Comparative Regional Study to Identify Gaps and Weaknesses in Collateral Valuation Methodologies, Rules and Regulations That Impede Access to Finance in the Balkans

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The purpose of this document is to present a comparative regional study to identify gaps and weaknesses in collateral valuation methodologies, rules and regulations that impede access to finance in the Balkans for review by Segura Consulting LLC.

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Abbreviations

ASB	Association of Serbian Banks
BHPA	Bosnia and Herzegovina Property Association
BoA	Bank of Albania
CAD	Current Account Deficit
CAGR	Compounded Annual Growth Rate
CAR	Capital Adequacy Ratio
CBK	Central Bank of Kosovo
CBBiH	Central Bank of Bosnia and Herzegovina
CRE	Counselor of Real Estate
EU	European Union
EUR	Euro
EVS	European Valuation Standards
FRICS	Fellow of Royal Institution of Chartered Surveyors
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPRR	Immovable Property Rights Registry
IVS	International Valuation Standards
IVSC	International Valuation Standards Council
KAA	Kosovo Appraisers Association
KPRM	Chamber of Valuers of Macedonia
LTV	Loan to Value
MCD	Mortgage credit Directive
NBRM	National Bank of Republic of Macedonia
NBS	National Bank of Serbia
NHA	National Housing Agency
NMIC	National Mortgage Insurance Corporation
RE	Real Estate
REV	Recognized European Valuer
RICS	Royal Institution of Chartered Surveyors
RMSSO	Macedonia State Statistical Office
RSD	Serbian Dinar
RWA	Risk Weighted Asset
SORS	Statistical Office of the Republic of Serbia
USPAP	Uniform Standards of Professional Appraisal Practice
TEGoVA	The European Group of Valuers' Associations
WB	World Bank
WEO	World Economic Outlook

1 Executive Summary

The aim of this study is to identify specific and common gaps and weaknesses in the framework for collateral valuation in Albania, Bosnia and Herzegovina, Kosovo, Macedonia, and Serbia. This research has been conducted with extensive communication with regional stakeholders in an effort to determine an objective overview of current situations, obstacles and reform steps achieved so far in this area. The goal of this research effort is to propose a series of cost-effective regional or bilateral programming activities (technical assistance) that would contribute to increased conformance with high international standards on collateral valuation. With more reliable collateral valuations in the Region, the resulting enhanced access to finance would hopefully lead to an increase in credit growth and more dynamic economic prospects in the Balkans.

Balkan countries share a degree of underdevelopment in European context, and valuation of collateral is not an exception to this rule. Due to the imprecise collateral valuations there are relatively substantial weaknesses in financial intermediation in the Balkans (see section 4.1). A common feature of these weaknesses is that they mostly lead to lower access to finance and lower GDP, with the risk of deteriorating bank assets and bailout fiscal costs for some of them. More precise collateral valuation in the Balkans could decrease or eliminate weaknesses in collateralized lending and would improve regional access to finance, GDP growth, and/or financial stability.

In addition, all of these countries share a common European Perspective, and some of them have even achieved an EU Candidate status: so much the more reason for Balkan countries to deal with the potential room for improvement in the area of collateral valuation and its alignment with EU and international standards.

Substantial and long-lasting increase in collateral valuation credibility and precision in the Balkans can be achieved with considerable results in five important segments of an effective collateral valuation system:

- Standards of valuers' professional practice and conduct
- Competence of valuers
- Licensing and supervision of valuers
- Databases for precise valuations
- Adequate regulatory treatment of collateralized lending

Some of the countries in the Balkans have moved forward, but overall the current situation has a lot of room for improvement. The valuation of real estate and other potential collateral for lending and other purposes has traditionally been underdeveloped in the Balkans. Registers of real estate were as a rule incomplete, and sometimes lacking a unified registering system. One of the major achievements in the transition period was the establishment of a relatively well-functioning register of real estate ownership in most of the Balkans as a basic prerequisite for mortgage lending. Another important fact is that the stock of apartments, previously under government or so-called social ownership, is now largely under the private ownership of tenants and can be used for collateralized lending.

However, collateral valuation and the valuers' profession are, on average, below advanced international standards. In recent years we can observe significant regional differences since some countries have started reforming the area of collateral valuation and the valuers' profession. Despite this, as a rule, valuation methodologies are lagging behind international best practices and valuers on the whole lack adequate knowledge and proof of an unbiased valuation approach. Databases on real estate prices are often incomplete and unreliable. Other useful databases for advanced valuation techniques are often unavailable.

Regulation and supervision of valuers is mostly weak or nonexistent. Standardization of valuation reports is just starting to appear as an important professional standard. Protection of the valuer's profession, certification of adequate valuation knowledge, and licensing of valuers are open issues with different approaches and development across the region.

Valuers' associations, if existent, are frequently weak relative to the capacity needed for self-regulatory organizations, and government oversight or supervision in practical terms is still weak or nonexistent. Most of the valuers' associations are members of TEGoVA[1], and some have made positive steps in strengthening the profession. However, much more needs to be done in the region as a whole to create the conditions necessary for more effective collateralized lending.

Even the most advanced Balkan countries need at least an assessment of and possible amendments to the five important segments of an effective collateral valuation system (see section 5.3). In some of the countries certain elements of the system have not yet been dealt with at all. In addition, there is obvious room to conduct certain regional activities as well (see section 5.2).

More precise and credible collateral valuation for financing purposes can increase the credit quality of borrowers and, with adequate regulatory treatment of loans with precisely-valued collateral, may further decrease the cost of borrowing. Therefore, improved collateral valuation may increase both demand and supply of bank credits and support credit growth in the Balkans.

Our extensive regional survey implies that access to finance in the Balkans is not limited in terms of availability of financial institutions or financial resources. The limitations seem to arise mostly from the incapacity of companies (especially SMEs) to increase their credit quality (and decrease their credit risk) as perceived by the banks, which proves to be crucial for them to gain access to finance on relatively favorable terms and increase their economic activity. In that respect, precise collateral valuation and some forms of government development support may substantially improve the average credit profile of a SME borrower in the Balkans.

Therefore, more precise collateral valuation with the support of effective public development programs could prove to be most important for increasing access to finance and prospects of economic growth in the Balkans.

[1] TEGoVA - The European Group of Valuers' Associations, is a pan-European association of professional bodies working for standards, ethics and quality in the real estate valuation market. The association is composed of 60 valuers' associations from 33 countries representing more than 70,000 valuers in Europe. See more at: http://www.tegova.org.

2 Regional Overview

Balkan countries (Albania, Bosnia and Herzegovina, Kosovo, Macedonia, and Serbia) share certain commonalities in terms of macroeconomic performances and development of financial institutions and markets. First is the fact that they have descended from socialist economic systems and that most of them (except Albania) used to be a part of the same country, i.e., Yugoslavia, sharing the same legal and institutional infrastructure and a common market. In addition to that, these countries have been involved for some time in social unrest and turmoil including wars and civil wars, from the 1990s up to the early 2000s, with time lost in the transition process, and therefore lag behind other transition economies in certain aspects of their economic and institutional development.

Therefore, Balkan countries share a degree of underdevelopment in the European context, and valuation of collateral is no exception to this rule. But all of these countries share a common European Perspective,[2] and some of them have an EU Candidate status (Macedonia, Serbia, and Albania). So much the more reason for Balkan countries to deal with the potential room for improvement in the area of collateral valuation, potentially with an important impact on credit activity, investments and the economic growth of the region.

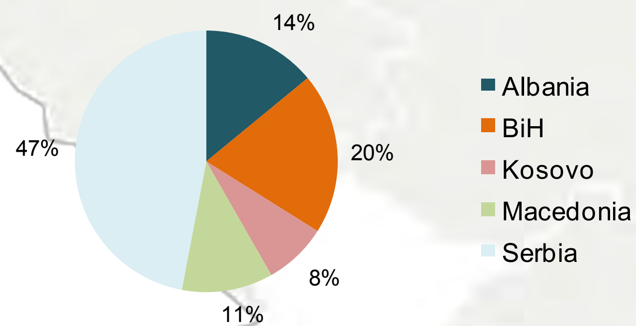
[2] See http://ec.europa.eu/enlargement/countries/check-current-status/index_en.htm

2.1 Macroeconomic Overview

In terms of economic activity, Balkan countries are characterized by a relatively low GDP per capita and very modest overall economic activity. The largest of the group (Serbia) has less than 7.5 m inhabitants and a total GDP below EUR 35 bn, and yet it represents 47% of the regional GDP.

The regional GDP breakdown by country is presented in Graph 2.1. Serbian GDP accounted for almost 50% of the region's GDP in 2013, followed by Bosnia and Herzegovina.

Graph 2.1 Breakdown of Regional GDP (2013)



Source: IMF World Economic Outlook, October 2014.

Comparing GDP per capita corrected for Purchasing Power Parity (PPP), Balkan countries range from EUR 5,800 (Kosovo) to EUR 9,900 (Serbia). Most of the countries have experienced substantial setbacks in terms of GDP due to the wars and social unrests in the region in the 1990s, and some of the most severely hit (BiH, Serbia, Kosovo) have not yet recovered their pre-transition GDP levels.

Table 2.1 Balkan Countries: Key Macroeconomic Indicators for 2013[3]

Country	GDP per capita (EUR at PPP)	GDP real change in %	Fiscal Balance in % of GDP	Inflation CPI, Year average, %	Public debt in % of GDP	Unemployment rate in %
Albania	7,600	0.50%	-4.90%	1.90%	70.00%	15.60%
BiH	7,300	2.50%	-2.20%	0.20%	42.40%	27.50%
Kosovo	5,800	3.40%	-2.00%	1.80%	6.30%	31.00%
Macedonia	9,000	2.90%	-4.20%	2.80%	42.70%	29.00%
Serbia	9,900	2.60%	-4.70%	7.80%	59.60%	22.10%

Source: Vienna Institute for International Economic Studies (WIIW).

Balkan countries have mainly stabilized their economies. Inflation is relatively low, and budget deficits are more or less under control (below 5% of GDP). Public debt is on the rise, but still on average below the levels of industrialized nations in comparison to the GDP. Unemployment, however, is very high, ranging from 15.6% (Albania) to 31.0% (Kosovo).

[3] According to the Vienna Institute for International Economic Studies (WIIW), http://wiiw.ac.at/.

In terms of economic growth, Balkan countries fare rather modestly and below expected performance. If we look at the past decade (Table 2.2), we see that before the global crisis growth rates were higher, but still not encouraging in terms of the necessary catching-up with the rest of Europe. Even in the pre-crisis period, GDP growth was mainly (about 70 %) driven by non-tradable[4] sectors.

Table 2.2 Pre-Crisis and Post-Crisis Economic Growth in the Balkans

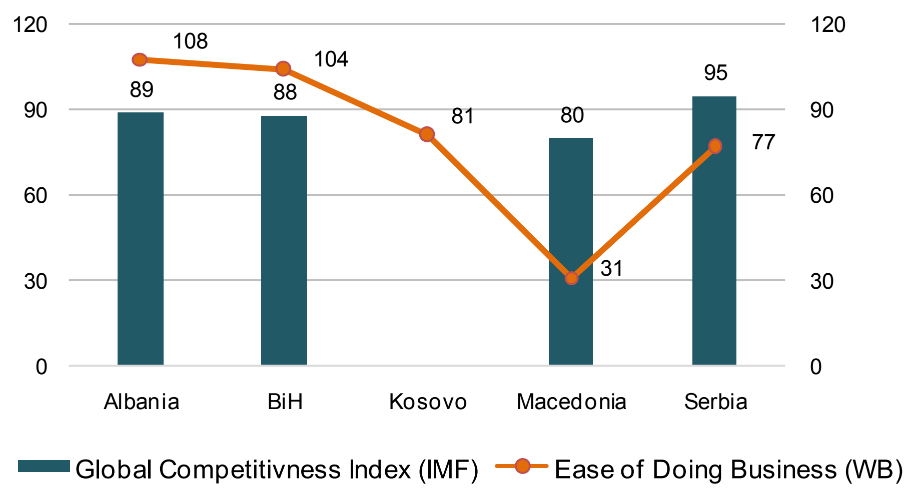
Country	GDP real growth rate, 2002-2008	GDP real growth rate, 2008-2013
Albania	6.00%	2.15%
BiH	5.20%	-0.02%
Kosovo	4.70%	3.50%
Macedonia	4.70%	1.44%
Serbia	5.00%	-0.02%

Source: IMF.

Note: Rates are calculated by applying compounded annual growth rate (CAGR).

This has kept the Balkan industries at a low level of competitiveness with substantial room for improvement in terms of a business-friendly environment (except perhaps for Macedonia).

Graph 2.2 Global Competitiveness and Ease of Doing Business in the Balkans, 2012-2013



Source: IMF.

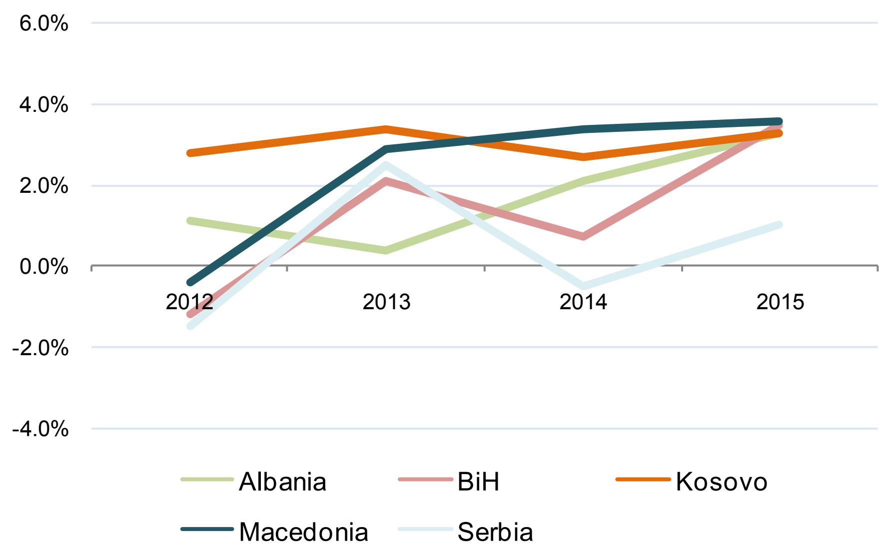
Note: Lower ranking implies greater competitiveness.

[4] According to IMF estimates for the period 2004-2008 for a selected group of Balkan countries.

After the crisis we see stagnant economic trends with deteriorating public debt positions. Some of the countries have already reached worrying levels of public debt to GDP (Albania, Serbia) with certain further deterioration in the near future.[5]

Foreign direct investments (FDI) are in a gradual retreat from the region, and internal sources for growth are rather limited. The largest economy in the region (Serbia) is heading towards negative growth in 2014 and a relatively stagnant 2015[6] with an increasing budget deficit and public debt to GDP in the years ahead.[7] Alongside the predicted weak EU recovery, this draws a bleak economic growth picture for the Balkan countries in the next several years.

Graph 2.3 Balkan Countries: Real GDP Growth in %, Status and Immediate Prospects

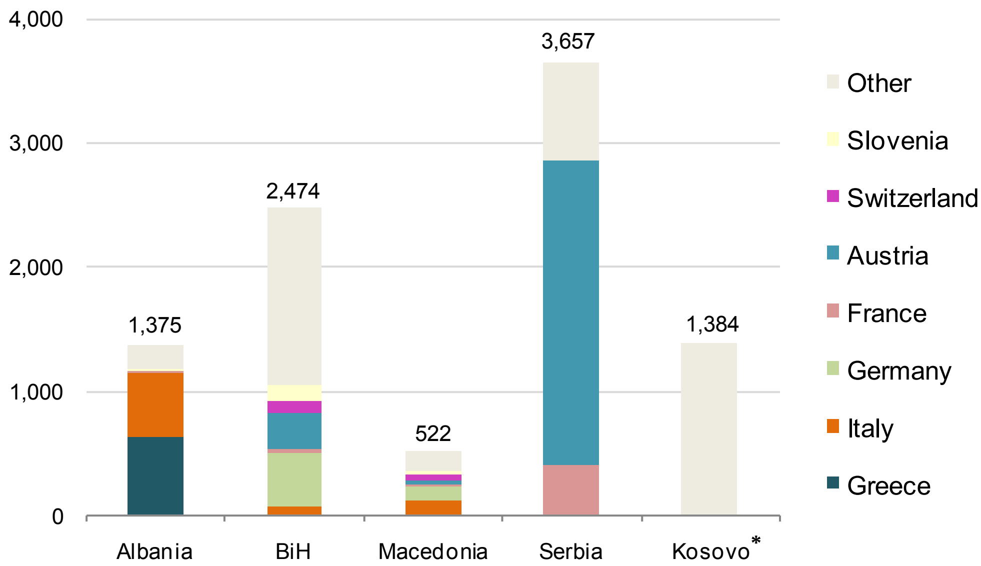


Source: IMF, World Economic Outlook.

In all of the Balkan countries, remittances from diaspora play a significant role, not just in terms of current account balance, but also in terms of domestic spending, savings, and banks' local sources of funding. Remittances in the Balkans are sort of a "social cushion" supporting the population's standard of living, and decreasing the pain of high levels of unemployment. Most of the remittances are used for consumption, housing investments and savings; some is used for support of SMEs. But part of them stays outside of the official economy, either as idle savings (mattress savings), or for support of the grey economy.

[5] According to Analyses in IMF Central, Eastern, and Southeastern Europe, Regional Economic Issues, April 2014.
[6] According to WIIW estimates.
[7] According to IMF estimates.

Graph 2.4 Remittances Breakdown in the Balkans, 2012 (EUR m)



Source: World Bank Bilateral Remittances Matrix.

Note: (*) Disaggregated data was not available.

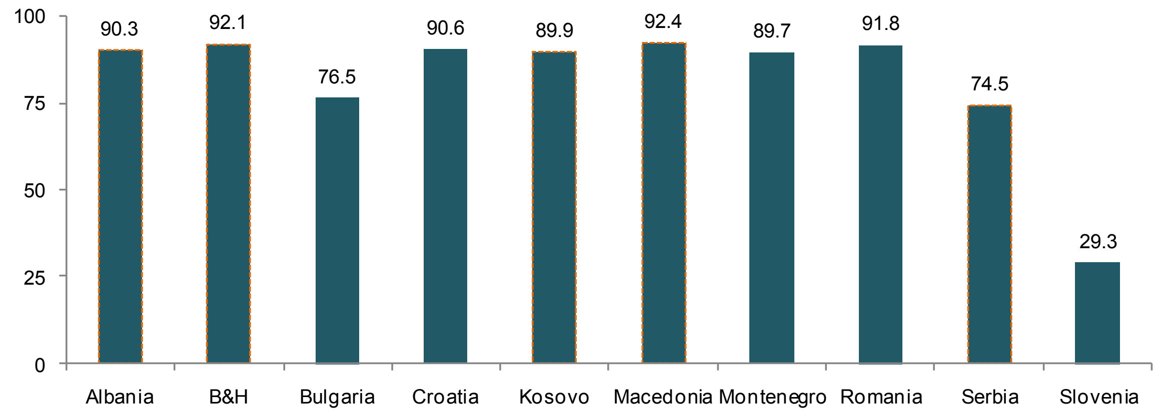
With limited sources of investments coming from the government, FDIs, or remittances of diaspora, the increase of private investments supported by a local financial system will prove to be crucial for economic growth in the Balkans in the near future. In that respect, adequate collateral valuation may prove to be of specific importance to support collateralized private financing in the Balkans.

2.2 Banking Sector

Financial systems of Balkan countries are dominated by banks and their activities. Bank assets are 88.9%[8] of the total financial assets of these countries. Non-banking financial institutions are vastly underdeveloped and sometimes nonexistent. Balkan countries have witnessed many significant developments in the banking sector in the past decade and a half. From the late 1990s until 2008, the regional banking sector experienced accelerated growth. International banks, mainly from neighboring countries to the Balkans (Austria, Greece, Italy), but from some other countries as well (France), have entered the markets, bringing with them credibility, capacity to borrow from abroad, and attracting domestic savings, and thereby creating a substantial financial capacity for credit growth. Foreign banks, mainly operating as subsidiaries, have introduced certain new banking practices and provided the main channel of capital inflow, substantially supporting economic growth and quickly dominating banking markets in the Balkans.

[8] CREF calculation based on national statistics.

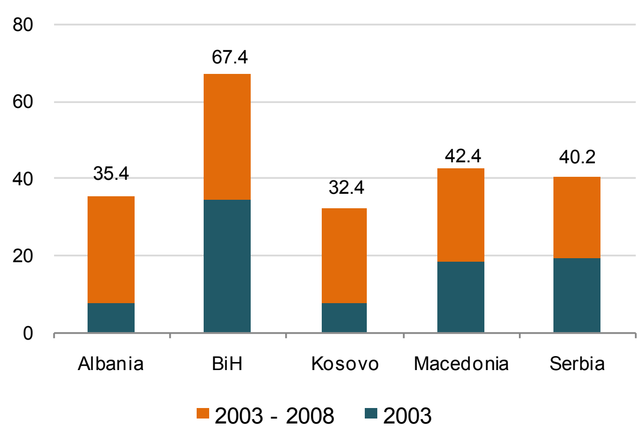
Graph 2.5 Asset Share of Foreign Banks in the Balkans and Peer Countries, 2011 (%)



Source: IMF and CBK.[9]

Lending growth was significant, but not as high as in Central and Eastern Europe, nor as high as in Balkan EU member countries (Romania, Croatia, and Bulgaria). Still, the gap in the banking sector development compared to the rest of CEE and SEE countries and the EU started to shrink. Despite that, Balkan countries remain in the group of European countries with lower financial penetration within the economy, and therefore untapped growth potential in banking activities. This proves to be particularly important since, at present, the Balkan states apparently do not have at their disposal alternative sources of funding and investments (financial markets, non-banking financial institutions, FDIs, government). Credit growth was present before the crisis (Graph 2.6), but not to the same degree as in some other peer countries. Since then, credit growth has virtually stopped, and correlates to low and stagnant rates of economic growth.

