/rating)	50%
Comparable sales	75%
Zoning	50%
Percentage who maintain a register of unacceptable valuers	0%

¹² One LMI undertakes quarterly reviews for new customers and reverts to a 6 or 12-monthly cycle thereafter.

Table 7

LMI selection and valuation process	
Percentage who have a process for 'approving' valuers	0%
Three most common characteristics that LMIs stipulate to ADIs	
PI insurance	50%
Reputation	38%
Registered valuer	63%
Percentage where LMI risk management is responsible for making decisions regarding appropriate valuers	0%
Are valuers rejected	
Often	0%
Rarely	37%
Never	63%
Percentage where LMI risk management is responsible for making reject decision	0%
Percentage who mandate API format	88%

Table 8

LMI monitoring	
Percentage who have a process for reviewing valuers	37%
Percentage where risk management is responsible for reviewing valuer performance	0%
Percentage who have declared a valuer unacceptable over the past 12 months	0%
Percentage who monitor the renewal of the valuer's PI cover	0%

Table 9

LMI disputes	
Percentage who have adjusted claims due to inadequate valuer performance	0%
Percentage who have subsequently pursued valuers through the legal process	75%
Percentage who communicate valuer disputes with the API	0%



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