

# **GUIDELINES**

**FOR THE PREPARATION OF REAL ESTATE APPRAISALS USED FOR  
THE PURPOSE OF OBTAINING A LOAN FROM A FINANCIAL INSTITUTION**

**BANK OF ALBANIA**

## ***Introduction***

A valuation for a real estate, required as collateral, for the purpose of granting a loan by a credit institution operating in Albania, shall conform to the criteria established in the methodology defined by the Council of Ministers of the Republic of Albania, as laid down in Decision No.658, dated 26.09.2012.

The valuation of collateral provided by a borrower as a guarantee is an integral part of the credit approval process and sound credit risk management practices. Although, each individual lending decision should be based on the borrower's ability to pay (personal credit standing), the collateral represents an additional source of payment should the borrower default.

Therefore, the collateral value, allows a more precise identification of the level of risk inherent in an individual loan as well as of the loan portfolio as a whole. The collateral value also allows the institution to better determine risk-based pricing by loan products.

Consequently, it is crucial, that real estate valuations be prepared using a common set of standards. This assures consistent valuations not only within a given institution but across the financial system as a whole. Such standards also provide useful guidance to all parties (lenders, borrowers, and appraisers) as to the required scope of a real estate valuation.

In this sense, lenders are required to have a thorough understanding of the standards and to review all valuations to ensure that they are in full compliance with the standards. They are also encouraged to discuss the standards with their clients (borrowers) to ensure that they fully know and understand the valuation process.

Current volatility in the marketplace as a result of the global financial crisis poses a particular challenge for financial institutions, borrowers, and appraisers alike.

A better understanding of and adherence to these standards should help all appraisers reach convincing conclusions, increasing confidence in the marketplace, and improving the climate for non-performing loan resolution by reducing challenges to valuations in the credit restructuring or foreclosure processes.

In the following, some principles are disclosed in relation to the independent appraiser and the valuation process, which banks have to adhere.

## PRINCIPLE 1

Real estate valuation should be consistent and founded on a common understanding of valuation approaches and processes. For this reason, the appraisers should have knowledge and refer to the European Valuation Standards, especially the ethical standards. Box 1 provides some general definitions of the European Evaluation Standards<sup>1</sup>, which should be taken into consideration by all appraisers, provided they are not inconsistent with the legislation in force.

### Box 1: European Valuation Standards

#### 1. Market Value

Appraisers should use the following definition of Market Value unless otherwise directed by legislation in force:

“The amount for which the asset should exchange on the valuation date between a willing buyer and a willing seller, in an arm’s length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.”

#### 2. Valuation bases other than Market Value

The appraiser should establish the purpose for which the valuation is required before using any basis of value other than Market Value. Save as required by European and national law and regulation in any particular case, the appraiser should only use recognised bases of valuation that are compatible with the purpose of the valuation and, in doing so, honour the principles of transparency, coherence and consistency. Such other bases of value may need to be used as required by law, circumstances or a client’s instructions where the assumptions underpinning Market Value are not qualified or cannot be met. The result will not be a Market Value.

#### 3. Qualified Appraiser

Each valuation carried out in accordance with these standards must be carried out by, or under the strict supervision of a Qualified Appraiser. Appraisers will at all times maintain the highest standards of honesty and integrity and conduct their activities in a manner not detrimental to their clients, the public, their profession, or their respective national professional valuation body. All Qualified Appraisers and their representative professional or technical organisations are required to adhere to the

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<sup>1</sup> For the full text of comments, refer to European Valuation Standards 2012, seventh edition, <http://www.tegova.org/en/p4912f1dc0472d>

TEGoVA Code of Ethics and Conduct and the Code of Conduct of their Member Association.

#### ***4. Valuation Process***

The terms of engagement and the basis on which the valuation will be undertaken must be set out in writing before the valuation is reported. The valuation must be researched prepared and presented in writing to a professional standard.

#### ***5. Reporting the Valuation***

The valuation must be presented in clear written form<sup>2</sup> to a professional standard, transparent as to the instruction, purpose, basis, method, conclusion and prospective use of the valuation.

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<sup>2</sup>In the Valuation Report or its Annex.

## **PRINCIPLE 2:**

### **Valuation of the real estate placed as collateral must be performed by a licensed internal or external appraiser.**

(1) When valuation is performed by an internal appraiser (a staff member of the financial institution), he or she must be qualified and comply with the standards set out in pertinent legal and sublegal acts. That appraiser shall be free from other functions such as the lending, investment, and fund collection functions, and shall have no direct or indirect interest, financial or otherwise, in the real estate subject to valuation. If the qualified persons available to perform a valuation appraisal are involved in the lending, investment, or fund collection functions, the licenced financial institution shall take appropriate steps to ensure that the appraisers exercise independent judgment and that the valuation is adequate. Such steps include for example, but are not limited to, prohibiting management and other staff of the financial institution from participating in any approval involving assets on which they performed a valuation.