Graph 2.6 Pre-Crisis Credit-to-GDP[10] Ratio and Its Change (% of GDP) in the Balkans



Source: IMF.

[9] CBK Annual Report 2012, page 35.
[10] Data refers to domestic credits to private non-financial sector.

If we look at the current situation (Table 2.3) in the Balkans and compare it with France, the U.K., and the U.S., with Credit-to-GDP in 2013 of 114%, 165%, and 198%[11] respectively, we clearly see substantial room for additional banking activity and development in the Balkans.

Table 2.3 Credit-to-GDP (%) in the Balkans in 2013

	Albania	BiH	Kosovo	Macedonia	Serbia
Credit to GDP	37.6	62.1	35.5	49.1	46.6

Source: IMF.

However, the nature of credit growth between 2003 and 2008 was such that it was fueled with borrowings from abroad, extending the loan-to-deposit ratio in some Balkan countries beyond 1 (100%), and therefore raising the issue of the stability of foreign financing of local banks. That was especially the case when the predominant source of foreign financing was short-term loans and deposits from parent banks to their Balkan subsidiaries. The so-called Vienna Initiative was crucial at the beginning of the financial crisis to prevent abrupt deleveraging of bank subsidiaries in the Balkans. That has been of significant importance for the preservation of financial stability in the region in the period since 2007.

In many Balkan countries, credit growth took the form of extensive FX lending (or FX-linked lending). For several years in the mid-2000s, capital inflows contributed to a rise in FX lending (and sometimes to real appreciation of local currencies, as was the case in Serbia and Albania), which has led to an increase of imbalances and risks in the banking sector. FX lending to unhedged borrowers has contributed to the rise in NPLs and relative deceleration in credit activity in the aftermath of the global financial crisis and EU sovereign debt crisis. Bank nonperforming loans to total gross loans (%) stand at a relatively high level in the Balkans (Table 2.4) and pose a threat to regional financial stability especially in the medium and long run. High NPLs, as a rule, increase the average financing costs of banks, decrease credit growth and tend to increase lending rates. The interplay between these factors with potential deterioration in the exchange rate may pose a serious threat to financial stability. However, NPLs are currently on a relatively stagnant path and with relatively high provisioning levels for potential losses (high total loan-loss reserves to gross NPLs) and the capital adequacy of banks is still relatively solid.

Table 2.4 NPLs to Total Gross Loans (%) in the Balkans in 2013

	Albania	BiH	Kosovo	Macedonia	Serbia
NPLs to gross loans	23.5	15.1	8.5	10.9	20.6

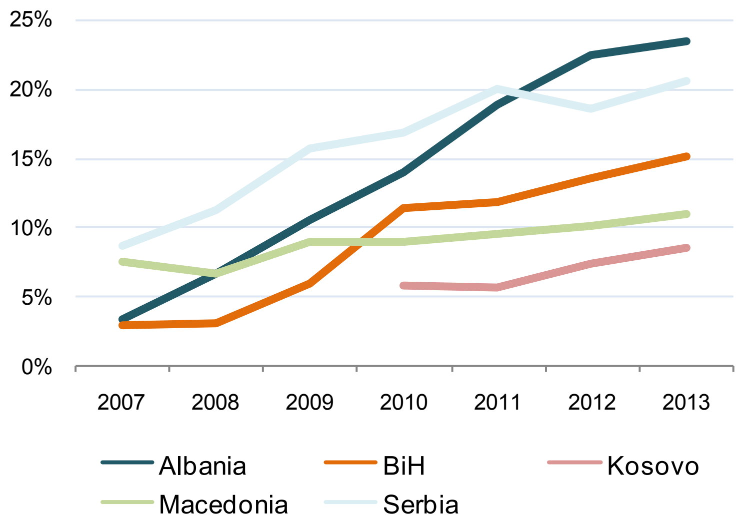
Source: World Bank.

However, if we want to have a better assessment of the nature of current NPLs in the Balkans, we should bear in mind that banks in Balkan countries started from different positions (some at a greater level of NPLs than others) in 2007. Therefore, the rate of increase of NPLs was

[11] World Bank data, see http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS.

different (Graph 2.7), and that is, most probably, a more realistic depiction of the deterioration in the quality of bank assets.

Graph 2.7 Bank NPLs to Total Loans 2007-2012 in the Balkans

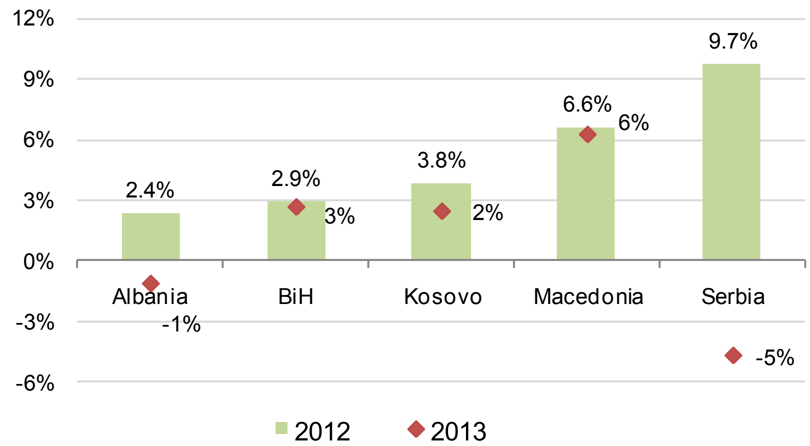


Source: World Bank.

Still, it is worth noting that sensitivity to international banks' capital flows has not been completely eliminated in the Balkans by the Vienna Initiative. Since the new regulatory requirements in the EU, a new banking model with international banks in the Balkans has been emerging. More emphasis is now given to greater independence for their subsidiaries and a more balanced funding model based on domestic sources of funding (deposits and locally issued bonds). Still, recovery in lending in the Balkans has been slow and some international banks have started to be more selective in terms of their commitment to certain Balkan financial markets. Since 2012, the Second Vienna Initiative (known as “VI 2.0”) has been involved in the close monitoring of international bank groups' deleveraging moves and strategies for the near future, so as to prevent a negative financial stability impact on the Balkan and other CEE and SEE countries. Banks in the Balkans have gradually embarked on their own assets restructuring, M&As and NPL cleansing. This process is expected to intensify in the years to come, with the aim of strengthening their financial position.

However, despite the international initiatives and restructuring moves by international banks and their subsidiaries designed to strengthen and stabilize the banking sector, credit growth in the Balkans has been in decline (red dots below blue bars - Graph 2.8), and this poses a challenge for future economic growth. It is important to see not just the reasons for this, but also the ways out of this situation.

Graph 2.8 Credit Growth in the Balkans (%, y-o-y, nominal, exchange-rate-adjusted)



Source: IMF.

One of the things that is relatively obvious is that, despite an ongoing financial consolidation of the international parent banks, funding does not seem to be a constraint on lending activity in the Balkans, especially at the current low levels of demand. These lower levels of demand are most probably the consequence of the fact that, to a certain degree, clients have experienced FX risk as unhedged borrowers, and in a stagnating economic environment are reluctant to borrow on prevailing market terms. On the other hand, on the supply side, restrictive regulation with a deteriorating credit quality of the corporate and household sectors, as well as inadequate credit risk mitigation available, disqualify a substantial portion of potential borrowers.

More precise and credible collateral valuation for financing purposes can increase the credit quality of the borrowers and, with adequate regulatory treatment of loans with precisely-valued collateral, may decrease the cost of borrowing. Therefore, improved collateral valuation may increase both the demand and supply of bank credits and support credit growth in the Balkans, without which higher rates of economic growth seem unattainable in the years to come.

2.3 Collateral Valuation for Lending Purposes

The valuation of real estate and other potential collateral for lending and other purposes has traditionally been underdeveloped in the Balkans. Collateral had been officially in use for lending purposes in the countries of ex-Yugoslavia before WWII. From the end of the war until the 1990s, it was possible in ex-Yugoslavia to pledge the right over an asset by the bank, but this was not in widespread use. Traditionally, most households did not take out mortgage loans, although they could have, and did, to a lesser extent, in the late 1970s and 1980s. The reason for this was that, in the socialist system, housing was mainly provided by companies to their employees. Commercial loans were granted with collateralized real estate but with imprecise valuations and almost nonexistent foreclosure by the banks. The registers of real estate were as a rule incomplete, and sometimes lacking a unified registering system. Traditionally, property registers were in the Austrian-type land books (*Grundbuch*) in BiH and large parts of Serbia, while cadastre registers and a deed or land-registry certificate (*tapia*) system were used in the rest of the region. One of the major achievements in the transition period was the establishment of a relatively well-functioning register of real estate ownership in the Balkans as a basic prerequisite for mortgage lending. Another important fact to bear in mind is that the stock of apartments, previously under government or so-called social ownership, is now largely under the private ownership of tenants and can be used for collateralized lending.

However, collateral valuation and valuers are generally below par, though we can observe significant regional differences. As a rule, valuation methodologies are lagging behind international best practices and the valuers on the whole lack adequate knowledge and proof of an unbiased valuation approach (mainly court experts, and very frequently engineers by training). Databases on real estate prices are incomplete and unreliable, mainly due to tax avoidance practices. Most of the valuations are done with replacement cost (corrected for depreciation) and DCF (discounted cash flow) technique, but without the implementation of more sophisticated methodologies and techniques needed for lending purposes.

Regulation and supervision of valuers is mostly weak or nonexistent. Standardization of valuation reports is just starting to appear as an important professional standard. Protection of the valuer's profession, certification of adequate valuation knowledge and licensing of valuers are open issues with different approaches and development across the region.

Valuers' associations, if existent, are frequently weak relative to the capacity of self-regulatory organizations, and government oversight or supervision is in practical terms largely nonexistent. Most of the valuers' associations are members of TEGoVA, and some have made positive steps in strengthening the profession. However, despite certain improvements that have taken place in some of the countries, much more needs to be done in the region as a whole to create the necessary conditions for more effective collateralized lending and increased access to finance in the Balkans.

3 Country Overviews

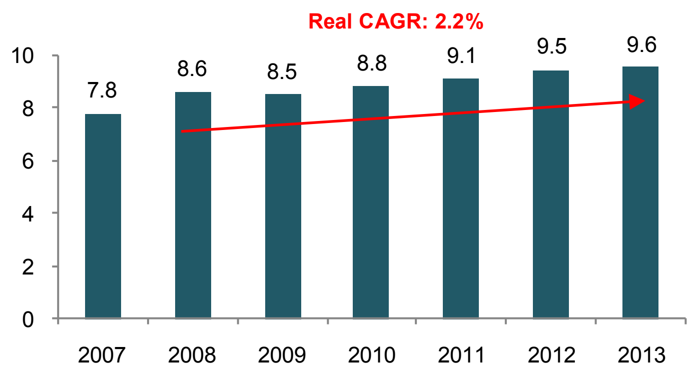
3.1 Albania

3.1.1 Macroeconomic Overview

Population:	2.8 m (2013)
Currency:	ALL (Albanian Lek)
Income group:	Upper middle income (WB)

Albanian nominal GDP amounted to EUR 9.6 bn in 2013. Graph 3.1 presents GDP values in current prices in EUR recorded in the period of 2007-2013[12].

Graph 3.1 Albania: Nominal Gross Domestic Product, 2007-2013 (EUR bn)



Source: IMF World Economic Outlook, October 2014.

Note: Data as of 2013 presents IMF estimates.

The impact of the global economic crisis on the Albanian economy has been noticeable, but to a lesser extent than in other Balkan countries (except Kosovo, which has been virtually resistant to the crisis when it comes to GDP growth)[13]. Actually, according to IMF data for Albania, all annual growth rates in the 2000s are with a plus sign, but somewhat lower after the beginning of the crisis, especially in 2012 and 2013 (largely due to the impact of the Eurozone crisis, in addition to a decrease in domestic demand). The period of rapid GDP growth in the pre-crisis period (the average annual growth rate in the period of 2002-2008 was 6.0%[14]) has been replaced by a period of somewhat slower growth (an average annual GDP growth rate of 2.2%,[15] see Table 3.1 where the growth rates are presented), as well as other selected key macroeconomic indicators). The lowest y-o-y GDP growth rate was recorded in 2013, which amounted to 0.4%. According to IMF estimates, 2014 is expected to have a relative increase of

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[12] Database is International Monetary Fund (IMF), World Economic Outlook Database (WEO), October 2014.
[13] More about reasons behind Albania's resilience to the global and Eurozone crisis, see IMF Country Report No. 13/7, January 2013.
[14] Calculated as CAGR using IMF data for GDP in constant prices.
[15] Calculated as CAGR using IMF data for GDP in constant prices.

GDP of 2.1%.[16] A major part of the Albanian GDP belongs to services, whose share in the GDP equaled to 63% in 2013[17].

Table 3.1 Albania: Key Macroeconomic Indicators

Albania	2007	2008	2009	2010	2011	2012	2013
Population (m)	2.96	2.93	2.90	2.87	2.84	2.82	2.79
GDP real growth rate	5.90%	7.54%	3.35%	3.53%	2.33%	1.14%	0.44%
Inflation rate	3.06%	2.16%	3.72%	3.36%	1.66%	2.43%	1.85%
Unemployment rate	13.40%	13.10%	13.80%	14.00%	14.00%	13.40%	15.60%
Current account balance/GDP	-10.37%	-15.57%	-14.30%	-11.20%	-13.32%	-9.99%	-10.37%
General government public debt (EUR bn)	4.24	4.81	4.95	5.15	5.56	5.92	6.77
General government public debt/GDP	53.43%	56.08%	60.82%	58.81%	60.41%	62.93%	70.53%

Source: IMF (World Economic Outlook, October 2014).

Notes: Latest actual data on population are from 2010; other data are estimates as of 2013, excluding inflation data.

Despite relatively high remittances, the level of current account deficit (CAD) to GDP in Albania is constantly relatively high, ranging from 10-16% in the observed period (2007-2013, see Table 3.1). Albania has a recorded high inflow of FDI, with a share of FDI inflow in GDP of 9% (calculated as simple average for the 2007-2013 period based on yearly IMF data). The share of exports in GDP increased significantly - by 10 pp (2006-2013), while the increase of share of imports in GDP was smaller - 3 pp in the same period. In 2013 exports made 35% of GDP, while ratio of imports to GDP was 53%.[18]

Albania has a relatively high public debt to GDP, reaching 70.5% at the end of 2013, i.e., EUR 6.8 bn (Table 3.1), which is among the highest in the region. The share of public debt in GDP in the period 2007-2013 increased by 17.1 pp. Government measures for fiscal consolidation had been undertaken by the start of 2014.[19] The first steps consisted of amending several tax rates, while the forthcoming period will mainly depend on economic growth and efforts to enhance tax collection.

An inflation-targeted regime in Albania was effective, with the inflation rate remaining low and stable. In 2014 a one-off increase is expected in the inflation rate, due to an implemented raise in taxes. Nevertheless, due to the lower domestic demand (because of the fiscal consolidation measure), and low imported inflation, inflation is expected to remain low and within the Bank of Albania (BoA) target range of 2-4%. Unemployment is high, reaching 15.6% in 2013. Another problem is the level of informal employment. The aim should be to create labor-intensive (job-rich) growth, as well as education and training of higher quality. Therefore, Albania should improve its macroeconomic environment, addressing the legal and regulatory framework, decreasing its perceived level of corruption and shadow economy, tackling problems with the energy sector and pension system, etc.[20]

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[16] IMF WEO.

[17] WB indicators, *Services, etc. value added (% of GDP).*

[18] Source for data on exports and imports in GDP for all countries is WB database.

[19] See http://www.financa.gov.al/files/userfiles/Programimi_EkonomikoFiskal/Programi_Ekonomik_e_Fiskal/EFP_2014_english_FINAL.pdf.

[20] European economy, European Commission Occasional Papers 198, July 2014, p. 9.

3.1.2 Property Market Overview

3.1.2.1 Residential Property Market Overview

Data from the Bank of Albania suggest that in Albania there was a total of EUR 737.8 m of residential mortgage loans as of August 2014 (see Table 3.2).

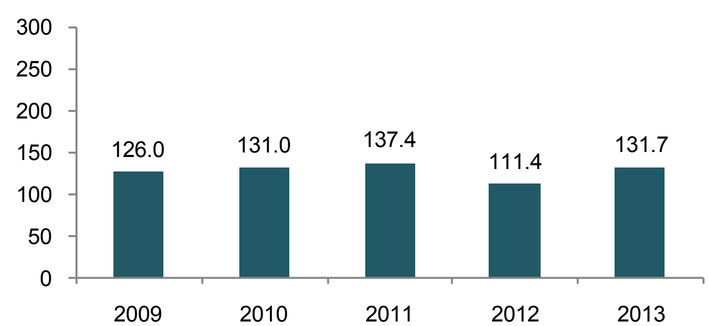
Table 3.2 Albania: Value of Outstanding Residential Collateralized Loans, August 2014

	August 2014
Value of Outstanding Residential Collateralized Loans (EUR m)	737.8

Source: BoA.

Annual increases in residential mortgage loans are presented in Graph 3.2, for the period 2009-2013. According to these data, the average annual lending activity in Albania, when collateralized residential yearly loan values are observed, equals EUR 127 m. Data also suggest that the annual lending value was somewhat variable in the observed time interval: it was EUR 126.0 m in 2009, then increased to EUR 131.0 m in 2010, and finally reached the highest level for the observed period in 2011 of EUR 137.4 m. In 2012, compared with the previous years, the lending value was on a distinctly lower level (EUR 111.4 m). During 2013, the total value of new loans was EUR 131.7 m, slightly less than in 2011 (see Graph 3.2). In the first half of 2014, banks in Albania issued an additional EUR 68.1 m of new residential mortgage loans. Therefore, during this period, from 2009 to the end of June 2014, the total value of outstanding residential mortgage loans increased by EUR 127 m.

Graph 3.2 Albania: Value of New Residential Collateralized Loans, 2009-2013 (EUR m)



Source: BoA.

Note: Numbers are recalculated by CREF using exchange rate data from the European Commission.

The value of residential mortgage loans presented as a share of GDP value was 7.7% (Table 3.3). The percent represents the share in August 2014, and is provided by the Bank of Albania.

Table 3.3 Albania: Share of Outstanding Residential Mortgage Loans in GDP, 2014

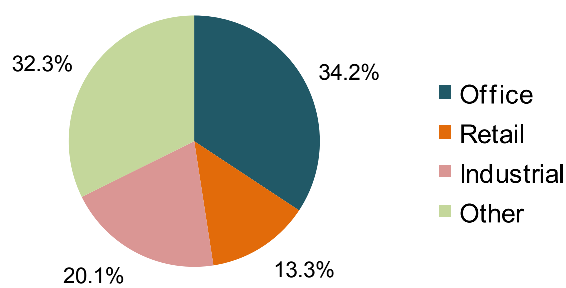
	August 2014
Residential Collateralized Loans/GDP	7.7%

Source: BoA.

3.1.2.2 Commercial Property Market Overview

The structure of commercial property in Albania is given in Graph 3.3. According to these data, offices represent 34.2% of the total of Albanian commercial properties. Share of retail assets in the total equals 13.3%. About one fifth of the total property (20.1%) is industrial complexes. Therefore, other kinds of properties make for more than a third of the total commercial property in Albania.

Graph 3.3 Albania: Breakdown of Commercial Properties by Types of Assets



Source: Raiffeisen Bank.

When it comes to commercial mortgage loans, the total value of such loans in Albania at the end of August 2014 was EUR 759.3 m (see Table 3.4). Therefore, according to the data from the Bank of Albania, the level of commercial and residential mortgage loans was approximately the same.

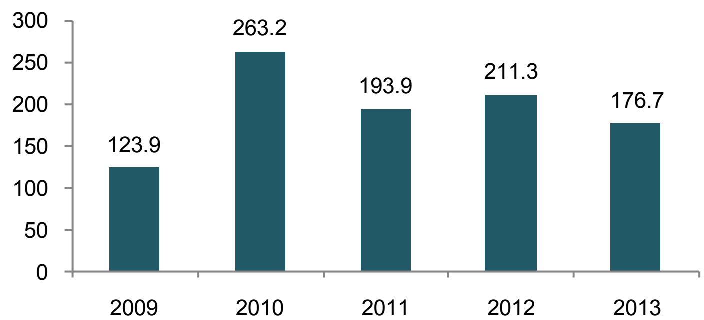
Table 3.4 Albania: Value of Outstanding Commercial Collateralized Loans, 2014

	August 2014
Value of Outstanding Commercial Collateralized Loans (EUR m)	759.3

Source: BoA.

