Panel 4. Property Value

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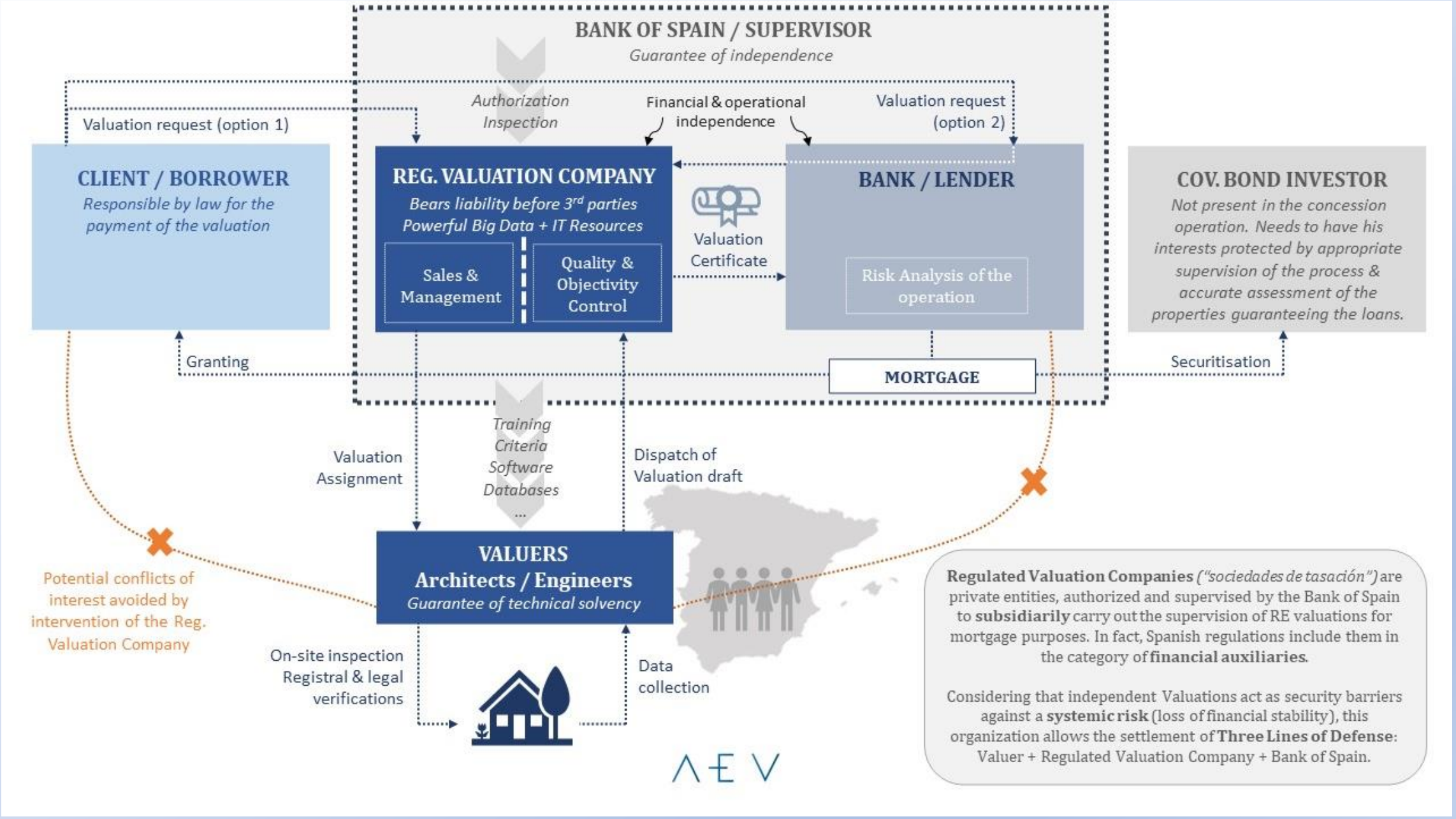
The Spanish perspective

Paloma Arnaiz | Secretary General of the AEV

Overview of the Spanish valuation system for secured lending



Overview of the Spanish valuation standards (Orden ECO 805/2003) for secured lending

BASIS OF VALUE >> Mortgage Lending Value (individual property level): *the value of a property as determined by a **prudent valuation** of its future marketability, taking into account the **long-term sustainable aspects** of the property, the normal regional market condition as well as the current and possible alternative uses. Speculative elements must not be taken into consideration.*

Type of property	Usual valuation approach	Methodology for MLV
Residential Properties	Market approach (sales/comparison method)	An adjustment may be applied to MV, through a discount (to be determined by the VC), if it is estimated that significant and sustained price drops could occur within the next year
Commercial Properties	Income approach (Cash-Flow projection)	Analysis of historical data on price trends and their economic drivers; consideration only of situations or circumstances that are likely sustainable in the medium to long term; elimination of speculative elements from rental income

The adjustment factor (Residential Properties)

- Adjustments to Market Value are to be applied ONLY under the following circumstances:
  - ✓ **Only the comparison method** has been used for the calculation of the property value; and
  - ✓ The Valuation Company estimates that there is a **high probability** that the value will experience a **significant reduction** in nominal terms **within one year** from the valuation date, which shall **last, at least, 3 years**.
- No further specific methodologies were defined in the Order on how to determine the discounts/adjustments.
- During the first years of life of the regulation, Valuation Companies were not able to build consistent and homogenous methodologies for the calculation of adjustments, due to the lack of sufficient data and the inexistence of the necessary technological means. However, in the past few years, the development of statistic & analytic techniques (modelization) and the increasing availability of databases have permitted the development of forecasting models. Currently, **at least the biggest VC do have and apply their own models for the determination of adjustments to MV**.
- For its part, **the AEV has been working on the development of its own forecasting model**, which is intended to act as a reference for those companies which do not have advanced models in place, and also as an additional input for the decision-making in those companies that already use their own models.

The adjustment factor (Residential Properties)

AEV's model has been developed by the University of Alicante (Professor Paloma Taltavull), and it predicts housing prices, at municipal level, for the next 6 years, for set of around 300 localities (those with a population > 25,000 inhabitants). The models developed make it possible to determine:

(1) The long-term relationship of prices, explained by its **fundamental variables**, and its future prediction.

(2) The way in which these variables and their mutual interrelation generate price deviations from their equilibrium path in the short term.

The adjustment factor (Residential Properties)

- The economic theory considers there are **five fundamental variables** that explain the stable evolution of residential prices:

1. **Changes in population** (which are the best indicator of new potential demand)
2. **Average income** (which indicates the population's ability to pay)
3. **Investment flows** for the purchase of residential properties (basically, financial flows or number of mortgages, which reflect how many new funds reach the market)
4. **Interest rates** (which approximate the cost of using the capital); and
5. **Housing supply** (which limits the reaction of prices) in each market.

- Thus, the data needed for the development of the model are (at local level and on year-by-year basis since 1995):

✓ Average residential price
✓ Population
✓ Average annual net income
✓ Number of residential mortgages granted
✓ Average interest rate of mortgage loans
✓ Volume of residential offer available in the market

Thank you