Country-Specific Legislation and Practice

Country Chapter

Russian Federation

Introduction

One of the guiding principles of TEGoVA is to promote consistency of standard definitions of value and approaches to valuation trans-Europe. The publication of European Valuation Standards (EVS) provides the state, investors, the financial industry, valuers and their clients with a common benchmark which can be consistently applied, irrespective of the location of a real estate asset.

Whereas harmonisation of valuation standards enable recognised bases of valuation to be reported, the preparation and publication of a valuation must also respect client need, national legislation and custom. Customary differences, particularly in respect of valuation methodology, may result from the requirements of statute or regulation.

This Country Chapter illustrates differences that currently exist across Europe. The Country Chapters are not intended to provide definitive advice. The text that follows has been provided by TEGoVA Member Associations (TMAs) to outline country-specific legislation and practice.

The European Group of Valuers’ Associations (TEGoVA)
Boulevard Saint-Michel 45
1040 Brussels
Belgium

Tel: +32 (0)2 503 32 34 Fax: +32 (0)2 503 32 32
Email: info@tegova.org Website: www.tegova.org
Russian Federation

Professional bodies represented on TEGoVA:

- РОССИЙСКОЕ ОБЩЕСТВО ОЦЕНЩИКОВ (РОО)
  Russian Society of Appraisers (RSA)

- ПАРТНЕРСТВО РОССИЙСКОГО ОБЩЕСТВА ОЦЕНЩИКОВ (ПРОО)
  Partnership of the Russian Society of Appraisers (PRSA)

National property market and ownership

The Russian property market emerged in the beginning of 1990th following the reform of the previously existing system that stipulated the vesture of property ownership in the state or collective sectors.

At present it is one of the most dynamic property markets in the Eastern European region which withstood well the pressures of the economic crisis of 2008. Real property assets, especially those in the cities, are viewed by investors as a sound financial alternative to volatile stock market investments and therefore have a lot of trust and confidence riding on them. Thus, this market can be represented as tying up most of the monetary economic surplus generated by the national economy plus some foreign direct investments – which in aggregate conflate to create a stupendous and beneficial economic performance due to liquidity effects. One of the salient features of this market across its various segments – both commercial and residential – is a relatively low dependence of its final buyers on the credit finance, though this decoupling of market behavior from the vicissitudes of credit is ebbing away as some standard funding mechanisms tend to permeate its reaches. This includes both the systemic trend among developers to enhance their reliance on credit and the government–sponsored efforts regarding the institution of refinancing vehicles, in the likeness of American Fannie Mae and Freddie Mac, to encourage owner-occupational borrowing and securitization of mortgages. This also comes
on the wings of current efforts to cheapen mortgage credit rates (currently above 10% per annum in hard currency) thus boosting availability of credit and creating additional liquidity inflows into the market. Therefore, the national property market becomes less autarkic in its institutional underpinnings and merges into the general economic framework after the Western pattern. For example, a number of property development companies are already well-represented on the national stock market, with daily quotations.

The principal function of the valuation profession regarding property market is mainly a passive reflection of prevailing market prices, given that the commercial and residential property market is more or less well developed in major Russian cities. Only in respect of land (and other illiquid real or financial assets) some active pricing functions of valuers are still possible, as land in Russia is not so freely traded a resource, especially in the cities -- where it tends to be government-owned and let out on long-term leases subject to administrative transfer and normative valuation inputs. In fairness, with respect to land and property, legal jurisdictional peculiarities of Russia to this day throw a veil of complications on economic valuation problems. Though value represents an integral numerical estimate of utility of economic relations, it is often believed in Russia, that actual or immediate items subject to valuation are legal property rights. To that extent, Russian Law still operates with a number of antiquated property entitlements inherited from Soviet Union practices that are not exactly freeholds or leaseholds, but something in between (e.g. “the right of continuous termless use”). Currently, there is a drive to phase out all those odd property titles and to leave only plain freeholds and leaseholds under the recognition of law. Consequently, few such titles are presented to the market for exchange today. At the same time, few existing industrial owners—especially on the low-end of the market—care to convert their titles (at some cost, not necessarily related to leasehold or freehold market value) to either freehold or leasehold in a timely manner. Therefore, the government has been compelled, for the last five years, to extend the deadline for title conversion every time it expires.

Many cities in Russia favor some characteristic ownership patterns, e.g. the standard structure of property ownership in Moscow is the fee simple interest in buildings and 49-year lease of the underlying land, though some other cities now also allow full property ownership of land. Such organic dissociation of property in land and buildings also has roots in the peculiarities of national taxation (albeit it is likewise associated with national accounting provisions for deprecating PP&E items, similar to IFRS conventions). For example, there is no stipulation of uniform tax on the whole property, but a property item is split for taxation purposes between underlying land subject to the land tax (or statutory rent, if held under lease) and land
improvements subject to the corporate property tax the level of which depends on the accounting book value of the improvements.

The Land tax is assessed as a percentage of so-called ‘cadastral value’ of land updated at intervals of 5 years or so. This value is supposed to proxy for stabilized market value determined by mass appraisal methods. However, the administration of cadastral value assessments run by state-associated bureaus or companies is currently in an unsettled and chaotic state, with scarcely effective avenues of appeal open to those whose rights are unfairly breached because assessed cadastral value of their land exceeds its observed market counterpart by order of multiples. At the same time, there is a sustained and promising political trend to outsource cadastral value assessments away from state-associated firms and subsume them within oversight by the institution of independent Professional Valuation.