If we look at annual changes in commercial collateralized loan lending activity for the period starting from 2009 and ending with June 2014, loan stock increased in total by EUR 1,047 m. The average yearly increase in the loan value was EUR 194 m (when observing data from 2009 to 2013). From the beginning of 2014, an increase of EUR 78.2 m was recorded. In 2009, probably because of the global crisis, the lending value was relatively low at EUR 123.9 m. A recovery in lending activity then occurred in 2010, when EUR 263.2 m of new loans was issued. In the following years, 2011, 2012 and 2013, the lending value was around EUR 200 m (194, 211 and 177 m respectively, see Graph 3.4).

Graph 3.4 Albania: Value of New Commercial Collateralized Loans, 2009 - 2013 (EUR m)



Source: BoA.

The share of the value of commercial collateralized loans in GDP was 7.9%. Data are at the end of August 2014, provided by the Bank of Albania (Table 3.5). This suggests that the percentage of commercial collateralized loans is only 0.2 percentage points higher than the percentage of residential collateralized loans of GDP (see Table 3.3).

Table 3.5 Albania: Share of Outstanding Commercial Mortgage Loans in GDP

	August 2014
Commercial Collateralized Loans/GDP	7.9%

Source: BoA.

3.1.3 Valuation

3.1.3.1 Regulatory Framework

In Albania there is no specific legal framework (law) regulating RE evaluation tasks for lending purposes. Instead, there are decisions, guidelines and legal rules in other legal documents serving as regulation framework for the area of RE valuation tasks.

Several documents can be cited as an important regulation framework in the valuation procedure:

- Decision of the Council of Ministers No. 658, dated September 25, 2012: “On the adoption of methodology for evaluation of immovable properties in the Republic of Albania”;

- Collateralized lending in Albania in terms of loan loss reserves is regulated by Regulation No. 62 of the Bank of Albania: "On credit risk management from banks and branches of foreign banks";[21]
- A regulation, "On Capital Adequacy,"[22] and a new regulation, "On Capital Adequacy Ratio," which was approved by the Bank of Albania in July 2013 and which will enter into force on December 31, 2014.[23] These regulations contain the criteria and rules for the calculation of capital adequacy ratio and the minimum capital adequacy ratio. The important part of the new regulation is ANNEX 1, Part 2: "Minimum requirements for the valuation of immovable properties";
- "Guidelines for the Preparation of Real Estate Appraisals Used for the Purpose of Obtaining a Loan from a Financial Institution" (hereinafter referred to as Guidelines), issued by the Bank of Albania.[24]

RE valuation should be consistent with well-known international practice, the European Valuation Standards defined by TEGoVA, but "provided they are not inconsistent with the legislation in force,"[25] as the Guidelines stipulate.

3.1.3.2 Valuation Basis

The definition for market value can be found in the Regulation "On Capital Adequacy Ratio" (Annex 1, Part 2, p.134) and in the Guidelines (Principle 1).

The Regulation "On Capital Adequacy Ratio" states that value of the property should not exceed the market value, and the value of the collateral should be an appropriately-reduced value based on the market value or mortgage lending value.

In the Guidelines, a possibility of valuation basis other than market value has also been noted (retrieved from the TEGoVA "Blue Book"). The Guidelines contain the same statement as the one found in the Blue Book: if valuers use a valuation basis other than market value (other "recognized basis" as defined in the document), they should establish a purpose for which the valuation is required. "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 Guidelines, Principle 1, Box 1: European Valuation Standards).

> "The Sale Comparative Method is used for residential lending purposes, while Depreciated Replacement Cost Method, Discounted Cash Flow Method, Investment Method, or Residual Method is used for commercial lending purposes."
>
> *Intesa Sanpaolo Bank Albania*

In Principle 5 of the Guidelines it is noted that valuation should be performed using market value. Immediate liquidation value should be used in the case of non-performing loans or a higher possibility of collateral liquidation. Here, a recommendation has also been given about the necessity of financial institutions to frequently perform revaluation of RE over time, in accordance with the

[21] http://www.bankofalbania.org/web/Regulation_no_62_On_credit_risk_management_from_banks_and_branches_of_foreign_banks_3281_2.php?kc=0,28,0,0,0
[22] http://www.bankofalbania.org/web/Regulation_on_capital_adequacy_ratio_6067_2.php?kc=0,28,0,0,0
[23] http://www.bankofalbania.org/web/Regulation_On_Capital_Adequacy_Ratio_6786_2.php?kc=0,28,0,0,0
[24] http://www.bankofalbania.org/web/pub/guidelines_property_valuation_eng_28_01_2014_6324_1.pdf
[25] http://www.bankofalbania.org/web/pub/guidelines_property_valuation_eng_28_01_2014_6324_1.pdf

type of RE, change in market conditions or a significant decline in RE price, as well as in the case of a non-performing loan.

3.1.3.3 Valuation Methodology

Valuation methodology used for property valuation is defined in the Decision "On the Adoption of Methodology for Evaluation of Immovable Properties in the Republic of Albania" based on the Law "On Restitution and Compensation of Property"[26] and its amendment.[27] Methodology is defined so as to be in accordance with the international standard for RE evaluation. The value of property is calculated using market price, type of property and its purpose of valuation.

3.1.3.4 Valuation Report

There is not any legislation that sets standards in terms of the form of a valuation report. Therefore, according to general practice, the report is self-regulated by internal practice/rules of banks.[28]

Still, in the Guidelines of the BoA (Principle 1, Box 1) there is an explanation about the report of valuation that is also based on the TEGoVA "Blue Book." Although there is no specific obligation to follow a certain pattern, the Guidelines could serve as some recommendation for the report in terms of form and content:

"The valuation must be presented in clear written form meeting professional standards and with transparency in terms of the instruction, purpose, basis, method, conclusion and prospective use of the valuation."

In addition, as it is stated within the "Blue Book" and the Guidelines (Principle 1, Box 1):

"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 in line with professional standards."[29]

3.1.4 Valuer

3.1.4.1 Regulatory Framework

The legal framework for a real estate valuers' profession is laid out in the regulation published by the Council of Ministers. This document is titled, "Regulation on Criteria and Procedures for Licensing Valuers of Immovable Properties."[30] It consists of general regulation for the property valuer, not only for lending purposes. This regulation defines criteria, procedures and responsibilities in the area of licensing legal entities or individuals for the assessment of real estate and the manner of obtaining professional licenses in the field of real estate appraisal, etc.

In addition, in Principle 2 of the Guidelines it is stated that the valuer has to have a license.

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[26] Law No. 9235, dated July 20, 2004.
[27] Law No. 55/2012.
[28] This conclusion is drawn from an extensive interviewing process with relevant parties in Albania. Official data on this issue are not available.
[29] Guidelines for the Preparation of Real Estate Appraisals Used for the Purpose of Obtaining a Loan from a Financial Institution", Bank of Albania (2014), Principle 1, Box 1, p 4.
[30] The Decision No. 953, as of December 12, 2012.

3.1.4.2 Education/Qualification

"Each valuation conducted 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 organizations are required to adhere to the TEGoVA Code of Ethics and Conduct and the Code of Conduct of their Member Association." ("Guidelines for the Preparation of Real Estate Appraisals Used for the Purpose of Obtaining a Loan from a Financial Institution", Principle 1, Box 1).

Minimal requirements regarding the valuers' qualification are stated in "Regulation on Criteria and Procedures for Licensing the Valuers of Immovable Properties No. 953 as of December 12, 2012."

"Such requirements include**:

- Individuals or legal entity evaluator seeking to obtain a professional license, such as appraiser of building and construction site, must hold a Master's Degree from a faculty of engineering, economy or natural sciences (math / physics departments).
- Individuals or legal entity evaluator seeking to obtain a license, such as land appraiser of agricultural/forest/unproductive land must hold a Master's Degree from a faculty of agriculture (agronomy / economics department) or forest engineering.

The individuals or legal representatives of entities seeking a professional license shall not be found guilty of misconduct in professional capacity.

Certificate of qualification in the field of real estate appraisal:

- A Second-Level Professional License is obtained when the individual or legal entity has conducted a program of study of continuing education at institutions defined by laws and regulations in force or have obtained official recognition of certificates issued by foreign institutions from the Ministry of Education and Science.
- A First-Level Professional License is obtained when the individual or evaluator employed by a legal person has had no less than two years of experience since obtaining the Second-Level License, this based on the activity performed in this area documented with references issued from a supervisor who holds a first level professional license."

** This text is given in the "Regulation on Criteria and Procedures for Licensing the Valuers of Immovable Properties," Decision No. 953, dated December 12, 2012, Council of Ministers, Republic of Albania (2012).

3.1.4.3 Use of Valuer Title

The use of the title of valuer is protected by the previously mentioned "Regulation on Criteria and Procedures for Licensing Valuers of Immovable Properties No. 953 as of December 12, 2012." In this regulation all the requests, rules, norms, principles, etc., for obtaining a valuer's title and performing valuations are explained in detail. Such extended rules and frameworks contained in this document protect the lenders from risk of engaging an ineligible person for RE valuation.

Also, there is an association of valuers in Albania: The Albanian Society of Real Property Valuers, which is a member of TEGoVA.

In addition, internal rules in the banks are designed in such a way to provide them safety and protection to a large extent when engaging valuers in terms of valuers' eligibility.[31]

3.1.4.4 External vs. Internal

Financial institutions in Albania are allowed to engage either an internal or external valuer. The practice is that a bank has its own internal rules (according to an interview with *Raiffeisen Bank Albania*).

Moreover, Principle 2 of the Guidelines establishes some frameworks for conditions that external/internal valuers should meet when doing valuations for a financial institution. Above all, they should be: qualified, independent of lending or fund-investment functions (referring to internal valuers), engaged directly by a financial institution (for external valuers), and without having their own interest in the particular RE undergoing valuation.

Furthermore, Principle 3 of the Guidelines recommends that financial institutions have a roster of licensed valuers, compiled at their own discretion. The cost for borrowers should be transparent and agreed in advance, before the valuation process starts. The appraisers should avoid any conflict of interest.

3.2 Bosnia and Herzegovina

3.2.1 Macroeconomic Overview

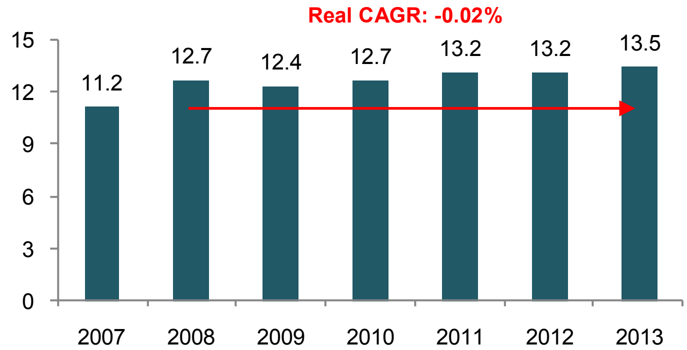
Population:	3.9 m (2013)
Currency:	BAM (Bosnia and Herzegovina convertible mark)
Income group:	Upper middle income (WB)

The nominal GDP of Bosnia and Herzegovina (BiH) amounted to EUR 13.5 bn in 2013. Graph 3.5 presents GDP values in current prices in EUR, recorded in the period 2007-2013.[32]

Bosnia and Herzegovina consists of two political entities: Federation of Bosnia and Herzegovina (FBIH), and Republic of Srpska (RS).

[31] Conclusion derived from the questionnaires.
[32] Database is International Monetary Fund (IMF), World Economic Outlook Database (WEO), October 2014.

Graph 3.5 Bosnia and Herzegovina: Nominal Gross Domestic Product, 2007-2013 (EUR bn)



Source: IMF World Economic Outlook, October 2014.

Notes: Data as of 2013 presents IMF estimates.

The BiH economy was notably affected by the global economic crisis. The real GDP recorded a very high average annual growth rate in the period 2002-2008 of 5.2%.[33] After 2008, GDP started to record very low y-o-y growth or even decline. In the period 2008-2013, average annual growth rate of the BiH real GDP was slightly negative, but very close to zero (-0.02%).[34] During that period, real GDP recorded drops in 2009 and 2012 (see Table 3.6). Y-o-y growth rate of GDP expressed in constant prices in 2013 suggests that economy has started to recover, but the IMF estimates indicate that a low growth of 0.7% can be expected in 2014, as well.[35]

Table 3.6 Bosnia and Herzegovina: Key Macroeconomic Indicators

Bosnia and Herzegovina	2007	2008	2009	2010	2011	2012	2013
Population (m)	3.92	3.91	3.90	3.90	3.89	3.88	3.88
GDP real growth rate	5.98%	5.59%	-2.72%	0.84%	0.96%	-1.21%	2.10%
Inflation rate	4.94%	3.81%	-0.03%	3.08%	3.05%	2.05%	-0.09%
Unemployment rate	29.01%	23.41%	24.07%	27.20%	27.60%	28.00%	27.00%
Current account balance/GDP	-9.12%	-14.12%	-6.55%	-6.15%	-9.75%	-9.26%	-5.44%
General government public debt (EUR bn)	2.09	3.95	4.45	4.98	5.38	5.87	5.74
General government public debt/GDP	18.71%	30.90%	35.79%	39.14%	40.80%	44.65%	42.54%

Source: IMF (World Economic Outlook, October 2014).
Notes: Data on CAP, GDP and population for 2013 are estimates.

The BiH CAD narrowed after the global crisis started (2009-2010), but it widened during the following years (2011-2012) and narrowed again in 2013. Compared with 2007, the share of exports in GDP in 2012 decreased by 12 pp, while the share of imports in GDP fell by 25 pp, reaching 31.2% and 55.1% of GDP, respectively. In 2013, export recorded growth, particularly due to energy sector exports, accompanied by a modest increase in imports due to low

33 Calculated as CAGR, using IMF data for GDP in constant prices.
34 Calculated as CAGR, using IMF data for GDP in constant prices.
35 IMF WEO.

domestic demand. CAD is not expected to broaden considerably in the short to medium-term, because domestic demand will probably not record a significant recovery.

Fiscal deficit and public debt level in BiH cannot be identified as a primary problem, since the levels can be compared to the regional averages. Still, debt-servicing costs are rising. The major part of the BiH public debt is domestic debt. Even the public debt is at a somewhat lower level than in neighboring countries, since it has recorded a strong increase of 23.8 pp during the observed six-year period (from 18.7% of GDP in 2007 to 42.5% of GDP in 2013). If one observes absolute data (the value of public debt), its level reached EUR 5.7 bn at the end of 2013 (Table 3.6). BiH negotiated a two-year stand-by arrangement with the IMF in September 2012, which was then extended until June 2015. Still, reforms have been implemented very slowly. Current problems on the revenue side are weak domestic demand and weak implementation of measures for improving revenue collection.

The unemployment rate in BiH was considerably high in 2013 at 27.0%, with a high percentage of unemployed youth. BiH is characterized by a very low activity rate of 43.6%. A significant number of jobs are still in the informal sector. The inflation rate is quite stable, with a currency board regime. Inflation has been maintained at a very low level, with some variations, mostly caused by food prices. In 2013 BiH even recorded deflation, due to the fall in aggregate demand.

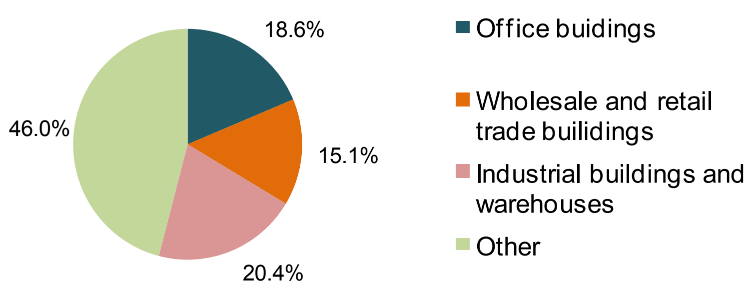
The business environment in BiH presents a significant obstacle to the growth of the economy. It is necessary for BiH to conduct sound structural reforms and take many steps in order to enhance the macroeconomic environment, which could become attractive for foreign investors.

3.2.2 Property Market Overview

3.2.2.1 Commercial Property Market Overview

The category of non-residential property constructed in Bosnia and Herzegovina (BiH) during 2011-2012 is presented in Graph 3.6. Offices constructed in this two-year period represented 18.6% of the total non-residential completed construction. The share of wholesale and retail buildings equaled 13.3%, while industrial buildings equaled 20.4% of total constructed non-residential property. Other kinds of non-residential construction comprised 46.0% of the total.

Graph 3.6 Bosnia and Herzegovina: Breakdown of Properties Constructed (2011-2012)



Source: Agency for Statistics of BiH.

3.2.3 Valuation

3.2.3.1 Regulatory Framework

In Bosnia and Herzegovina (BiH) there is significant room for improvement in the process of RE valuation, because it is estimated that the reform process is at its very beginning.[36]

In 2013 the Ministry of Justice of the Federation of BiH adopted the "Regulation on Estimating the Economic Value of Legal Entities, Assets, Liabilities and Equity." In the Republic of Srpska there is the "Regulation on Assessment of Real Estate Value," which was published by the Ministry of Finance in 2009.[37] These regulations constitute an important part of the regulation framework in Bosnia and Herzegovina with regard to the value of RE property in the country.

The regulation of collateralized lending in terms of capital adequacy can be found in the Decision on Minimum Standards for Capital Management of Banks and Capital Hedge in the BiH Federation[38] and in the Republic of Srpska.[39] Regulatory treatment of collateralized lending in terms of loan loss reserves is defined in Decision on Minimum Standards for Credit Risk and Assets Classification Management in Banks in the Federation of BiH[40] and in the Republic of Srpska[41].

3.2.3.2 Valuation Basis

Valuations are based on market value, defined in compliance with the IVSC definition.[42]

In the above-mentioned regulations provided by the Banking Agency of the Republic of Srpska and the Banking Agency of FBiH, "market value" is a term used in the context of collateral valuation.

3.2.3.3 Valuation Methodology

Sales, i.e., comparative methodology, as well as cost methodology, are applied for both residential and commercial lending. In addition, for commercial lending purposes, the income (capitalization) approach is also used.[43]

3.2.3.4 Valuation Report

In Bosnia and Herzegovina there is no regulation defining the standard structure of a valuation report.

> "Usually the form is based on a short description of location and buildings (pictures included) with basic data (construction year, the size of land plot and buildings in sq m), cost method adjusted with correction factors due to location, condition, marketability, etc."
>
> *UniCredit Bank Banja Luka*

[36] Zujo et al. (2014), p.4.
[37] Official Gazette of RS no. 37/09
[38] Official Gazette of the Federation of BiH, no: 46/14
[39] Official Gazette of the RS, no: 57/14
[40] Official Gazette of the Federation of BiH, number: 85/11
[41] Official Gazette of the RS 49/13, 01/14
[42] This conclusion is drawn from an interview process with relevant parties in BiH. Official data on this issue is not available.
[43] This conclusion is drawn from an interview process with relevant parties in BiH. Official data on this issue is not available.

3.2.4 Valuer

3.2.4.1 Regulatory Framework

In the Republic of Srpska a part of the legislation related to the area of valuers (when a valuer is a court expert) is the Law on Court Experts from 2005,[44] and the "Rulebook on Testing Qualifications of Candidates for Court Experts of the Republic of Srpska" (the Ministry of Justice). In both the aforementioned Law and the Rulebook it is stated that court experts are those individuals of the civil engineering profession who have been appointed by the Ministry of Justice through a public call.

In the Federation of BiH (FBiH) in 2013 the "Regulation on Estimating the Economic Value of Legal Entities, Assets, Liabilities and Equity" was adopted,[45] and in April 2014 the "Rulebook on the Procedure of Issuing Licenses to Authorized Valuers," as well as "Decisions on Remuneration"[46] (the Federal Ministry of Justice).

In BiH there are also associations that gather RE valuers.

Bosnia and Herzegovina Property Association (BHPA) was founded in 2012. The aim of this association is to be an institution that gives certificates to valuers.[47]

The primary role of the association mentioned above is to "set and maintain the highest standards of professional practice, education, ethics and professional conduct for its members and the broader property-related profession." This association is "committed to building and maintaining a strong base for the future of the property profession through broadening expertise and knowledge of its members." In addition, they state that they aim to harmonize the valuation process with global standards defined by RICS-a (Royal Institution of Chartered Surveyors).

The Association of Certified Appraisers in Bosnia and Herzegovina (UOPBiH) was established in 2010 as a professional, non-profit and non-governmental organization bringing together professionals in the field of appraisal of legal entities, assets, liabilities and capital in Bosnia and Herzegovina. In 2012 this association joined IVSC, the International Valuation Standard Council, as a member.