(2) Also, to ensure independence from lending or fund investment functions, the internal appraiser should report to the Credit Risk Committee (or an equivalent committee) or to the Audit Committee.

When a valuation is prepared by an external appraiser, the appraiser shall be engaged directly by the financial institution, and have no direct or indirect interest, financial or otherwise, in the real estate subject to valuation or the transaction.

(3) A financial institution may also accept a valuation prepared by a appraiser engaged directly by another financial institution, if:

(i) The appraiser has no direct or indirect interest, financial or otherwise, in the real estate or the transaction; and

(ii) The financial institution determines that the valuation conforms to its requirements and is otherwise acceptable.

All internal and external appraisers must be licensed. However, a licensed appraiser may not be considered competent solely by virtue of being licensed. Determination of competency shall be based upon the individual's experience and educational background, as they relate closely to the valuation process.

### **PRINCIPLE 3**

**Financial institutions should have an approved roster of licensed appraisers, who may perform real estate valuations. Including an appraiser in this roster is the discretion of the institution.**

The appraiser included in this roster should fulfil the requirements of professional objectivity meaning that she or he must be aware of anything that could be perceived as a conflict of interest.

He/she should ask the borrower to identify other interested or related parties so as to establish whether there is a possible conflict of interest for the appraiser, the appraiser's partners, co-directors or close family.

If such a conflict exists, then this should be disclosed in writing to the financial institution which may then choose whether or not to confirm the appointment of the appraiser, in accordance with the institutions regulations and policies, in a clear statement of the circumstances in any Certificate or Report that is produced by the appraiser.

When the borrower is obliged to pay for the valuation, the valuation costs shall be transparent and discussed in advance with the borrower, who should be given a copy of the completed valuation.

To enhance transparency, the financial institution may enable the borrower to choose an appraiser from a list without names, prepared by a group of internal appraisers or credit risk management that shows only the cost and time frame for the delivery of the valuation report according to different appraisers.

## **PRINCIPLE 4**

**Preparing a valuation is important for all real estates. However, the following cases may be an exception:**

1. When the credit amount is less than a certain amount, e.g. ALL 5,000,000;
2. When the value of the real estate placed as collateral exceeds the credit value significantly;
3. When the credit is not guaranteed by a real estate;
4. When there have been significant and material changes in the market conditions or physical aspects of the real estate that may affect the institution's collateral coverage for the disbursed credit, even after a new disbursement, or;
5. When there is no new disbursement, besides the necessary funds to cover the expenses for closing the project.

For transactions that do not require a valuation, as per the above-listed cases, the financial institution shall have an adequate valuation of the collateral in line with the best and secure banking practices.

Should a valuation or revaluation of collateral become necessary, to address various problematics in a safe and sustainable way, the Bank of Albania may request such an action from financial institutions.

## **PRINCIPLE 5**

**The financial institution should determine the real estate revaluation frequency over time to ensure that the market value reflects the actual market conditions.**

- the value of the real estate must be monitored on a continuous basis and at a given frequency, for example, once every three years for residential real estate;
- more frequent monitoring must be carried out when market conditions are subject to significant changes;
- a valuation shall be reviewed by an independent appraiser when information indicates that the value of the real estate may have significantly declined relative to general market prices; and
- a full collateral valuation should be conducted if the loan is not performing.

Under normal market conditions, the valuation should be carried out based on the market value.

However, another valuation basis, such as the immediate liquidation value, may be more appropriate when the loan is not performing and collateral liquidation is more feasible.

Differences in these valuation techniques should be documented in a transparent way and discussed with the borrower.

Financial institutions may take into consideration to add and define the proper collateral valuation techniques in the credit agreement.



## **PRINCIPLE 6**

The real estate title<sup>3</sup> obtained by the financial institution following collateral execution is subject to periodic valuation. The financial institution shall decide a reasonable and prudent time frame, for keeping such a real estate.

Upon the transfer of the real estate title to the financial institution, it should:

- reevaluate the real estate;
- compile a collateral valuation policy to monitor the value for each obtained real estate to be in line with prudential banking practices.

Such real estate must be sold by the institution within the period set out in the legal acts and, in any case, as soon as reasonable and prudent. Banks shall document efforts made to sell such real estates, including:

- Documenting all inquiries and offers by potential buyers;
- Methods used for advertising the sale of the real estate either by the bank or its agent, and;
- Other information reflecting efforts made to sell the real estates.

The management of the financial institution may approve to extend the retention period for a certain real estate, provided that the extension is endorsed by the above-mentioned documentation, which shows clearly that there is no market demand for this real estate.

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<sup>3</sup>Seized property shall mean:(i) immovable property seized by the financial institution as a result of the involuntary collateral execution; (ii) premises that are no longer used by the financial institution.