Even though it is necessary for valuers to be professionals, their formal education in BiH usually lacks all necessary knowledge in business operations related to RE valuations.[48]

3.2.4.2 Education/Qualification

In the Republic of Srpska if a valuer is a court expert, necessary qualification and education is defined by the Ministry of Justice. A court expert is a person who has passed an exam for court experts and who has been approved by the Ministry of Justice of the Government of the Republic of Srpska.[49] According to Article 3 of the Law on Experts, a person may be appointed as an expert provided that they meet specific requirements. Those requirements stipulate that

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[44] http://www.fbihvlada.gov.ba/bosanski/zakoni/
[45] Official Gazette of the Federation of BiH, No. 70/13.
[46] http://www.fmp.gov.ba/index.php?part=stranice&id=302
[47] http://www.bhpa.org/
[48] Zujo (2014).
[49] http://www.vladars.net/sr-SP-Cyrl/Vlada/Ministarstva/mpr/Documents/pravilnik%20o%20kvalifikacionom%20testiranju%20vjestaka%20cirilica.pdf

the person be a citizen of Bosnia and Herzegovina with appropriate experience and expertise in a particular area and a relevant degree, that they be characterized by proven professional abilities and high moral qualities enjoying the good reputation of a careful, objective and expeditious expert in a particular field.

In the Federation of BiH the aforementioned Regulation[50] and the Rulebook[51] were adopted, according to which a valuer is a person with Bosnia and Herzegovina nationality with a business capacity, the ability to speak Bosnian, Croatian and Serbian, and without criminal records. A valuer should have a degree in law, economy, or engineering with at least five years of experience in the valuation field, who attended classes and passed an exam for a certified valuer. After passing the exam, a certificate is issued by the Federation of BiH, and a license is given by the Ministry of Justice.[52]

The BHPA and UOPBiH are organizing professional education and training for valuers. One innovation in the region is an educational opportunity at the University of Sarajevo's School of Economics and Business, which in cooperation with the University of Melbourne organizes a Master's course. A student who successfully completes this course is given the title of Master of Property.[53]

3.2.4.3 Use of Valuer's Title

The valuers' profession is protected in the Federation of BiH by the Ministry of Justice of the Federation of Bosnia and Herzegovina.

Regulations that precisely define the process of obtaining a valuer's title, respective rights and obligations, as well as the reasons and manners of a title's revocation, were issued in the Federation of BiH in 2013 and 2014.

In the Republic of Srpska, there is a lack of regulations explicitly related to the title of licensed valuer.

3.2.4.4 External vs Internal

Financial institutions in Bosnia and Herzegovina are allowed to employ both external and internal valuers. Nevertheless, the practice increasingly applied by the banks implies engaging external valuers when there is a need for collateral valuation for lending purpose. One banker from the BiH observed that the code of conduct, which is consistent with the International Valuation Standards, represents a guarantee that a valuer will not be biased and/or under pressure during valuations.[54]

[50] http://www.fmp.gov.ba/useruploads/files/uredba_procjenitelji.pdf
[51] http://www.fmp.gov.ba/useruploads/files/pravilnik_za_izdavanje_licence.pdf
[52] http://www.fmp.gov.ba/useruploads/files/uredba_procjenitelji.pdf
[53] Zujo (2014).
[54] These conclusions are drawn from an interview process with relevant parties in BiH. Official data on this issue are not available.

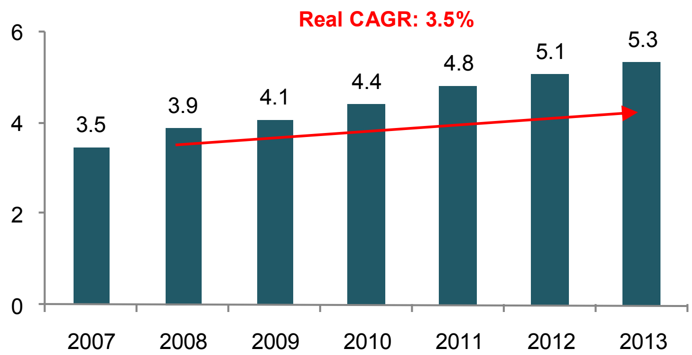
3.3 Kosovo

3.3.1 Macroeconomic Overview

Population:	1.8 m (2013)
Currency:	EUR (Euro)
Income group:	Lower middle income (WB)

Kosovo's nominal GDP amounted to EUR 5.3 bn in 2013. Graph 3.7 presents GDP values in current prices in EUR bn, recorded in the period 2007-2013[55].

Graph 3.7 Kosovo: Nominal Gross Domestic Product, 2007-2013 (EUR bn)



Source: IMF World Economic Outlook, October 2014.

Note: Data as of 2013 presents IMF estimates.

The global economic crisis did not significantly influence Kosovo's economy, judging by the growth rate of GDP. Since the beginning of the crisis, Kosovo has recorded an average yearly GDP growth of 3.5% (CAGR calculated for the period 2008-2013), which is one of the highest rates among the Balkan countries and not much lower than the average annual growth in the pre-crisis years (4.7% in the period 2002-2008). Kosovo recorded a cumulative growth of GDP of 20% in the period 2008-2013. The real y-o-y GDP growth rate in 2013 amounted to 3.4%. The yearly growth of GDP is expected to slow down in 2014 (the IMF projection of the 2014 annual growth of Kosovo's GDP amounted to 2.7%). In spite of the impressive growth rate, Kosovo's GDP per capita is still low and is the lowest compared to others in the region.

[55] Database is International Monetary Fund (IMF), World Economic Outlook Database (WEO), October 2014.

Table 3.7 Kosovo: Key Macroeconomic Indicators

Kosovo	2007	2008	2009	2010	2011	2012	2013
Population (m)	1.73	1.75	1.76	1.78	1.79	1.81	1.82
GDP real growth rate	8.30%	4.49%	3.59%	3.31%	4.38%	2.81%	3.39%
Inflation rate	10.51%	0.45%	0.09%	6.58%	3.55%	3.67%	0.51%
Unemployment rate	46.30%	47.50%	45.40%	n/a	n/a	30.90%	n/a
Current account balance/GDP	-10.23%	-16.19%	-9.22%	-11.70%	-13.69%	-7.51%	-6.36%
General government public debt (EUR bn)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
General government public debt/GDP	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: IMF (World Economic Outlook, October 2014) and WB.

Notes: Data as of 2013 (except data on population) present IMF estimates.

In the pre-crisis period, Kosovo had a significantly high CAD – which was, to a large extent, the consequence of a high trade deficit. CAD was mostly financed by a considerable inflow of foreign capital through FDI (because of privatization) and consistent high remittances, which reached an impressive average level of 18% of GDP for the period 2007-2013. When the crisis started, CAD began to fall as a consequence of the faster growth of exports than the growth of imports. The share of exports and imports in GDP in the period 2007-2012 increased by 2.6 pp and 1.1 pp, respectively. Still, the exports-to-GDP ratio was very low at the level of 18.4% in 2012, while imports constituted 52.8% of GDP value.

Kosovo's fiscal position is strong, with low and sustainable level of public debt[56]. Kosovo has the challenge of maintaining this position, taking into account the needs related to social and capital spending. Therefore, from 2014 with the SBA Kosovo has been implementing fiscal rules for establishing a ceiling for fiscal deficit of 2% of GDP and for public debt of 30% of GDP.

An extremely high unemployment rate characterizes Kosovo (over 30% of the active workforce), which probably reflects high informal employment. The inflation rate varied in the period 2007-2013 possible largely due to imported inflation, reaching high levels in 2007 and 2010, while remaining low in all other observed years, which is connected to the use of the euro. Political factors have placed high barriers to the attractiveness of the business environment, deterring foreign investors. Also, in order to improve its investment environment, Kosovo should improve public infrastructure.

3.3.2 Property Market Overview

3.3.2.1 Residential Property Market Overview

The number of outstanding residential mortgage loans in Kosovo at the end of June 2014, according to the data of the CBK, amounted to 4,260, with a total value of EUR 136.2 m (Table 3.8).

[56] IMF staff report, June, 2013.

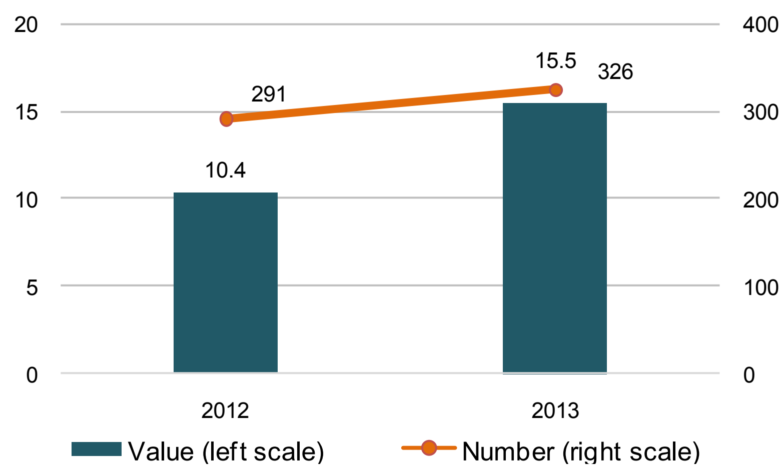
Table 3.8 Kosovo: Value and Number of Outstanding Residential Collateralized Loans, 2014

	June 2014
Value of outstanding Residential Collateralized Loans (EUR m)	136.2
Volume	4,260

Source: CBK.

The yearly increase in the value and number of residential mortgage loans is presented in Graph 3.8 for 2012 and 2013. The value and number of new residential mortgage loans in the first half of 2014 were considerably high, even exceeding the value and number of those issued during the whole of 2012. The number of loans increased by 291 in 2012, 326 in 2013, and 315 in 1H 2014, which equals an increase in value of EUR 10.36, 15.54, and 12.75 m, respectively.

Graph 3.8 Kosovo: Value (EUR m) and Number of New Residential Collateralized Loans per Year, 2012-2013



Source: CBK.

Outstanding volume of residential mortgage loans at the end of June 2014 was equal to 2.6% of GDP (Table 3.9).

Table 3.9 Kosovo: Share of Outstanding Residential Mortgage Loans in GDP, 2014

	June 2014
Residential Collateralized Loans/GDP	2.6%

Source: CBK.

3.3.2.2 Commercial Property Market Overview

The number of outstanding commercial mortgage loans in Kosovo was 900 at the end of June 2014. The value of loans reached EUR 147.8 m (see Table 3.10).

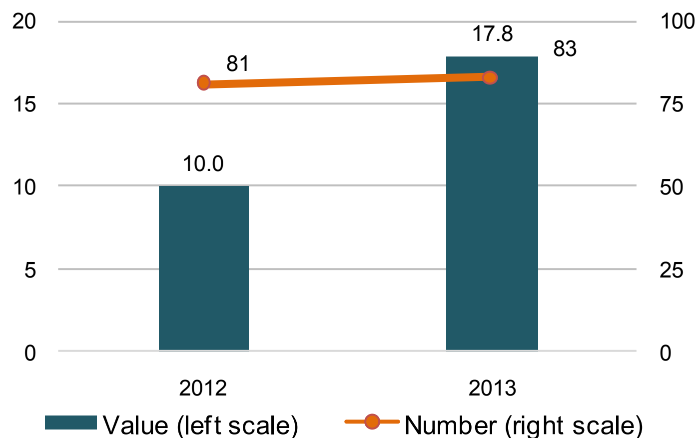
Table 3.10 Kosovo: Value and Number of Outstanding Commercial Collateralized Loans, 2014

	June 2014
Value of Outstanding Commercial Collateralized Loans (EUR m)	147.8
Volume	900

Source: CBK.

Value of commercial mortgage loans increased from 2012 to 2013. Even though the number of loans differed by only two, the value increased considerably. The value of new commercial collateralized loans was EUR 10 m in 2012, while in 2013 it reached EUR 17.8 m. This represents an increase in the number of loans by 81 and 83 in 2012 and 2013, respectively. The number and value of the loans in the first half of 2014 were relatively high. During those six months, the value generated from lending activity was higher than in the whole 2012, amounting to EUR 11.1 m, while the number of loans was slightly lower (78).

Graph 3.9 Kosovo: Value (EUR m) and Number of New Commercial Collateralized Loans per Year, 2012-2013



Source: CBK.

Table 3.11 Kosovo: Share of Outstanding Commercial Mortgage Loans in GDP

	June 2014
Commercial Collateralized Loans/GDP	2.8%

Source: CBK.

The ratio of commercial collateralized loans to GDP was 2.77% in June 2014 (Table 3.11). This is only 0.22 pp higher than the ratio of residential loans to GDP.

3.3.3 Valuation

3.3.3.1 Regulatory Framework

In Kosovo, the Law "On Property and Other Real Rights" published in 2009[57] comprises definitions and regulations related to mortgage (Chapter III). Also, an important regulatory framework is set by the Board for Licensing Real Estate Appraisers, which was established by the Ministry of Finance[58]. The Board published the "Regulation on Procedures and Criteria for Licensing Real Estate Appraisers". The CBK regulations (e.g., "Regulation on Bank Capital Adequacy,"[59] "Regulation on Credit Risk Management"[60]) are important regulations referring directly to RE valuation for lending purposes. The banking sector has been developing rapidly in Kosovo in recent years, mainly based on foreign capital. This has created a necessity and put pressure on the banking sector and on the country in general to develop and define all important legislation in the country, inter alia, regulation concerning collateral valuation procedures.

After the 1990s, most property records and documents serving to prove land and real-property ownership rights are missing. For example, according to data from 2008, about 80% of data that represented names of property landowners in the Immovable Property Rights Registry (IPRR) and cadaster were outdated[61]. Banks have a problem because of insufficient data on registered property for collateralized valuation for lending purposes.

Therefore, because of higher risk in the financial sector due to high gaps and weaknesses in legislation, rules and regulations in the area of collateral valuation, Kosovo banks have set high collateral requirements. The process usually demands high administrative costs and results in lower lending compared to real potential because of increased caution and banks' reduced willingness to lend. For example, for small firms in Kosovo, collaterals are usually three times higher than the value of the loan, while for medium and large firms the collaterals exceed the loan value by 1.5 times[62]. Therefore, a lot of lending is unrealized because the firms cannot provide such large collateral. In the case of residential lending, undefined property rights, missing, non-standardized and complicated procedures and high corruption all represent significant obstacles for both sides (banks and clients) for preparedness for residential mortgage lending.

Regulatory treatment of mortgage lending activity in terms of capital adequacy is provided in "Regulation on Bank Capital Adequacy"[63] by the CBK. Category 4 for CAR calculation (the corresponding weights: 75%) comprises the loans or the portions thereof supported by collateral in the form of first lien residential mortgages whose underlying indebtedness is not more than 30 days past due.[64] The LTV ratio of these loans or the portions cannot exceed 65% and the ownership of the residential property has to be documented and verified. Additionally, the

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[57] http://www.gazetazyrtare.com/e-gov/index.php?option=com_content&task=view&id=387&Itemid=28&lang=en
[58] Source: Questionnaire.
[59] http://www.bqk-kos.org/repository/docs/2013/Regulation on Bank Capital Adequacy.pdf
[60] http://bqk-kos.org/repository/docs/2012/Regulation%20on%20Credit%20Risk%20Management.pdf
[61] Source: Project appraisal document on a proposed credit and proposed grant to the Republic of Kosovo for a Real Estate Cadastre and registration project (RECAP), WB, 2009, p.18.
[62] Bajçinca (2014).
[63] This Regulation shall apply to all banks in Kosovo that are licensed by the CBK excluding branches of foreign banks.
[64] If a loan is more than 30 day past due, then the whole exposure of the same customer should be weighted the same as the loan, with the exception of cash-covered loans and if the source of payment for other exposures are different from the one for the loan(see "Regulation on Bank Capital Adequacy").

market value of collateral has to be valued independently by a qualified real estate valuer or using a tax base established by municipalities based on the Law on the Taxes on Immovable Property in the Republic of Kosovo (see Article 5, “Risk-Weighted Assets and Off-balance Sheet Claims,” of the “Regulation on Bank Capital Adequacy”).

For credit adequacy calculation, banks also apply rules and definitions contained in CBK regulations, such as the “Regulation on Large Exposures”, approved by the Board of the CBK in April 2013.[65]

> “The proper institutional and legal framework is in process. The Board for Licensing Real Estate Appraisers is establishing a proper legal and regulatory framework in this regard, supported by the Central Bank for lending purposes.”
>
> *CBK*

Regulatory treatment, in terms of loan loss reserves in the case of loans with collateral attached, is governed by the CBK’s “Regulation on Credit Risk Management.” Special provisions for collateral lending are defined in article 21 of this regulation:

Collateral security should be taken into consideration in the classification process in the following way: a) eligible collateral shall be deducted from the amount of exposure; and b) “other types of collateral should not be deducted from the amount of the exposure for the purpose of classification. However, that collateral, its condition, accessibility and value, when realistically applied, may be a factor in determining the severity of exposure classification.” This represents a significant statement underlining the importance of accurate collateral valuation.

3.3.3.2 Valuation Basis

Market value is used in Kosovo as a valuation basis. In addition, other bases used for the valuation of property under loan collateral depend on property type (whether it is residential or commercial property).[66]

In the CBK’s “Regulation on Credit Risk Management,” it is provided that fair market value and liquidation value of collateral be documented by a current appraisal made by a “competent party.” In this regulation these valuation bases are specified in the following way:

- Fair market value is the price at which an asset could be sold in the open, free market, with the willingness of a buyer and a seller and without compulsion on any of the parties.
- Liquidation value shall be considered (in accordance with the specification given in Article 21 of the above-mentioned Regulation) so that banks’ ability to access and liquidate the collateral within a reasonable period can be estimated.

3.3.3.3 Valuation Methodology

Methodologies typically applicable in Kosovo for RE valuation for lending are sales (i.e. comparison), income and cost methodology.[67]

[65] http://www.bqk-kos.org/?cid=2,190
[66] This conclusion has been drawn from an interview process with relevant parties in Kosovo. Official data on this issue are not available.
[67] This conclusion has been drawn from an interview process with relevant parties in Kosovo. Official data on this issue are not available.

3.3.4 Valuer

3.3.4.1 Regulatory Framework

The “Regulation on Procedures and Criteria for Licensing Real Estate Appraisers,” issued by the Board for Licensing Real Estate Appraisers, represents an important part of an ongoing process in the regulatory framework in RE valuation in Kosovo.

Still, as mentioned above, according to CBK regulations, the market value of collateral has to be valued independently by a qualified real estate valuer or using a tax base established by municipalities based on the Law on the Taxes on Immovable Property in the Republic of Kosovo.

3.3.4.2 Education/Qualification

According to the Regulation stated in subchapter 1.1.2.1, an RE valuer should be a resident of Kosovo, at least 21 years of age, with a university degree in the fields specified within the above-mentioned Regulation, in addition to other criteria related to experience and background. This Regulation also defines the details of the required education and qualifications for obtaining a license for performing RE valuation work. Still, the establishment of a proper institutional and legal framework is in progress, with much room for improvement in order to achieve compliance with international standards and EU regulations.

In Kosovo there is the Kosovo Appraisers Association (KAA), which has been a member of TEGoVA since 2010. The KAA consists of 31 members, who are qualified valuers. The KAA was established in 2009 with the aim of introducing valuation standards, educating individuals, and enhancing their professionalism in the valuation field.

3.3.4.3 Use of Valuer’s Title

The title of valuer is generally protected in Kosovo. The “Regulation on Procedures and Criteria for Licensing RE Appraisers,” established by the Board for Licensing Real Estate Appraisers, governs this subject.

3.3.4.4 External vs. Internal

Both external and internal valuers are involved in property valuation for credit institutions. It is not unusual for both types of valuers to be engaged by a bank in the RE appraisal process. In addition, the type of RE and value of the potential loan usually determine to whom banks will provide value property.[68] The published “Regulation on Procedures and Criteria for Licensing Real Estate Appraisers,” together with the “Code of Ethics,”[69] represent an important part of Kosovo’s legislation, considerably defining and thus providing objectiveness and impartiality of valuators in RE value assessment.

[68] This conclusion has been drawn from an interview process with relevant parties in Kosovo. Official data on this issue are not available.

[69] Conclusion derived from an insight into questionnaires' answers and from examining a document “Regulation on Procedures and Criteria for Licensing Real Estate Appraisers”, which was submitted by one of the respondents.

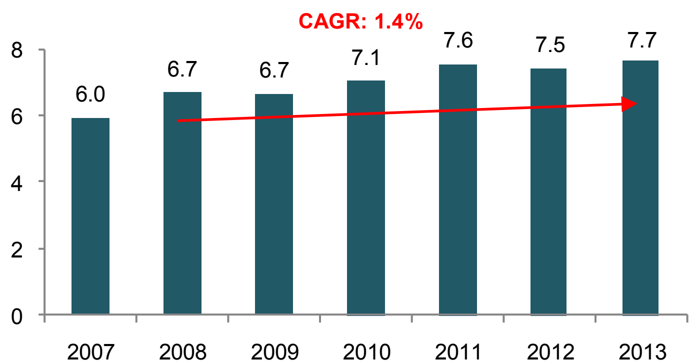
3.4 Macedonia

3.4.1 Macroeconomic Overview

Population:	2.1 m (2013)
Currency:	MKD (Macedonian Denar)
Income group:	Upper middle income (WB)

The nominal GDP of FYR Macedonia amounted to EUR 7.7 bn in 2013. Graph 3.10 presents GDP values in current prices in EUR, recorded in the period 2007-2013.[70]

Graph 3.10 Macedonia: Nominal Gross Domestic Product, 2007-2013 (EUR bn)



Source: IMF World Economic Outlook, October 2014.

The growth of GDP in Macedonia was very fast in the pre-crisis period – the average annual real GDP growth rate (CAGR) was 4.7% (calculated for the period 2002-2008), but it slowed down considerably in the following period because of the global crisis (the average annual growth rate of GDP in the period 2008-2013 was 1.4%). In the post-crisis period, observing y-o-y growth rates (the real growth rate of GDP, as well as other key macroeconomic indicators in the observed period are presented in Table 3.12), GDP dropped in 2009 and 2012. In 2013, GDP recorded a y-o-y growth rate of 2.9%, driven by net exports. The IMF projected that the y-o-y growth of GDP in 2014 would be even higher, reaching a level of 3.4%. According to the IMF, the primary reasons behind this will be an increase in domestic demand, which will be stimulated by private consumption and public infrastructure projects.

Table 3.12 Macedonia: Key Macroeconomic Indicators

Macedonia	2007	2008	2009	2010	2011	2012	2013
Population (m)	2.05	2.05	2.05	2.06	2.06	2.07	2.07
GDP real growth rate	6.15%	4.95%	-0.92%	2.90%	2.77%	-0.39%	2.91%
Inflation rate	6.67%	4.10%	-1.64%	2.96%	2.78%	4.75%	1.39%
Unemployment rate	34.93%	33.78%	32.18%	32.05%	31.38%	31.30%	30.02%
Current account balance/GDP	-7.06%	-12.83%	-6.82%	-2.03%	-2.53%	-3.03%	-1.91%
General government public debt (EUR bn)	1.36	1.40	1.61	1.73	2.09	2.49	2.76
General government public debt/GDP	22.95%	20.92%	24.15%	24.45%	27.95%	33.43%	35.86%

Source: IMF (World Economic Outlook, October 2014).

Note: Data on general public debt as of 2013 present IMF estimates.

[70] Database is International Monetary Fund (IMF), World Economic Outlook Database (WEO), October 2014.

The level of CAD considerably decreased in 2009 and remained low after that (see Table 3.12, Current account balance/GDP). The share of exports in GDP increased by 7.1 pp in the period from 2006 to 2013, whereas the share of imports in GDP increased slightly more, by 8.1 pp, during the same time interval. CAD is expected to broaden in 2014 (to 4.5% of GDP, according to IMF estimates).

Public debt, even though it increased in the observed period, is still at a relatively low level compared to the regional standards. Public debt in Macedonia in 2013 was EUR 2.8 bn, i.e., 35.9% of GDP. Unemployment rate in Macedonia is consistently at an exceptionally high level (about one third of the active workforce). However, unemployment has showed a favorable trend during the observed years – a tendency of decline – from 35% in 2007 to 30% in 2013.

Inflation varied, starting from a high level of 6.7% in 2007, and then decreasing to 4.1% in 2008. In 2009 it reached a negative value (i.e., Macedonia experienced deflation in 2009) of -1.6%. After that, the inflation rate increased to 3.0% in 2010 and 2011, with a further increase in 2012, when it reached a level of 4.7%. In 2013, the inflation rate again dropped to a level of 1.4%, due to lower food and commodity prices.[71]

3.4.2 Property Market Overview

3.4.2.1 Residential Property Market Overview

The total number of outstanding residential mortgage loans as of August 31, 2014, according to the National Bank of the Republic of Macedonia (NBRM), is 17,786, i.e., EUR 396 m (

Table 3.13 Macedonia: Value and Number of Outstanding Residential Loans with Residential Property Under Mortgage, 2014

). Here, the data represent loans approved to households and collateralized with residential property.[72] Annual flows representing the value of new lending are shown in Graph 3.11 for the period from 2010 to the end of 2013. During this period, the number of these loans (with residential property under mortgage) slightly decreased each year, whereas the total value of loans recorded a gradual growth. The loans increased by EUR 80 m on average per year (for the period 2010-2013) or by 3,245 new loans. In the first half of 2014, banks issued 1,840 new loans with residential property under collateral, which equals to almost EUR 54 m. In the observed period (2010-1H 2014), there were 14,818 new loans issued, with a total value of EUR 372 m. The yearly increase in the number of loans was 3,513 in 2010, 3,385 in 2011, 3,048 in 2012, 3,032 in 2013, and 1,840 in 1H 2014, which equals to an increase in value of EUR 62, 76, 81, 98 and 54 m, respectively.

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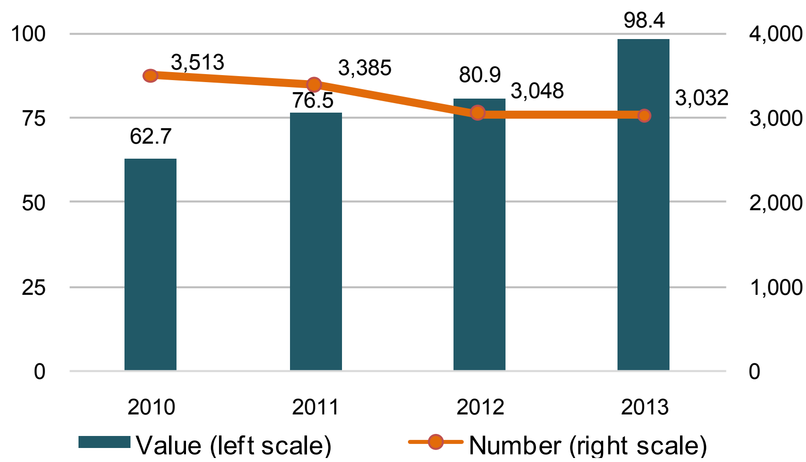
[71] IMF staff report, July 2014.
[72] Source: NBRM.

Table 3.13 Macedonia: Value and Number of Outstanding Residential Loans with Residential Property Under Mortgage, 2014

	August 2014
Value of Outstanding Residential Collateralized Loans (EUR m)	396.0
Volume	17,786

Source: NBRM.

Graph 3.11 Macedonia: Value (EUR m) and Number of New Residential Loans with Residential Property Under Mortgage, 2010-2013



Source: NBRM.

Note: Numbers are recalculated by CREF using exchange rate data from European Commission.

The share of the outstanding value of these loans (approved to households and collateralized with residential property) in GDP was 4.8% at the end of March 2014 (Table 3.14).

Table 3.14 Macedonia: Share of Outstanding Residential Loans with Residential Property Under Mortgage in GDP, 2014

	March 2014
Residential Collateralized Loans*/GDP	4.8%

Source: NBRM.

Note: (*) Residential property under collateral.

Based on the data of the National Bank of the Republic of Macedonia, the total value of household loans collateralized with commercial property is given in Table 3.15. The outstanding value of the loans as of August 31, 2014 amounted to EUR 10.8 m (see Table 3.15). That is 333 lending loans in total.

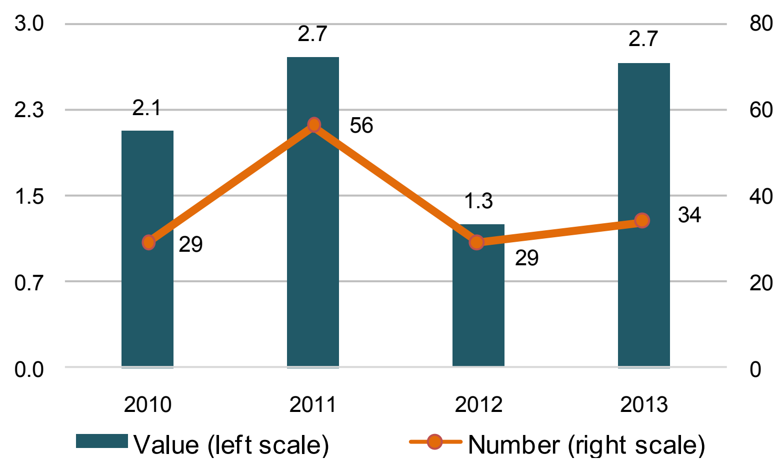
Table 3.15 Macedonia: Value and Number of Outstanding Residential Loans with Commercial Property Under Mortgage, 2014

	August 2014
Value (EUR m)	10.8
Volume	333

Source: NBRM.

Thus-defined residential mortgage loans increased by an average of EUR 2.2 m per year during the observed period (2010-2013), or by about 37 loans per year. During the first half of 2014, banks approved an additional 21 loans with a total value of EUR 0.8 m. Annual increases are presented in Graph 3.12. According to these data, the value of new loans in the observed years was EUR 2.1, 2.7, 1.3 and 2.7 m in 2010, 2011, 2012 and 2013, respectively. Yearly increases in the number of this kind of loan for the same period (2010-2013) were 29, 56, 29 and 34, respectively.

Graph 3.12 Macedonia: Value (EUR m) and Number of New Residential Loans with Commercial Property Under Mortgage, 2010-2013



Source: NBRM.

Table 3.16 Macedonia: Share of Outstanding Residential Loans with Commercial Property Under Mortgage in GDP, 2014

	March 2014
Commercial Collateralized Loans*/GDP	0.1%

Source: NBRM.
Note: (*) Commercial property under Collateral.

Residential loans with commercial property under collateral presented as a share of GDP was 0.1% on March 31, 2014 (Table 3.16).

The LTV of outstanding residential loans with a residential mortgage equals 63.6,[73] while the LTV of outstanding residential loans with a commercial mortgage attached equals 62.6,[74] calculated as an average at the end of 2011.

Table 3.17 Macedonia: Households According to the Dwelling Ownership (Tenure), 2013

	Structure of households	Number of households
Total	**100.0%**	**555,266**
Owner	91.2%	506,465
Leaseholder of a state dwelling	0.3%	1,483
Leaseholder (of the whole dwelling) in private property	0.5%	2,744
Leaseholder (in a part of the dwelling) in private property	0.1%	434
Relationship (living with parents, children, other relatives)	6.7%	37,202
Other	1.2%	6,938

Source: Macedonia State Statistical Office (RMSSO).

Note: The total number of units represents the RMSSO data. The number of households according to specific ownership, expressed in units, are CREF calculations based on an adequate percent of the RMSSO data on total households.

The total number of dwellings in Macedonia in 2013 was 555,266, according to the State Statistical Office of the Republic of Macedonia. The structure of dwellings indicates that the majority of these dwellings are occupied by the owner (91.2% of the total number of dwellings, which is approximately half a million households, see Table 3.17). Percentages of rented households are 0.3 (about 1,483 units), 0.5 (2,744 units) and 0.1 (434 units), for state, whole private, and parts of private dwellings, respectively. Households living with relatives make up 6.7% of total households, which is approximately 37,202 units. Other dwellings make up 1.2% of the total, i.e., 6,938 units (Table 3.17).

3.4.3 Valuation

3.4.3.1 Regulatory Framework

Macedonia has legislation regulating the valuation of RE property: The Law on Appraisal[75] (Ministry of Transport and Communications, with amendments).[76]

The Law on Appraisal also represents the legal framework for property valuers for lending purposes. The Law "regulates the valuation, areas of appraisals, conditions and methods of appraisal, entities performing valuation, conditions and procedures for taking the licensing exam or for the revocation of an appraiser's license, rewards and compensation costs for the

[73] Source: NBRM.
[74] Source: NBRM.
[75] Official Gazette, No.115, and No.185, http://bsv.gov.mk/files/zakon-procena.pdf.
[76] http://bsv.gov.mk/files/izmena1.pdf, http://bsv.gov.mk/files/izmena2.pdf, http://bsv.gov.mk/files/izmena3.pdf

appraiser, competence, organization and operation of the Chamber of Valuers of the Republic of Macedonia, as well as other issues relating to assessment."

The Chamber of Valuers of the Republic of Macedonia (KPRM) was founded by the Ministry of Transport and Communications, and its work and scope is defined by the Law on Appraisal. The KPRM is a member of TEGoVA. It performs numerous activities to promote and develop the valuers' profession, such as participation in conferences, scientific bodies, seminars, training, setting professional standards and best practices, and collaboration with similar international organizations. Besides the KPRM, there is one other organization of appraisers from Macedonia that is a member of TEGoVA - the Bureau for Court Expertise.[77]

In addition, RE valuation in Macedonia is also defined by the "Methodology for Assessment of the Market Value of Real Estate,"[78] as well as by European and international standards for value assessment.[79]

These regulations (the Law, the Methodology) contain the definition of valuation methodology, the form of a valuation report, education/qualification that valuers need to possess, and their obligations and rights.

Collateralized lending in terms of loan-loss reserves in Macedonia is regulated by the "Decision on Credit Risk Management" (NBRM)[80]. Capital adequacy is defined in compliance with the Basel II approach and is regulated by the "Decision on the Methodology for Determining Capital Adequacy" (NBRM).[81]

According to the "Decision on Credit Risk Management" (see Part II.2, point 11), for credit exposures in D and E risk categories (i.e., non-performing credit exposures) that the bank expects to collect through activation of the collateral, the value of collateral may be taken into account for certain kinds of collateral instruments (a pledge on residential property or commercial real estate, a pledge on claims on the Republic of Macedonia and first-rate collateral instruments[82]) for the purpose of determining the amount of impairments (calculated as the difference between the carrying amount of a balance sheet item and the present value of future expected cash flows based on those claims). Collateral fulfilling the requirements stated in item 11 of the Decision has to be taken into account when calculating the present value of expected future cash flows. The

> "The methodology for determining banks' capital adequacy in the Republic of Macedonia is in compliance with Basel II standardized approaches, including for credit risk. Accordingly, some collateralized claims (claims secured by residential property and claims secured by commercial real estate) have special (separate) treatment when determining capital requirements for such claims."
>
> *NBRM*

[77] http://www.bsv.gov.mk/
[78] Chamber of Valuers, Official Gazette of RM No. 54/2012, 17/2013, 21/2013, 142/2014, (Методологијата за проценана пазарната вредностна недвиженимот).
[79] Documents (the Law, methodologies, etc.) which represent the legislation framework for RE valuations in Macedonia can be found on the website of the Chamber of Valuers: http://komoranaprocenuvaci.mk/?page_id=30.
[80] Official Gazette of FYRM, No. 50/2013 and No. 157/2013.
[81] Official Gazette of FYRM, No. 47/12, No. 50/13 and no. 71/14.
[82] First-rate collateral instruments are defined in Point 12 of "Decision on Credit Risk Management."

value of the future cash flows should be equal to the lesser collateral value and the total credit exposure covered by the collateral. Collateral value equals 70% of the market value of appraisal for residential property and 50% of the market value appraisal for commercial property.

This “special (separate)” treatment of collateral cited by the interviewee (see the text box above) can be found, e.g., in points VI.1.8 and VI.1.9 of the "Decision on the Methodology for Determining Banks’ Capital Adequacy."A risk weight of 35% shall be applied to loans with residential property as collateral and of 100% to loans with commercial property as collateral (as specified in items 71 and 72 of this decision).

In addition to these regulations, NBRM also has the “Decision on the Accounting and Regulatory Treatment of Foreclosed Assets.”[83] This Decision sets out the methodology for the accounting and regulatory treatment of foreclosed assets.

3.4.3.2 Valuation Basis

Real estate market value presents the basis for valuation in Macedonia. A detailed methodological framework containing all the necessary information about RE value estimation was published in the "Methodology for Assessment of the Market Value of Real Estate" (Chamber of Valuers of Macedonia). The market value, which is the basis of valuation in Macedonia, is even defined in the title of the specific legal methodological framework.

3.4.3.3 Valuation Methodology

In the "Methodology for Assessment of the Market Value of Real Estate" it is noted, inter alia, that methodology represents the basis for collateral valuation for lending purposes. As basic elements used for determining the market value of real estate, Paragraph 1 of Article 5 of the above-mentioned Methodology states the following: the type of construction, construction between floors, roof structure, installations, elevator, flooring, sanitary facilities, facade windows, doors, facade, insulation, and exclusiveness, with additional elements (as defined in Article 6 of the "Methodology for Assessment of the Market Value of Real Estate") such as location, attractiveness, etc. This methodology is also specifically defined depending on the type of object, whereas depending on the zone where the building is situated, special points are added for the assessed value of the building intended for amortization.

3.4.3.4 Valuation Report

In Macedonia, there is a legal framework for the content of valuation reports, a detailed explanation of which is part of the "Methodology for Assessment of the Market Value of Real Estate."

Article 6 of the above-mentioned Methodology states what information each report should contain: data on the person/entity ordering the valuation, the purpose of valuation, the description of urban and ownership status of the real estate (the object of valuation), construction characteristics, the parameters used for making the valuation, and the conclusion on the defined market value of the real estate. The report should also contain a certain number of photographs of the interior and exterior of the object, in order to illustrate its characteristics.

[83] Official Gazette of FYRM, No. 50/13.

3.4.4 Valuer

3.4.4.1 Regulatory Framework

The Law on Appraisal represents the framework for property valuers in Macedonia.

The Law defines a certified valuer as an individual or a group possessing a license for valuation in a certain field, issued by the relevant Ministry. A valuer is a person who has passed a licensing exam for valuers and is employed by a relevant valuer for the purpose of assessment.

There is a registry of licensed valuers for the territory of Macedonia, which is issued and regulated by the Chamber of Valuers.

3.4.4.2 Education/Qualification

The Law on Appraisal defines that a valuer should possess the following characteristics (Article 3 of the Law): legitimacy, competence, fairness, impartiality, professionalism, independence, autonomy, economy, responsibility, diligence and efficiency.

The valuer takes a licensing exam. The licensing exam can be taken by persons who are citizens of Macedonia, with a permanent address in Macedonia, persons with a university degree, persons who are not banned from performing this activity, persons with at least five years of experience and who have a certificate of completed training for performing valuations in a certain field.

The Law also defines that the valuer is obliged to continue with his/her professional training, to take part in conferences, courses and other types of education in their home country and abroad. The valuer should also attend the annual course for continuing education organized by the Chamber of Valuers in cooperation with the Ministry.

Additionally, the Law defines ethical norms and the code of conduct for the valuers, their obligation to keep information confidential and avoid conflict of interest. The Law specifies ways of behavior and characteristics that valuers should possess, as well as tasks that they should not accept in order to avoid conflict of interest and sanctions applied when valuers do not behave in accordance with rules. This can to a large extent guarantee that valuers will not be biased or coerced by pressure.

3.4.4.3 Use of Valuer Title

The title of valuer in Macedonia is protected by the Law on Appraisal. According to the Law, the Chamber of Valuers of Macedonia should keep a record of authorized valuers. They follow and record changes; therefore, there is one central state registry of valuers. This protects lenders from the risk of hiring an unqualified valuer. Also, the Law defines in detail the ways of obtaining, as well as reasons for revoking, an appraiser's license.

3.4.4.4 External vs. Internal

It is not precisely stated in any legal framework whether credit institutions should employ external or internal valuers. Both internal and external valuers are used by banks in collateral valuation, and this choice is not related to the type of real estate or the value of the potential loan.[84] One of our respondents has replied that assessments required for the needs of a bank should be performed by independent valuers and not valuers employed in banks, because if valuations are performed by the independent valuers one will have the real property valuations as a result.

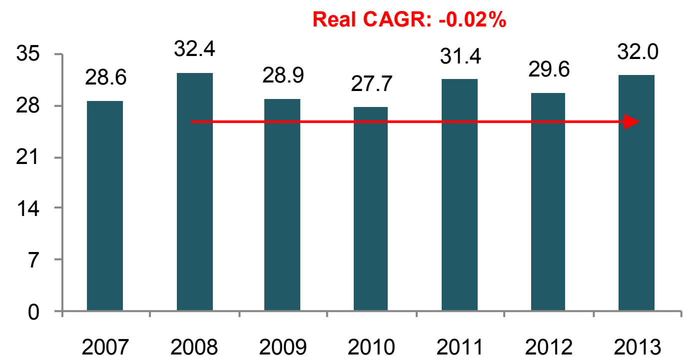
3.5 Serbia

3.5.1 Macroeconomic Overview

Population:	7.2 m (2013)
Currency:	RSD (Serbian Dinar)
Income group:	Upper middle income (WB)

Serbian nominal GDP amounted to EUR 32.0 bn in 2013. Graph 3.13 presents GDP values in current prices in EUR recorded in the period 2007-2013.[85]

Graph 3.13 Serbia: Nominal Gross Domestic Product, 2007-2013 (EUR bn)



Source: IMF World Economic Outlook, October 2014.

Note: Data as of 2013 present IMF estimates.

The global economic and financial crisis has had a significant negative effect on the economy of Serbia. The result is that GDP, after its rapid growth in the pre-crisis period (the average annual growth rate in the period 2002-2008 was 5.0%[86]), has experienced slowed growth or decline in the years since the beginning of the crisis (real growth rates of GDP, as well as other key macroeconomic indicators in the observed period are presented in Table 3.18). The average annual growth rate (CAGR) of GDP in the period 2008-2013 was -0.02%,[87] where in the observed period the GDP's downward trend was observed in 2009 and 2012. The recorded real y-o-y GDP growth rate in 2013 amounted to 2.5%. In 2014 the quarterly values of GDP indicate

[84] This conclusion is drawn from extensive interviewing process with relevant parties in Macedonia. Official data on this issue is not available.
[85] Database is International Monetary Fund (IMF), World Economic Outlook Database (WEO), October 2014.
[86] Calculated as CAGR using IMF data for GDP in constant prices.
[87] Calculated as CAGR using IMF data for GDP in constant prices.

that Serbia is in recession for the third time since 2008, and at the level of 2014 a y-o-y decline of GDP is expected to be of at least 1%.[88]

In the years before the crisis, Serbia had an extremely high CAD, primarily due to a high trade deficit, which was financed by a high influx of foreign capital. The level of CAD after the onset of the crisis has been considerably reduced (Table 3.18) as a result of falling domestic demand on the one hand, and the growth of export (primarily due to export of FIAT cars and restoration of the production capacity of Petroleum Industry of Serbia [NIS]) on the other.

Table 3.18 Serbia: Country's Key Macroeconomic Indicators

Serbia	2007	2008	2009	2010	2011	2012	2013
Population (m)	7.38	7.35	7.32	7.29	7.26	7.20	7.20
GDP real growth rate	5.38%	3.82%	-3.51%	1.01%	1.57%	-1.52%	2.50%
Inflation rate	11.03%	8.85%	6.60%	10.25%	7.00%	12.18%	2.20%
Unemployment rate	18.80%	14.70%	17.40%	20.00%	24.40%	23.10%	21.00%
Current account balance/GDP	-17.77%	-21.71%	-6.61%	-6.78%	-9.13%	-12.28%	-6.54%
General government public debt (EUR bn)	9.94	10.03	10.80	12.70	15.18	18.38	20.77
General government public debt/GDP	34.58%	33.39%	38.07%	46.49%	49.50%	62.42%	65.80%

Source: IMF (World Economic Outlook, October 2014).
Note: Data on population in 2013 present IMF estimates.

Serbia's debit is growing rapidly. External debt is above 80% of GDP (80.6% of GDP at the end of 2013), of which the external public debt amounted to 41.3% of GDP at the end of 2013.[89] The rapid increase in external debt is the result of a considerable state debt in the observed period due to a high fiscal deficit, while the economy and banks largely repay external debt. Total public debt (both domestic and foreign) amounted to EUR 20.8 bn at the end of 2013, accounting for 65.8% of GDP (Table 3.18). The amount of public debt in EUR has more than doubled in the period 2007-2013 (an increase of 31.2 pp). The government has started implementing fiscal consolidation measures, which will be intensified at the end of 2014 and throughout 2015, aimed at reducing the fiscal deficit and ensuring the sustainability of public finances.

Serbia has a very high unemployment rate. In Serbia, more than one fifth of the active workforce is unemployed. Inflation in Serbia until 2013 was above the National Bank of Serbia (NBS) target corridor, whereas after 2013, due to the fall in aggregate demand and decline in prices of agricultural and food products, inflation has been under the NBS target corridor.

Serbia needs to improve its economic environment, which has been largely responsible for the lack of significant improvement/deterioration of macroeconomic conditions after 2008. It also sets a limit on the further growth of economic activity.

3.5.2 Property Market Overview

3.5.2.1 Residential Property Market Overview

According to the Credit Bureau (CB) of the Association of Serbian Banks (ASB), there are currently 94,401 outstanding residential mortgage loans in Serbia. The total sum (value) of the

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[88] Quarterly Monitor (QM) 37, FREN.
[89] QM 37, FREN.

loans is EUR 2,957.9 m. The data on the value and number of outstanding residential mortgage loans for the period from 2006 to September 2014 are presented in Table 3.19. During this period, despite the economic crisis, there was a continual yearly increase in the volume of loans, although from 2010 with a significantly lower rate than prior to 2010.

The largest increase in the number of residential mortgage loans was recorded in 2009, whereas the largest increase in the value of these loans during the observed period (2006-2014) took place in 2008. Cumulative growth of the number of residential mortgage loans was 275% during the observed period (it increased from 25,184 in 2006 to 94,401 in 2014), whereas the value of these loans grew by 377% in the same period (from EUR 620.2 m at the end of 2006 to EUR 2,957.9 m at the end of 3Q2014, see Table 3.19). The increase in the number of residential collateralized loans for the period 2006-2008 (96%) was almost equal to the growth recorded during the period between 2008 and September 2014 (91%). Observing the data on the value of these loans, a significantly higher increase in residential collateralized credit activity was recorded in the two-year period before the global crisis (2006-2008, an increase of 300%), than in the almost six-year period after that (2008-September 2014, an increase of 159%).

Table 3.19 Serbia: Value and Number of Outstanding Residential Collateralized Loans, 2006-2014

	Value (EUR m)	Volume
2006	620.2	25,184
2007	1,235.5	35,957
2008	1,861.0	49,364
2009	2,192.7	71,137
2010	2,620.8	75,730
2011	2,834.7	85,676
2012	2,939.9	92,825
2013	2,899.2	94,013
3Q 2014	2,957.9	94,401

Source: ASB CB.

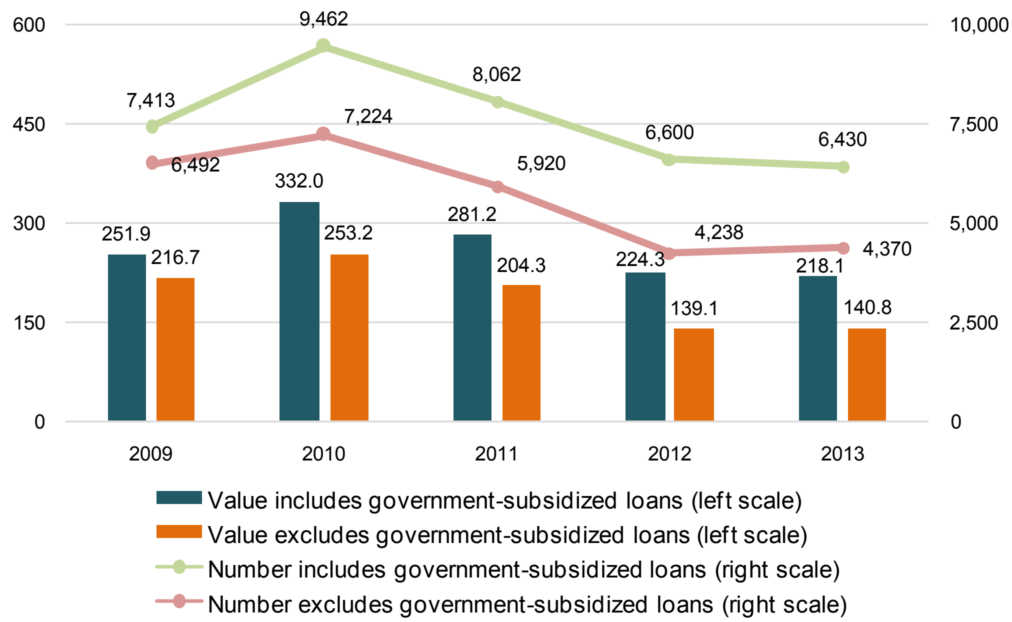
Yearly changes in currently active insured mortgage loan portfolios (data as of October 8, 2014) for the period 2009-2014 in value and in volume, according to the National Mortgage Insurance Corporation (NMIC), are shown in Graph 3.14.[90] Graph 3.14 presents two types of loans: residential mortgage loans, including government-subsidized mortgage loans,[91,92] and those residential mortgage loans that exclude government-subsidized.

[90] There are differences in data of ASB and NMIC, because ASB presents data on all residential mortgage loans, whereas NMIC presents data only on insured loans. Also, data on new loans are presented yearly, but include only those that were still insured as of October 8, 2014.

[91] Government-subsidized residential mortgage loans are home loans with an RS government subsidy for retail clients (a program for the period 2005-2013, with a requirement introduced in 2009 that apartments must be newly built), loans for military professionals, in accordance with the RS Program of Home Loan Subsidies for Military Professionals (which was first introduced in 2008 and is still in force in 2014), and loans for health workers (the program was applied only during 2008). These loans currently make up 21% of the value and 24% of the number of all currently insured loans with NMIC (residential mortgage loans and government-subsidized residential mortgage loans).

[92] The value of government-subsidized loans includes only the value of bank-approved loans.

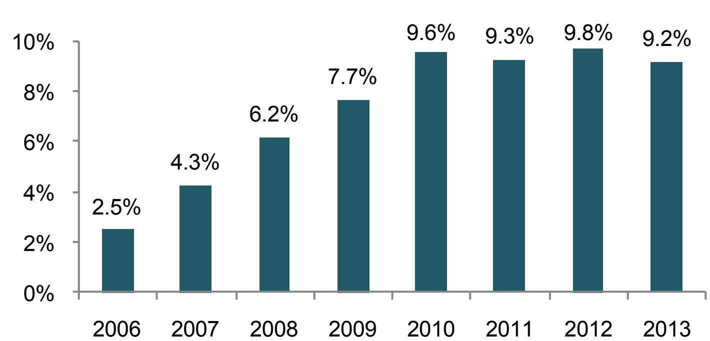
Graph 3.14 Serbia: Value (EUR m) and Number of New Residential Collateralized Loans per Year, 2009-2013



Source: NMIC.
Note: All data present annual values in newly insured loans, but only those loans that are part of an active portfolio, according to the data of NMIC as of October 8, 2014.

The value of outstanding residential mortgage loans as a percentage of GDP was, according to ASB data, 2.5% in 2006. It was followed by rapid growth in subsequent years, reaching a tripled share in GDP at the end of 2009, with a further rise of the residential mortgage loans-to-GDP ratio to a level of above 9% after 2010 (see Graph 3.15). After 2008, the growth is partly due to an increase in the number of outstanding mortgage loans, partly to a decrease in the value of GDP as the consequence of the global crisis (especially in 2009, when GDP shrunk by 3.5%), and partly because of a decrease in the value of RS dinars compared to the euro (since GDP is calculated in RS dinars, and mortgage loans are predominantly euro-denominated). Still, according to these data, the level of residential mortgage loans in GDP stagnated and slightly varied after 2010 at around 9.5%. At the end of 2013, the share of residential loans in GDP was 9.2% (Graph 3.15).

Graph 3.15 Serbia: Share of Residential Mortgage Loans in GDP, 2006-2013



Source: ASB CB.

According to NMIC, the average collateral value of residential loans was EUR 54,652 in 2013. The average for the previous five years was EUR 57,153.[93]

The LTV of outstanding insured residential mortgage loans (including government-subsidized loans), calculated as average value for the period from 2005 to October 2014, is equal to 66.3%. For loans excluding government-subsidized loans, the LTV, calculated as an average for the same time interval (2005 - October 2014), equals 65.7%.[94]

Table 3.20 Serbia: Households According to Dwelling Ownership (Tenure), 2011

	Structure of households	Number of households
Total	**100.0%**	**2,536,714**
Owner	93.1%	2,361,681
Leaseholder of a state dwelling	0.2%	5,073
Leaseholder (of the whole dwelling) in private property	1.6%	40,587
Leaseholder (in a part of the dwelling) in private property	0.2%	5,073
Relationship (living with parents, children, other relatives)	4.3%	109,079
Other	0.6%	15,220

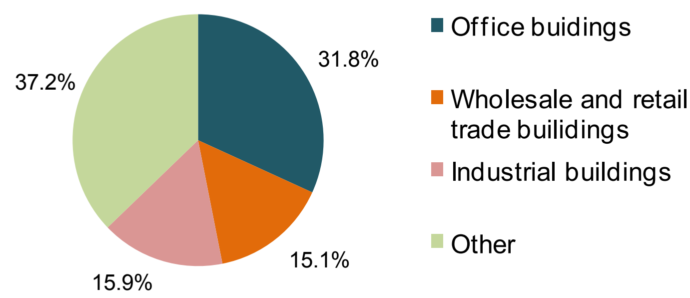
Source: SORS.

According to the data of the Statistical Office of the Republic of Serbia (SORS), the total number of dwellings in Serbia in 2011 amounted to 2,536,714 (Table 3.20). The majority of these dwellings are owner property - 93.1%, i.e., approximately 2,361,681 dwellings. The same percentage - 0.2% of the total number of dwellings, or about 5,073 units - applies to state-rented and partly-rented private property. The percentage of private property that is rented in its entirety equals 1.6% (40,587 units). Of the total number of households, 4.3% are households living with their relatives, or approximately 109,079 units. Other dwellings make up 0.6% of the total, i.e., 15,220 units (Table 3.20).

[93] Data are for all insured loans (including government-subsidized).
[94] Source: NMIC.

3.5.2.2 Commercial Property Market Overview

Graph 3.16 Serbia: Structure of New Non-Residential Properties, 2011-2013



Source: SORS, Statistical yearbook 2014.

Out of a total number of non-residential buildings constructed in Serbia in the period 2011-2013, office buildings constitute nearly one third (31.8%). Wholesale and retail trade buildings represent 15.1%, while constructed industrial buildings represent 15.9% of the total number of completed non-residential constructions in the observed period. We calculated the share of other non-residential completed constructions (37.2%) as the difference between all finished non-residential buildings and constructed office, trade and industrial buildings (see Graph 3.16). Therefore, the category Other includes hotels and similar buildings; traffic and communication buildings; tanks, silos and warehouses; public entertainment and educational institutions, hospitals and other health care institutions; and other buildings not elsewhere classified (non-residential farm buildings, buildings for worship and other religious activities, historic or protected monuments[95]).

3.5.3 Valuation

3.5.3.1 Regulatory Framework

An important law for property valuation is the Law on State Survey and Cadastre.[96] Among other things, this law regulates the valuation of real estate (RE), as defined in Chapter VIII of the above-mentioned Law (Article 149, 150 and 151). In Article 149, the valuation of RE is defined as determining the market value of the immovable property registered in the RE cadastre. Additionally, this part of the Law specifies that the value be determined by mass appraisal,[97] and that evaluation and recording of the value be performed by the Republic Geodetic Authority, which submits temporary data of general assessment to local authorities for an opinion before determining the individual value of the property. There are also a number of other laws that, for

[95] Source: Statistical Yearbook, 2014, pp. 288-289.
[96] Official Gazette of RS, No. 72/2009, 18/2010 and 65/2013.
[97] Property mass appraisal includes a general assessment of property value and determination of the value of individual property based on data from the general valuation (Law, Article 150).

a variety of purposes (taxes, confiscation, expropriation, etc.), define the method of calculating the value of real estate.

In addition to this law, real estate valuation is regulated in more detail by a set of secondary legislation (regulations, rules and manuals) that introduces additional regulations for the process of property valuation in accordance with the purpose. The most recently adopted relevant regulation is the Republic Geodetic Authority Ordinance, “Rulebook on Real Estate Valuation.”[98] The Rulebook defines the procedure, manner and methodology for assessing the value of real estate.

Some important definitions for the valuation of real estate for lending purposes are present in certain NBS regulations, notably decisions in the area of bank supervision. Individual banks additionally define this topic through their internal policies, in accordance with the regulatory framework.

Definitions of a valuer and market value, as well as regulatory treatment of collateral value in bank lending activities, are regulated by NBS decisions governing this area: “Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items,”[99] “Decision on the Capital Adequacy of Banks,”[100] and “Decision on Risk Management by Banks.”[101]

In point 29, subpoint 1 of the “Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items,” it is specified what a mortgage property shall possess in order to be considered adequate collateral.

Collateralized lending in terms of loan loss reserves is based on the same decision. In point 34 of the above-mentioned Decision, loan loss reserves are given for every category of receivables from a borrower (A to E). The important item in the Decision is placed at the end of point 29, where it states that a bank’s receivables secured by adequate collateral may be classified into a category above the category they would have otherwise been classified in.

Capital adequacy regulation is defined in the “Decision on Bank Capital Adequacy.” In point 264 of this decision there is a list of conditions for recognition and determination of the value of real estate property as eligible collateral. In point 52 of the same Decision it is stated which conditions a bank’s exposure secured by RE property (if it is recognized as eligible as defined in the above-mentioned point 264) shall meet so that a more favorable credit risk weight of 35% for the calculation of RWA could be applied. Together with other stated conditions, item number 4 is especially noteworthy where it is stated that exposures or part of an exposure does not have to exceed 75% of the market value of a residential real estate that is the subject of a mortgage.

Therefore, although banks benefit if loans have better and more valuable mortgages attached, reliability and accuracy in RE valuation are of great importance for financial system stability.

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[98] Official Gazette of RS, No. 113/2014.

[99] Official Gazette of RS, No. 94/2011, 57/2012, 123/2012, 43/2013 and 113/2013.

[100] Official Gazette of RS, No. 46/2011, 6/2013, 51/2014.

[101] Official Gazette of RS, No.45/2011, 94/2011, 119/2012, 123/2012, 23/2013 – other decision, 43/2013 and 92/2013.

3.5.3.2 Valuation Basis

Market value is not uniformly defined in domestic legal acts. In the study made by Bozic and Mihajlovic (2014, pp. 14-15), an emphasis is placed on the different definitions of "market value" found in legal documents that have been a part of the domestic legal framework for different areas. This serves as an example of the inconsistency in defining that term, which Bozic and Mihajlovic point out as just one example of the difficulties one can come across when dealing with the topic of the valuation process in Serbia.

The regulations in Serbia do not explicitly prescribe which valuation bases shall be used for RE valuation for lending purposes, and that depends on the type and characteristics of a specific property. The market value is typically used to determine the value of a mortgage attached to a loan for both commercial and residential property,[102] which is in accordance with NBS regulations. Still, for the assessment of the value of certain assets, other valuation bases are also used, such as liquidation value, building value, and mortgage lending value.[103]

The "Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items" provides a definition of the market value of RE in point 2, subpoint 5. The definition is as follows:

"The market value of real estate is the estimated amount for which the property may be sold on the date of valuation, provided the buyer and the seller act voluntarily, knowledgeably, prudently and without coercion; this value shall be transparently and clearly documented and determined by an authorized valuer."

3.5.3.3 Valuation Methodology

Methodologies commonly applied by valuers in Serbia include a sales approach (i.e., comparison), which is most commonly used, together with an income approach (i.e., capitalization) and cost approach.[104]

Relevant regulations in terms of the competence of the National Bank of Serbia do not oblige licensed appraisers to apply certain methodology when making appraisals for lending purposes.

3.5.3.4 Valuation Report

There are no regulations that prescribe a strict form of valuation report for banks. A valuation report's form is largely defined by banks, which have their own valuation report form.[105] Despite the lack of standard in Serbia, reports contain most of the relevant information and explanation on methodology, information about valuers, valuation bases, valued property, information sources, etc. Thus, reports commonly provide some important information for valuers, banks,

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[102] This conclusion has been drawn from an extensive interview process with relevant parties in Serbia. Official data on this issue are not available.

[103] This conclusion has been drawn from the inspection of valuation reports that we were provided with by the banks that participated in our research, as well as from the answers of our questionnaire participants. Official data on this issue are not available.

[104] This conclusion is drawn from an extensive interview process with relevant parties in Serbia. Official data on this issue are not available.

[105] According to participants' answer.

customers and other users of the reports. However, current trends indicate the need for standardization of reports with good international practice, which clearly defines the standard form.

3.5.4 Valuer

3.5.4.1 Regulatory Framework

In Serbia, the valuers' profession is to certain degree regulated by the Law on Court Experts,[106] but there is a lack of regulations specifying the requirements that an individual must meet in order to carry out this work.

According to NBS rules, the “Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items” gives the definition of an authorized valuer (in point 2, subpoint 4):

“An authorized valuer is a court expert of relevant profession, a legal entity established to perform expertise activities in accordance with the law on requirements for the performance of expertise activities or an authority which, pursuant to the law governing tax procedure and tax administration, is competent for conducting tax proceedings; this person shall not be a person related to the borrower in the manner set forth by the Law on Banks and shall not be involved in the process of lending approval or sale of real estate.”

Therefore, from the standpoint of the regulations governing banking operations, in addition to the appraisals performed by the court experts of appropriate profession and legal entities established for performing expertise in line with the Law on Court Experts, valuations made by a competent body for the conducting of tax procedure are also acceptable. Court-sworn experts in Serbia are appointed by the Ministry of Justice.

The Mortgage Credit Directive (MCD) prescribes customization and standardization and the profession of valuers:

“Member States shall ensure that internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so that they can provide an impartial and objective valuation, which shall be documented in a durable medium and of which a record shall be kept by the creditor.”

In Serbia there are two associations of appraisers that are members of TEGoVA: the National Association of Valuers of Serbia (NAVS) and the Association of Court Experts L.T.D. Belgrade (USVB). They are working on achieving compliance with international valuation standards to the highest possible extent.

3.5.4.2 Education/Qualification

According to international standard regulations (IVSC, TEGoVA, etc.), a valuer is obliged to possess adequate education, relevant work experience, professional knowledge and practical experience in a particular field. Besides education and qualifications, it is especially emphasized that this

> “Generally, the practice of valuer (in Serbia) is performed by civil engineers with a background in construction and architecture.”
>
> *NBS*

[106] Official Gazette of RS, No. 44/2010.

profession implies behavior in line with ethical and moral principles, i.e., that a valuer is obliged to comply with the code of conduct and ethics.

In Serbia, the Law on Court Experts defines the necessary criteria for an individual to fulfill, in addition to the general legislative requirements for work in state institutions in order to be appointed as court expert,[107] such as:

- to have an adequately acquired university education;
- to have at least five years of relevant work experience;
- to possess expert knowledge and practical experience in a particular field; and
- to be worthy of the work requirements of a court expert.

Exceptionally, a court expert may be a person who has at least completed secondary school, if there are not enough experts with a completed university education for a particular area of expertise. Maintenance of the Register of Court Experts is in the jurisdiction of the Ministry of Justice. This register is publicly available on the Ministry of Justice website.

A legal entity may carry out expertise if it meets the following requirements:

- that it is registered in the register of the relevant authority for expertise in a specific area; and
- that the persons employed within that legal entity are registered in the Register of Court Experts.

Professional services requiring the expertness of sworn experts can also be performed by public authorities, provided that the condition for this expertizing process is met, as well as by scientific and technical institutions.

In compliance with international standards, valuers must participate in an ongoing development program for improving their performance. For that reason, internationally recognized certificates are usually issued for a limited number of years. Additionally, it is defined by standards that an association of valuers is obliged to organize training and other forms of education for its members (see for example the TEGoVA "Blue Book," p. 161). The NAVS organizes ongoing education and continuous training in this area for valuers in Serbia.

3.5.4.3 Use of Valuer Title

The title of valuer is not protected in Serbia, because of the lack of specific regulation about this profession.

On the website of the Ministry of Justice one can find the Registry of Court Experts. Some valuers in Serbia possess internationally recognized titles (FRICS, CRE, REV, ASA, etc.) or do valuations under the auspices of an organization.

Valuers in Serbia are commonly members and a

> "As previously stated, the qualified valuer must be a court-appointed expert and as such is regarded as a qualified valuer. Additionally, employees of highly reputable real estate valuation companies when acting as agents of those companies are deemed trustworthy as well."
>
> *NBS*

[107] Law on Court Experts, Article 6.

part of one or a number of Serbian organizations of valuers: USVB, NAVS, Vojvodina Association of Court Experts, Novi Sad, Association of Valuers of Serbia, and others.

The Belgrade Association of Court Experts and the National Association of Valuers of Serbia (NAVS) are TEGoVA members. The NAVS was upgraded to "REV AWARDING MEMBER" by TEGoVA in 2012, which enables NAVS to award REV (Recognized European Valuer[108]) certificates to its accredited members. At present there are 36 valuers with the REV title in Serbia.[109]

3.5.4.4 External vs. Internal

According to the regulations of the NBS, a bank may engage either an internal or external valuer for collateral valuation. An appraiser may be a bank employee, provided that the appraiser is a court expert without any association with the debtor, pursuant to Article 2, paragraph 25 of the Banking Act, and excluding their possible involvement in the process of loan approval or real estate sale. In practice, banks usually outsource a valuer who is also a court expert.

[108] REV is defined in the TEGoVA "Blue Book," part 4.4, p. 46.
[109] Lists of Serbian REV valuers are available on the following link:
http://www.tegova.org/en/p48f7266103340/?regtma=t506d95630975f&action=register.search&regzoeksubmit=1#result

4 Main Challenges and Weaknesses in the Region and by Country

Weak practices of collateral valuation and lack of institutional strength in the Balkans may hamper access to finance and further development of collateralized lending, financial deepening of regional economies and, most importantly, the potential higher rates of economic growth very much needed for this region in order to start catching up with the rest of the transition economies and the EU.

In this section we will describe the weaknesses of imprecise collateral valuation and collateralized lending in the Balkans and propose tailor-made measures for every country in order to improve this important institutional segment.

4.1 Weaknesses of Collateralized Lending in the Balkans

4.1.1 Weakness 1

The first obvious possibility is that imprecise collateral valuation is recognized as an unacceptable risk for the bank. In terms of a bank's ability to absorb credit risk, unreliably valued collateral may be treated as an unacceptable credit risk mitigant, since the bank may not be in a position to realistically calculate the amount of loss in the situation of a borrower's default. By such a credit risk assessment, the potential borrower may be perceived as being of unacceptable credit quality and denied the requested loan. This has a direct impact on the denial of access to finance and lower economic activity.

Imprecise collateral valuation	→	*Unpredictable loss given default*	→	*Bank refuses to extend loan*	→	*No access to finance*	→	*Lower GDP*

4.1.2 Weakness 2

An alternative to Weakness 1 is the situation in which the bank does not reject the client, but accepts him or her as a borrower of lower credit quality and therefore with a higher interest rate to pay. Still, the higher interest rate deters borrowing and therefore lowers access to finance, but also increases the average interest rates of borrowers and the likelihood of loans becoming non-performing. This not only reduces the potential GDP, but also increases the risks in the lending bank and risks of the financial system, and may pose a risk to public finance in the situation that taxpayers' money is needed to bail out the banking system.

Imprecise collateral valuation	→	*Imprecise prediction of loss given default*	→	*Bank grants loan with higher interest rate*	→	*Lower access to finance and more potential NPLs in the future*	→	*Lower GDP, higher systemic risk and potential bailout fiscal cost*

4.1.3 Weakness 3

Again, an alternative to Weakness 1 is the situation in which the bank does not reject the client, but accepts him or her as a borrower and demands an additional credit risk mitigant. This increases the total cost of borrowing, again lowering access to finance and increasing the likelihood of a loan becoming non-performing. And again, this leads to lower GDP and higher systemic and fiscal risks.

Imprecise collateral valuation	→	*Imprecise prediction of loss given default*	→	*Bank grants loan with lower LTV imposed by bank*	→	*Rise in total cost of borrowing*	→	*Lower access to finance and more potential NPLs in the future*	→	*Lower GDP, higher systemic risk and potential bailout fiscal cost*

4.1.4 Weakness 4

Another weakness of vague collateral valuation is that the bank may grant a loan but more conservatively impose a lower loan-to-value (LTV) ratio. In this way, the bank achieves overcollateralization as a well-known method of reducing credit risk exposure, but decreases the total loan amount available on a collateral, thereby reducing access to finance and potential GDP.

Imprecise collateral valuation	→	*Imprecise prediction of loss given default*	→	*Bank grants loan with lower LTV imposed by bank*	→	*Lower access to finance*	→	*Lower GDP*

4.1.5 Weakness 5

Without precise collateral valuation, the regulator may be more restrictive, and therefore increase the cost of financing. Namely, if there is uncertainty about the loss in the event of a borrower's default because of imprecise collateral valuation, the regulator may impose higher required loan loss reserves (LLRs) on a bank for such a collateralized loan. These higher LLRs pose an additional cost to the bank and induce a rise in interest rates. Again, this lowers access to finance and consequently the GDP.

Imprecise collateral valuation	→	*Imprecise prediction of loss given default*	→	*Regulator imposes higher loan loss reserves*	→	*Rise in interest rates*	→	Lower access to finance	→	Lower GDP

4.1.6 Weakness 6

Another regulatory response to imprecise collateral valuation may be for a regulator to impose lower LTV for collateralized loans if they are to be treated as a lower-risk asset with lower-risk weights when calculating risk-weighted assets (RWAs) and capital adequacy ratio (CAR). This potential measure again reduces the loan amount per pledged asset, decreasing access to finance and potential GDP.

Imprecise collateral valuation	→	*Imprecise prediction of loss given default*	→	*Bank grants loan with lower LTV imposed by bank*	→	*Lower access to finance*	→	*Lower GDP*

4.1.7 Weakness 7

If the system of mortgage lending is operating in a way that the first mortgage creditor to claim the mortgage right over the pledged asset is the so-called “first in order mortgage lender” irrespective of the loan amount against the value of the collateral, then every other loan against the same collateral is treated as a riskier “second in order mortgage” with a higher interest rate, reducing access to finance and potential GDP. If mortgage lending were precise, all the creditors and their collateralized loans up to a certain LTV limit could be treated as a “first in order mortgage lender,” thereby decreasing interest rates, increasing access to finance and potential GDP. In other words, more precise collateral valuation would enable the system to be able to produce much more space for “first in order mortgage lending”, without deterioration in a position of any existing borrowers or increase in risks.

Imprecise collateral valuation	→	*Only first mortgage lender is “first in order mortgage lender”*	→	*Every other loan against same collateral is “second (third, etc.)in order mortgage lender”*	→	*Rise in interest rates*	→	*Lower access to financ e*	→	*Lowe r GDP*

4.1.8 Weakness 8

If there is not only an imprecise collateral valuation, but also a moral hazard in collateral valuation and a bias towards overvaluation of collateral, serious systemic risks may arise. Overvalued collateral leads to higher loss in the event of a borrower’s default. This higher loss would be realized against a lower LLR and lower capital adequacy ratio than would be the case if the collateral were valued precisely. This increases bank risk, systemic risk, and potential bailout fiscal costs.

Overvalued collateral	→	*Higher loss given default than predicted*	→	*Lower LLR and lower bank capital than necessary with higher bank risks*	→	*Higher systemic risk*	→	*Potential bailout fiscal costs*

4.1.9 Weakness 9

Collateral overvaluation can have yet another negative impact. Namely, overvalued collateral may induce banks to keep the overvalued loan and its overvalued collateral on the bank books. This may artificially increase bank capitalization and bank profits, motivating further delay in the process of bank balance sheet cleansing, thereby delaying a supply of fresh loans. This directly lowers access to finance and potential GDP.

Overvalued collateral	→	*Keeping overvalued loan and collateral on the bank's books*	→	*Artificially better bank capitalization and bank profits*	→	*Delayed cleansing of bank balance sheets and delayed supply of fresh loans*	→	*Lower access to finance*	→	*Lower GDP*

More precise collateral valuation in the Balkans could decrease or eliminate all of the mentioned weaknesses in collateralized lending and would improve regional access to finance, growth prospects and/or financial stability.

4.2 Countries' Specific Recommendations

4.2.1 Albania

Albania is one of the Balkan countries having taken certain positive steps in improving the collateral valuation process in the country. The valuers profession is relatively solidly protected and regulated in newly-enacted government rules.

Primarily, the area for potential further improvement is related to adequate valuation methodology and the way of reporting, as well as supervision of valuers in their professional conduct. Valuation reporting is, at this stage, still without full standardization. Currently there are differences in valuation reports between banks, since they apply internal practices, different methods of evaluation, and different forms of the report.

Currently there is a solid start in the creation of reference prices in the housing market in Albania. A database has been formed by the National Housing Agency (NHA), and data are available for open market housing. Still, for determining the reference price, the NHA does not use any approved methodology.[110] Taking into account that the Registry of Real Estate in Albania uses these data for calculation of tax on property transfers, and other entities for different financial and compensation purposes, there is an obvious need for standardization and better transparency of the methodology used. Therefore, there is lack of databases that will (1) be available to all stakeholders and that will contain real data, based on sound methodology (to include different variables in RE appraisals, not just current average market price); (2) be transparent and modified in accordance with characteristics of the property and purpose of

[110] Thanasi (2014).

valuation: (3) be up-to-date; and (4) include dynamics in the process of valuation of RE property.

Besides this, there is a relatively visible absence of a leading national institution with a clear mandate to regulate a collateral valuation process, i.e., to lead and to be responsible for a reform agenda in this field.

Therefore, in terms of development of precise collateral valuation, Albania would most probably benefit the most by further developments in the following areas:

- valuation methodologies;
- standardization of Valuation reports,
- supervision of Valuers;
- databases for real estate valuation.

Additional improvements in the area of collateral valuation are needed as well as more standardization and compliance with international regulation, trends and expectations (defined in MCD from 2014) since Albania is an EU candidate country and needs to harmonize standards and practices in this field with the EU.

4.2.2 BiH

BiH is, one could say, at the very beginning of the process of the creation of a credible collateral valuation system. BiH could benefit in the areas of:

- development of a legal framework for collateral valuation;
- development of sound methodologies;
- development of a system of education and certification;
- development in a system of licensing, and supervision of valuers;
- creation of appropriate databases for competent valuation.

Ideally, this should be done in a standardized way across the entities of BiH. Finally, access to finance could be improved through better regulation of collateralized lending by banking regulators.

4.2.3 Kosovo

Overall, legislation and regulation in Kosovo are quite weak. Trends in the country and region related to financial services and financial growth dictate the necessity for strong legislation, rules and methodology in the field of collateral valuation. The association of valuers exists but the overall framework for a credible valuation process is still developing. Kosovo would most probably benefit in the areas of:

- development of legal framework for collateral valuation;
- development of sound methodologies;
- development of a system of education, and certification;

- further development of a system of licensing, and supervision of valuers.

In addition, the creation of appropriate databases for competent valuation is also necessary. Finally, regulation of collateralized lending could be further developed in order to support easier access to finance.

4.2.4 Macedonia

Property valuation in Macedonia is relatively well regulated. Still, there are some weaknesses and gaps remaining. As in the rest of the Balkans, the lack of good databases for conducting advanced valuation techniques hampers progress in the area. Apart from the Public Revenue Office, no other institution has property data to be used. Therefore, Macedonia would most probably benefit in the area of collateral valuation if:

- there were one comprehensive set of databases and one central registry for RE, which would enable easier and more reliable RE appraisals in Macedonia;
- there would be a further development in the area of supervision of valuers.

However, to a large extent Macedonia has effectively regulated the valuation process and valuation profession compared to other Balkan countries. Still, additional improvements in the area of collateral valuation are needed since Macedonia is a country that is on the way of joining the EU and needs to fully harmonize standards and practices in this field with international practice.

4.2.5 Serbia

Regulation of real estate valuation for lending purposes in Serbia has a lot of room for improvement. We can point out the following shortcomings as the main ones:

- the lack of standardization in regulations;
- the lack of a centralized set of real estate databases; and
- the need for improving the process of education, certification, licensing and supervision of valuers.

Therefore, we recommend that improvement should be made addressing three essential problems.

Firstly, it is our view that Serbia should have a standardized valuation procedure. The consequences of gaps and weaknesses in regulation have a direct effect on the RE valuation procedure, making it slow and partly unreliable. From a macroeconomic perspective, weak regulations put a limit on, and therefore reduce, potential banking-system activity in Serbia and hinder Serbian GDP growth. In particular, as defined in the MCD, a country that is in the EU, as well as a country that is on its way to joining the EU like Serbia, should harmonize their standards in this field with international practice.

Secondly, it is our view that Serbia should have a unique set of RE databases. The lack of centralized databases containing data important for RE valuation leads to inadequate valuations and the inability of tracking the value (by type, by geographic location, using the index of RE value on a state level, etc.). Currently, only the NMIC provides data and calculates an index, but only for residential mortgage loans. Creating a centralized database of all RE properties in

Serbia that will incorporate all RE transactions, as well as their appraised values, would help valuers to improve accuracy in valuation.

Thirdly, it is our view that Serbia should have better-defined criteria for the licensing of valuers, as well as more standardized procedures and educational requirements. Therefore, standardization in the area of education and licensing within the valuers profession is needed to produce a higher number of competent and credible professionals in this field.

In addition, full standardization of valuation reports and a clear mandate for the supervision of valuers, with a goal of preserving and improving the quality of valuations and the profession of valuers, is an important step very much needed for the country.

5 Detailed Programming of Actionable Recommendations for Targeted Regional or Bilateral Follow-Up Activities

5.1 Thorough Reform Agenda on Collateral Valuation in the Balkans

Balkan countries need to develop their collateral valuation standards in line with international standards in this area (See 8.1 Appendix for an overview of International Standards in Collateral Valuation). For a well-functioning system of collateral valuation for lending purposes in the Balkans it is important to significantly improve the accuracy and quality of collateral valuations (especially real estate). There is an obvious need to establish trust and confidence in valuers and their valuations both among the lenders and borrowers, but also among the regulators and the general public at large. If we want to see a substantial and long-lasting increase in collateral valuation credibility and better access to finance as a result in the Balkans, in our view it is important to achieve results in several important segments:

- Standards of valuers' professional practice and conduct;
- Competence of valuers;
- Licensing and supervision of valuers;
- Databases for precise valuations;
- Adequate regulatory treatment of collateralized lending.

5.1.1 Standards of Valuers' Professional Practice and Conduct

These standards need to be consistently applied to achieve relatively uniform expectations of valuer performance. There has to be a designated institution (an independent institution, professional association, or government institution) dedicated to achieving and maintaining these standards, and a binding document (a law, bylaw, or other document) that clearly defines the valuation standards or an institution that has a delegated right to produce them.

Valuation standards should serve as a benchmark of good practice.

In a broad sense, these standards, among other things, should include clear definitions, a code of professional ethics and conduct (including responsibilities, disclosure, conflict of interests, etc.), valuation methodologies, a description of how valuation competence is obtained, demonstrated and documented, the licensing and supervision of the valuers profession, and the standardized structure of a valuation report.

Valuation methodology should be established as an attainable, sophisticated set of valuation techniques to be used to perform collateral valuation. It should be set in accordance with the availability of data and the achievable level of competence among the valuers profession in the short run. Valuation methodologies should evolve through time in accordance with professional and methodological advancements and data availability, but also as a result of the back testing of performed valuations, especially if valuation of collateral is conducted with an aim to produce a mortgage lending value, i.e., “The value of the property as determined by a prudent assessment of the future marketability of the property taking into account long term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property."[111]

As mentioned, there has to be an institution dedicated to the task of producing, achieving, maintaining, and improving valuation standards. This institution can be a professional association if it has the strong professional and publicly-recognized long-term credibility to serve as a self-regulatory organization. This, however, is seldom the case in the Balkans.

A viable alternative is to create an institution with a legal mandate to produce, achieve, maintain, and continuously improve national valuation standards. An additional possibility, sometimes perhaps more practical, is to delegate this task to an existing government institution or a supervisor, i.e., the central bank or an existing agency. Whatever the choice in the Balkans, institutional credibility and long-term commitment are essential.

WHAT	**HOW**
Adopt a legally-binding document regulating collateral valuation	a. Enact a by-law of the central bank, government, etc. b. Enact a specific law
Enact standards of valuers' professional practice and conduct	a. Defined by a legally binding document b. Produced by an independent institution designated by a legally binding document c. Produced by a government institution designated by a legally binding document d. Produced by a professional association designated by a legally binding document
Designate an institution dedicated to achieving, maintaining and developing standards of valuers' professional practice and conduct	By a legally binding document delegate this responsibility to: a. An independent institution b. A government institution c. A professional association

5.1.2 Competence of Valuers

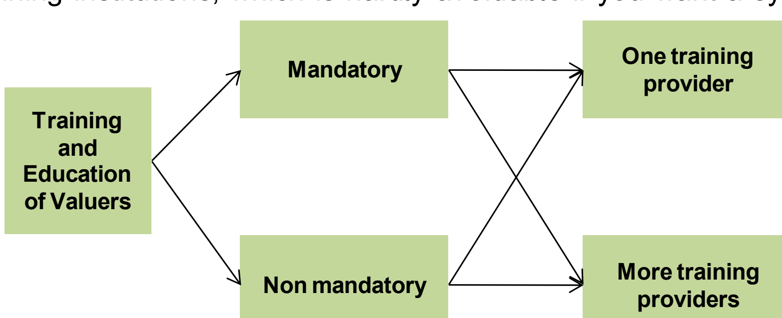
Naturally, a good definition of the collateral valuation system through professional valuation standards is an imperative first step. The second step needs to be to develop a competent profession, i.e., to increase the knowledge of valuation amongst the existing valuers, and to thoroughly develop valuation competence among the newcomers in the industry. This needs to be done in a credible way, with high international standards from the outset of the process, and with a full commitment to resist pressures from stakeholders potentially interested in the dilution of high professional standards in the valuers profession.

[111] TEGoVA, European Valuation Standards 2012, 7th Edition, p. 40.

A body of knowledge in line with high international standards and data availability should be the first step in building competence. This could be done with the support of local and international experts and/or a strong local valuers association, and facilitated with international assistance. The body of knowledge needs to be defined in such a way to create a necessary knowledge base for the precise implementation of advanced valuation methodologies in line with international standards. Future valuers need to be knowledgeable in order to understand advanced valuation techniques and capable of applying them in a uniform way. The definition of a body of knowledge needs to be accompanied by relevant suggested literature (probably mainly international). Both the body of knowledge and suggested literature need to be periodically updated in keeping with the evolvement of international valuation competence and available national databases.

WHAT	HOW
Define the body of knowledge and a list of suggested literature	Jointly developed by a supervisor of valuers (e.g., central bank) in cooperation with a professional association, academic educational institution, or independent institution formed by a legally binding document

The training and education of valuers is a very important element in this system. Despite the fact that training and education can be left to individual candidates (as is the case with some international professional exams),to try to study the suggested literature for the purpose of acquiring the defined body of knowledge, it is important to offer training courses to potential candidates. However, it is important to avoid conflict of interest situations in which the institution providing a professional license at the same time has defined the body of knowledge and organizes training courses for a fee, and/or sells its own publications as required literature. These situations must be avoided, since, as a rule, they lead to the deterioration of professional knowledge and standards of conduct. Therefore, training courses should be available, but perhaps not mandatory, especially if the body of knowledge and exams are kept institutionally independent of training. Educational institutions should be free to offer courses in collateral valuation (preparation courses for a valuers exam) for a fee, for interested candidates who want to attend such courses, but these institutions should not be involved in exams, certification or licensing of valuers. In this way, it would potentially be easy to avoid conflict of interest arising from keeping training for a fee and exams under the same institution. In addition, in this way it would potentially be relatively easy to avoid the burdensome and complicated process of licensing of training institutions, which is hardly avoidable if you want a system with mandatory



training that is not monopolized by the institution that holds the exams and certifies valuation knowledge.

Mandatory training of potential valuers before the exam creates, most probably, conflict of interest in a system with one training provider. In a system of mandatory training with multiple training providers, it is hard to avoid the burdensome process of licensing of training institutions. Therefore, in the Balkans, it might prove to be more practical not to insist on mandatory training and to allow one or more training providers to offer their courses to potential candidates for a fee. Candidates should also be free to acquire the literature of their choice from the list of suggested literature.

WHAT	HOW
Provide non-mandatory training and education	a. Exclusively by a professional association, government institution or independent institution b. Non-exclusively by multiple competing training and education providers

Exam and certification of knowledge has to be conducted without reference to the educational institution providing training (if any), and without reference to literature used in exam preparation. The exam needs to be held strictly by an institution separated from the training of valuers or the publication of literature in the field of valuation. Passing the exam should lead to issuance of a certification of knowledge. The exam and certification of knowledge can be conducted by a strong professional association, supervisor, or other government institution, or, possibly, could be delegated to a reputable academic institution. In the Balkans, however, a credible government institution (an existing supervisor, central bank, etc.) could prove to be a wise and practical choice. In any case, the exam and certification of knowledge should be separated from the licensing of valuers. Unlike the certification of knowledge, the license should be suspendable and revocable.

WHAT	HOW
Conducting of exam and issuance of certificates of knowledge	a. Supervisor (e.g., central bank) directly or subcontracting with an academic institution b. Independent institution directly or subcontracting with an academic institution c. Professional association

5.1.3 Licensing and Supervision of Valuers

In order for those who know how to value collateral to be in a position to conduct collateral valuation for financing purposes, valuers should be licensed. Broadly speaking, the license of valuers could be acquired by certificated knowledge, proof of professional conduct, and experience (if required), but needs to be maintained by proof of continuous education and impeccable professional conduct.

Publishing a professional code of conduct of valuers is not enough to maintain a high level of professional competence and ethics among the licensed valuers. It is important to supervise the profession. There are natural synergies in a system in which both the licensing and supervision of professional practice and conduct are done by the same institution. Again, in the Balkans, this could be done by an existing government institution (central bank, ministry, etc.). At this stage, most professional associations seem to lack the strength and sufficient integrity needed to be delegated with this task.

The supervisor should be easily accessible by banks, bank clients, sellers and buyers, valuers, and all other interested parties. The supervisor should focus on several important elements:

- sample performed valuations and compare them to the results of a required methodology;
- assess the adequacy of lender quality control practices concerning valuer performance and compliance with professional standards;
- investigate claims of professional misconduct of a valuer reported by banks, bank clients, sellers and buyers, and all other interested parties; and
- investigate valuers' reports of pressure and intended influence with an expectation of an imprecise collateral valuation.

Supervision of professional conduct may lead to fines, license suspending, permanent license revocation, and court procedures. The supervisor could maintain a public list of available licensed valuers for collateralized lending purposes.

WHAT	HOW
a. Issuance of valuer's license b. Supervision of valuations c. Maintenance of a public list of licensed valuers	a. Conducted by an existing supervisor (e.g., central bank, agency, ministry) b. Conducted by an independent institution c. Conducted by a professional association

The supervision of valuers is essential to ensure independent and unbiased collateral valuations.

5.1.4 Availability of Relevant Databases for Precise Valuations

In order to apply valuation methodologies, it is necessary to provide adequate databases for quality collateral valuation. A credible institution needs to be in charge of gathering relevant information into databases as well as of providing for their accuracy and accessibility. In the Balkans, it is essential to eliminate the almost omnipresent element of tax avoidance in official data on real estate transactions.

Not only should databases be accessible, but inquiries should be affordable in order to keep the transaction costs of collateralized lending low.

Precise data input is vital for the output of all market-based valuation techniques. If data is unreliable or nonexistent, valuation is less precise and the cost of financing is elevated. It is important to gather the salient information of completed transactions into databases and to make them available to valuers for valuation purposes. In addition, other information important in estimating net cash flows, discounting rates, and volatilities has to be gathered from other sources. As a rule, such information, and professional organizations dedicated to gathering it, still do not exist in the Balkans. Therefore a catalytic institution with integrity (e.g., central bank) should be involved in order to start a viable set of databases for collateral valuation purposes and give an impetus to database development. Naturally, collected data contained in the databases should be depersonalized to preserve and protect the confidentiality of information.

Existing institutions with available data should cooperate in this mutually beneficial effort in order to avoid cost and confusion and enhance the quantity and quality of data available for use by valuers, in order for them to enhance the accuracy and credibility of their valuations. Databases with quality data would enable more accurate mass generic real estate appraisals with valuation adjustments for specific real estates.

WHAT	HOW
Create a set of databases relevant for precise collateral valuation	a. Central bank (or other government institution) in cooperation with other institutions in possession of relevant data (cadastre, tax authority, mortgage insurance institution, bank associations) b. Independent institution or a professional association in cooperation with other institutions in possession of relevant data (cadastre, tax authority, mortgage insurance institution, bank associations)

5.1.5 Adequate Regulatory Treatment of Collateralized Lending

In order to enhance access to finance after improvements in collateral valuation for lending purposes, the regulatory burden could be adjusted as a loss, given that default in banks is less uncertain. This means that current, relatively strict regulation concerning collateralized lending can be eased, since the banking risks decrease as a consequence of more precise collateral valuations. As a rule, this has a direct impact on the decrease in the average cost of borrowing and increase in access to finance and GDP growth prospects.

The regulatory treatment of collateralized lending can be adjusted in several areas currently present in bank regulation in the Balkans.

Risk-weighted assets and capital adequacy ratio are both influenced by collateralized loans**.** According to the Basel standards, collateralized loans have a certain risk weight attached to them when producing an amount of risk-weighted assets in a bank. This is done for the purpose of capital adequacy calculations, i.e., calculation of the minimum amount of capital that needs to be held by a bank. In addition, a collateralized loan to be treated with such a (reduced) risk weight must fulfill certain criteria, one of which, as a rule, is a loan-to-value ratio. Both of these regulatory elements in collateralized loans treatment (risk weight and loan-to-value) could be reassessed and potentially adjusted accordingly in a situation of increase in credibility and precision of collateral valuation.

Loan loss reserves are different for collateralized loans. For the purpose of setting aside an amount of expected potential loss on a specific loan, supervisors often impose loan loss provisions in line with the quality of a borrower and attached risk mitigants (collateral being one of the most frequent). Collateralized loans, due to the value of collateral, are often treated more favorably and in a higher loan category with less loan loss provisions. Again, for the collateralized loan to have such a regulatory treatment, it must fulfill certain criteria, one of which, as a rule, is a loan-to-value ratio. Again, both of these regulatory elements in collateralized loans treatment (loan category and loan-to-value) could be reassessed and potentially adjusted accordingly in a situation of increase in credibility and precision of collateral valuation.

Value of collateralized NPLs in bank balance sheets is important. Due to the frequently present overvaluation of collaterals, some regulators impose a certain dynamics of decrease in collateral value (gradual timely declining in book value of collateral) attached to banks' NPLs. This is done in order to motivate banks to clean their balance sheets (conduct the foreclosure and sale of real estate assets), since in keeping the collateralized NPLs with overvalued collaterals banks may potentially hide some losses and artificially improve their financial performance. Here also, this regulation could be reassessed and potentially adjusted accordingly in a situation of increase in credibility and precision of collateral valuation.

Treatment of a "first in order mortgage lender" is also potentially influenced by collateral valuation. Currently, only the first according to the time of notation of pledge over collateral is treated as a "first in order mortgage lender" that has priority to be repaid in a foreclosure process. Therefore, the "first in order mortgage lender" bares less risk and can offer lower interest rates. If the collateral valuation is more credible and precise, all lenders up to a certain loan-to-value level (e.g., 70%) could be treated as a "first in order mortgage lender" and therefore decrease the average cost of borrowing from the banks.

WHAT	HOW
Adjustment in regulation of collateral lending that will decrease cost of borrowing and increase access to finance and GDP growth prospects.	Central bank (or a bank supervision agency) can amend their regulation and relax the requirements concerning collateralized loans in the area of risk weights, loan-to-value ratios, loan loss reserves categories and other rules.

5.2 Potential Areas of Regional Follow-Up Activities

There are a number of potential regional activities that could be conducted in the Balkans concerning collateral valuation.

Regional awareness of the issue should be raised. It is clear that it is not realized in all of the concerned countries and by all of the stakeholders how important precise collateral valuation is for an increase in access to finance and economic growth. This issue could be addressed with sequence of regional events. These could take the form of regional round tables on collateral valuation. Another way to approach this issue is through a regional conference, or a regional meeting of central bank governors with the special discussion topic of collateral valuation and its impact on credit growth, access to finance and economic growth in the Balkans.

Regional approach to standards of valuers' professional practice and conduct can prove to be important. It would be very useful if certain common attitudes were taken concerning valuation standards. Should the valuation standards be nationally developed, or taken from a common international source (TEGoVA, RICS, IVSC, etc.)? Who would be charged with the task of maintaining and developing valuation standards? What would be the role of existing supervisors, and could the central banks play a more prominent role concerning valuation for financing purposes (supervision, list of valuers, databases)? Is certification detached from licensing, and what level of information-sharing is regionally adequate for supervisors of valuers? Broad common directions in this area would be beneficial to overcoming the problem of so-called "regulatory arbitrage" and would also be beneficial to higher regional financial stability.

Regional standards in banking regulation concerning collateralized lending are important in order to avoid regulatory arbitrage for cross-border banking transactions. This is important as we speak, but also should be tied to a regional increase in precision of collateral valuation systems. Many of the banks operate regionally, and loans, including NPLs, could potentially be traded within the region's banks. In addition, companies are eligible for cross-border loans and should be addressed by the banks with similar regulatory requirements. All of these elements suggest that there is a need to try to converge in the Balkans in terms of banking regulation concerning collateralized lending.

Regional foreclosure standards are another important area. Differences in foreclosure in various regional countries can produce different lending risks in collateralized lending, and therefore, different regulatory treatment by the banking regulators and supervisors. Simple and effective foreclosure standards would be beneficial to all the Balkan countries, and without them, benefits of increased credibility and precision in collateral valuation would be diminished.

Regional certification and licensing of valuers with mutual recognition can be one of the regional goals in a developed, stable state of the valuers profession in the Balkans. At the beginning, at least establishing clear rules for conducting valuations in another country would be a solid step toward increasing professional mobility and competitiveness in the collateral valuation market.

5.3 Potential Areas of Bilateral Follow-Up Activities

1	**Standards of valuers' professional practice and conduct**	Full implementation: BiH, Serbia, and Kosovo Assessment and possible amendments: Macedonia and Albania
2	**Competence of valuers**	Full implementation: BiH and Kosovo Assessment and possible amendments: Macedonia, Albania, and Serbia

3	**Licensing and supervision of valuers**	Full implementation: Albania, BiH, Kosovo, , and Serbia Assessment and possible amendments: Macedonia
4	**Availability of relevant databases for precise valuations**	Full implementation: BiH, Kosovo, Macedonia, and Serbia Assessment and possible amendments: Albania
5	**Adequate regulatory treatment of collateralized lending**	Assessment and possible amendments: Albania, BiH, Kosovo, Macedonia, and Serbia

After the conducted analyses of the region, it is relatively clear that access to finance in the Balkans is not limited in terms of availability of financial institutions or financial resources. The limitations arise mostly from the incapacity of companies (especially SMEs) to decrease their credit risk perceived by the banks, and that is crucial in order for them to gain access to finance on relatively favorable terms and increase their economic activity. In that respect, precise collateral valuation and government development support may substantially improve the profile of a credit borrower in the Balkans.

Therefore, more precise collateral valuation and effective public development programs could prove to be most important for increasing access to finance and prospects of economic growth in the Balkans.

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8 Appendix

8.1 Summary of International Standards for Collateral Valuation

For public confidence and trust in the valuation process, good design valuation standards and national compliance with them are very important. It is especially important now, after the global crisis, to promote good regulations, which will lead to the convergence of countries' valuation standards. This helps to reduce investment risk and increase confidence in financial reporting, and ensures a consistent approach to portfolio and asset valuation.

There are several broadly applied valuation standards, mostly depending on the geographic location and/or choice of the country. They all represent a minimum set of quality control standards. These are the Uniform Standards of Professional Appraisal Practice (USPAP), European Valuation Standards (EVS), International Valuation Standards (IVS), and Royal Institution of Chartered Surveyors (RICS).

In the United States the generally accepted and recognized standards of appraisal practice are the USPAP. The USPAP are set by the Appraisal Foundation (AF), a private non-profit educational organization, through an independent board, the Appraisal Standards Board (ASB). The foundation sets ethical and performance standards, as well as minimum education, experience, and examination requirements, enforced by the individual states. USPAP outlines valuer's obligations through Definitions, Rules (an ethics rule, record-keeping rule, competency rule, jurisdictional exception rule, and scope-of-work rule), Standards, Standards Rules, and Statements. The USPAP are not obligatory, because the AF and ASB are not government entities, with the exception of making part of a law, regulation, or agreement.

Although there are some differences between the USPAP and the IVS, primarily due to accumulated differences in appraisal methodology, even they have the same aim. In 2006, the International Valuation Standards Committee (IVSC) and the AF jointly signed the "Madison Agreement," again updated in 2014 with the signing of a memorandum of an understanding in which they show an intention to work together towards the goal of reconciling the differences between the two sets of standards.

The IVSC is an independent, nonprofit, private-sector standards organization. Its operational headquarters is in London, UK. It sets the International Valuation Standards (IVS), which are technical and ethical standards for valuations. In 2012, the IVSC had over 70 member organizations from 54 countries. Its internationally diverse members represent Valuation Professional Organizations (VPO), Institutional Members (IM), Corporate Members (CM), and Academic Members (AM). The IVSC was founded in 1981 and named the International Assets Valuation Standards Committee (TIAVSC), with the objective of developing consistent standards across national borders. Members specialize in the valuation of many different types of assets and liabilities, such as business interests, real property, intangibles, capital equipment and financial instruments.

The International Valuation Standards (IVSs) are international standards and, together with technical information and guidance, consist of various actions required during the valuation process. They incorporate the IVS Framework, IVS General Standards, IVS Asset Standards and IVS Applications. The IVS Framework includes generally accepted valuation concepts, principles and definitions upon which the International Valuation Standards are based. The IVS General Standards include the scope of work, implementation and reporting. The IVS Asset Standards represent modifications, additional requirements or specific examples of how the General Standards apply for valuations of businesses, intangible assets, plant and equipment, real property interests, investment property under construction, and financial instruments. The Valuation Applications represent modifications, additional requirements or specific examples of how the General Standards apply depending on the purpose for which the valuations are required. Each application contains a standard and guidance.

The RICS "regulates and promotes the profession; maintains the highest educational and professional standards; protects clients and consumers via a strict code of ethics; and provides impartial advice and guidance." This latest version of the RICS's "Red Book," called the RICS Valuation – Professional Standards, was published in January 2014. Widely known as the "Red Book," it recognizes the high-level valuation principles and definitions that are embodied in the International Valuation Standards (IVS) published by the International Valuation Standards Council (IVSC), of which the RICS was a founding member. Still, the "Red Book" partly complements the IVS by providing detailed guidance and specific requirements, sometimes even concerning their global interpretation and practical implementation. The "Red Book" (2014) incorporates the latest version of the IVS from 2013. Therefore, valuation that is undertaken in accordance with the "Red Book" will also be compliant with the IVS.

The "Red Book" is mandatory globally for RICS members for written valuations. The three distinct sections in the global edition are: RICS Professional Standards (PS), RICS Global Valuation Practice Statements (VPS), RICS Global Valuation Practice Guidance Applications (VPGA), and National Standards. For members, the first two headings are mandatory material, while the third represents the advisory material - what is regarded as best practice.

The PS comprise: 1) Compliance with standards and practice statements where a written valuation is required; and 2) Ethics, competency, objectivity and disclosures.

The VPS comprise: 1) Minimum terms of engagement; 2) Inspections and investigations; 3) Valuation reports; and 4) Bases of value, assumptions and special assumptions. The VPGA comprise: 1) Valuation for inclusion in financial statements; 2) Valuation for secured lending; 3) Valuation of businesses and business interests; 4) Valuation of individual trade related properties; 5) Valuation of plant and equipment; 6) Valuation of intangible assets; 7) Valuation of personal property, including arts and antiques; 8) Valuation of portfolios, collections and groups of properties; and 9) Valuation in markets susceptible to change: certainty and uncertainty.

The Valuation Standards VS1–6 (VS 1 Compliance and ethical requirement, VS 2 Agreement of terms of engagement, VS 3 Basis of value, VS 4 Applications, VS 5 Investigations, VS 6 Valuation reports) of the 2012 edition, including the associated Appendices, have been reviewed and incorporated into the Global PS and Global VPS.

VPGA focuses on the pertinence and implementation of the PS and VPS for a particular purpose or in relation to a particular property or asset type. Although the applications are advisory, all members are expected to be familiar with them.

The UK edition of the "Red Book" contains national standards (standards within the UK). The last part contains standards that apply to other countries except the UK.

European countries, whether or not EU members, implement TEGoVA'a European Valuation Standards (EVS). The EVS are published in TEGoVA's "Blue Book". The main purpose of the "Blue Book" is to assist in their work valuers who are at the same time members of the 45 valuers' associations from 26 countries representing the membership of TEGoVA. The "Blue Book" has been structured in three parts containing European Valuation Standards and their application in Part I, European Union legislation pertinent to property valuation in Part II, and a series of technical documents in Part III. The third part encompasses a code of ethics and conduct, minimum educational requirements, an REV scheme, etc. What makes the EVS unique is its emphasis on the origin of concepts in EU law as the foundation of the profession, such as "market value" and "mortgage lending value," or the EU definition of "asset valuer" for state aid rules, or, again, under the Capital Requirements Directive, the concepts of "independent valuer" and valuation reporting when it comes to monitoring and reporting the values of property used as collateral.

All of the above-mentioned standards are primarily good practice in the valuation of assets and represent the minimum of requirements for an assessment process and a valuer, which should apply in a national economy. Although there are some differences among them (in the manner and scope of their definition), essentially they have the same goal, namely to bring about a widely used and coordinated manner of organizing a relevant assessment system and the valuers profession. This is primarily related to the creation of an adequate legal framework for property valuation, and trained and qualified valuers who will give a relevant assessment of the value of property, respecting ethical principles and socially-desirable behavior models. However, one should bear in mind that even the choice and application of good standards in a country with weak institutions or inadequate regulations is insufficient.

Licensing should be performed by a relevant institution, which will have strict monitoring of the assessment process and results, as well as of the people who make the assessment, whose work will be rewarded or punished in accordance with the results. Education and qualifications of valuers, as well as the opportunity for them to perform their work (awarding licenses) should be treated separately in a state. In addition, valuers should continuously work on their improvement and acquisition of new knowledge and practices, and to implement them in their assessments (such as, for instance, the current application of mortgage lending value as a valuation basis). Also, the relevance of the assessment depends largely on moral principles and valuers' proper behavior models, which must be in accordance with the code of ethics and conduct. Likewise, an institution that will supervise the work of valuers and the results could propose corrective measures aimed at applying methodologies of the highest possible quality.

These and other valuation standards include primarily definitions, a description of the valuation report contents, valuation methods, valuation basis, the protection of names, etc. Although countries are increasingly trying to apply them and to harmonize their system and practice with them, there has been deviation to a certain extent. Balkan countries mainly apply the EVS (Macedonia, Serbia, Kosovo and Albania), with the exception of Bosnia and Herzegovina, where mainly the IVS is mentioned.

Balkan countries should have a standardized valuation procedure. A similar valuation system and accepted standards would be helpful for valuation performed in one Balkan country to be relevant and valid in another. From a macroeconomic perspective, weak regulations put a limit on, and therefore reduce, potential banking-system activity in the Balkans and hinder GDP growth in countries and in the region. In particular, as defined in the MCD, a country that is in the EU, as well as a country that is on its way to joining the EU, should harmonize its standards in this field with international practice. Therefore, this is the right direction for the Balkan countries in the future: to converge their respective valuation standards, while at the same time converging with European standards, as well as international standards.

8.2 Exchange Rates

The following table shows currency exchange rates used for conversation of local currencies to euro.

Table 3.21 Exchange Rates Used

Exchange Rates	2006	2007	2008	2009	2010	2011	2012	2013	1H 2014	Aug-14	3Q 2014
USD/EUR (Period average)	/	1.3705	1.4708	1.3948	1.3257	1.392	1.2848	1.3281	/	/	/
ALL/EUR (Period average)	/	/	/	131.3756	137.8197	140.1842	138.9283	140.2817	139.959	/	/
ALL/EUR (End of period)	/	/	/	/	/	/	/	/	/	139.4400	
MKD/EUR (Period average)	/	/	/	/	61.515	61.52892	61.53035	61.58335	61.64813	/	/
MKD/EUR (End of period)	/	/	/	/	/	/	/	/	/	61.4971	/
KM/EUR (currency board)	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558	1.9558
RSD/EUR (End of period)	79.0000	79.2362	88.601	95.8888	105.4982	104.6409	113.7183	114.6421	/	/	118.8509

Source: ECB for USD/EUR, National Bank of Serbia for RSD/EUR, Bank of Albania for ALL/EUR for end-of-period exchange rates and EU Commission for period-average exchange rates (calculated as average of month averages), EU Commission for period-average exchange rates for MKD/EUR, Central Bank of Macedonia for MKD/EUR, and Central Bank of Bosnia and Herzegovina for KM/EUR.