On the other hand, accounting book value for corporate land improvements is grounded in national accounting conventions based on depreciated historic acquisition costs, not on the current fair value of the items. In general, the national accounting pattern for property is still rooted in the prevailing historic cost concept (alternatively, cost-approach based ‘reinstatement value’ is another, rarely exercised, option).

As to leases of commercial premises, short-term lease structure of well under 5 years is most wide-spread. Consequently, lease terms are reviewed and adjusted to current rent on a regular basis.

**Overview of the National Valuation profession**

The institution of the national valuation profession, in its current market-oriented manifestation, dates back to 1993 when the first professional valuation society, The Russian Society of Appraisers, has been established in the country and gained recognition for its capacity as the training and accreditation institution. Professional valuation saw its emergence without a specific linkage to any particular type of investment, property-related or otherwise. It was perceived as a universal type of economic measurements for exchange transactions, serving the primary interests of the market-oriented economy and manifesting or developing its capital prices. Real estate capital was its particular burgeoning niche, but never to the exclusion of holistic concerns with business valuation, investment-financial valuation and the assessment of investment projects. This created a link between these areas of practices and a vantage point for coherent economic thinking on the nature of capital valuation. Perhaps because of these features, professional valuation in Russia received official standing in 1996 when the Order of the Ministry of Labor established its status as “profession” and opened the way for an evolving
legal framework. Subsequent decade, which received appellation as the “era of state control in valuation”, involved a measure of substantial participation by the federal government in framing the terms of the Federal Valuation Law (first adopted in 1998 as The Federal Law #135), setting up the provisions for standardized appraisal education curriculum on the basis of higher education (2002), instituting and administering the licensing mechanism for appraisal firms (2001-2007), etc. These efforts created a reliable foundation from which the current self regulatory constitution of valuation regime, elsewhere referred to as the ‘era of professional self-regulation in the appraisal industry’, was able to launch itself following the 2007 reform brought on by “The Amendments to the Federal Valuation Law” Act (Federal Law # 157¹).

Under the current self-regulatory constitution, the appraisal profession is comprised of both business and property valuers who are deemed to be individuals with appropriate educational qualifications and mandatory membership in one of the self-regulated professional valuation organizations (SRPOs), such as the Russian Society of Appraisers. In reality, they also can and mainly do practice as employees of appraisal firms, but the locus of professional responsibility mainly rests with them as physical persons. Valuers in Russia are liable with all their personal property in the event of damages wrought by their professional misconduct. Such unlimited personal liability of valuers is supported by more practicable mechanisms involving obligatory individual professional insurance coverage to the amount of at least 300,000 rubles and is additionally hedged by a possibility of recourse to compensation funds of their respective SRPOs, formed out of their initial membership contributions (30,000 rubbles per head as per Federal Valuation Law provisions).

To pre-empt the build up of systemic risks of corruption or haphazard malpractice within the profession, work of all valuers is subjected to regular scheduled and surprise audits by control departments of their SRPOs carried out on the basis of inspection of their reports. Subsequent to such audits, SRPOs are endowed with a wide variety of statutory powers to discipline their delinquent members – up to suspending their membership and terminating their right of practice. This control mechanism is proving to be quite effective and it occasioned a notable thinning of ranks in the profession: It has been estimated that on the eve of the 2007 reform, which introduced self-regulatory mode into the profession, about 40,000 persons were entitled to practice professional valuation in the context of the now-repealed licensing mechanism, whereas current membership of the Russian Society of Appraisers, which has branches in the

¹ English language version of the current Federal Valuation Law can be downloaded from the Russian Society of Appraisers’ web page: http://www.mrsa.ru/default_e.asp
majority of constituent entities of the Russian Federation, comprises only around 6500 members. Since at the time of the reform it was widely feared that concentrated structure of oversight build around any one SRPO would place monopoly pricing powers over capital in the market-oriented economy into the hands of that single SRPO, the Federal Valuation Law stipulated a minimum threshold of only 300 members in order to be able to register a valuation institution with the SRPO status. Consequently, some SRPO societies of regional presence have made appearance and between themselves account for about half of professional valuers affiliated with them in the country. The breakdown of SRPO membership is shown in the following table:

<table>
<thead>
<tr>
<th>SRPO</th>
<th>Membership numbers, thousand</th>
<th>% of the total</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Russian Society of Appraisers</td>
<td>6,5</td>
<td>48%</td>
</tr>
<tr>
<td>The-Self regulated Association of Valuers</td>
<td>3</td>
<td>22%</td>
</tr>
<tr>
<td>(SMAOc)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others 5 smaller and regional SRPOs</td>
<td>4 (2008 est.)²</td>
<td>30%</td>
</tr>
<tr>
<td>(NKSO/RKO, ARMO, Sibyr, MSO, OPEO)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>13,5</td>
<td>100%</td>
</tr>
</tbody>
</table>

Fig. 1 Membership in national self-regulated professional organizations of valuers (as of May 2010).

Apart from statutory functions of oversight, SRPOs have secured for themselves a number of other important decision-making powers. For example, the imprimatur of an SRPO’s Council of Experts is indispensible for valuation reports related to some purposes (such as dissenting shareholder stock repurchases). In similar vein, SRPOs’ Councils of Experts serve as valuation-related dispute resolution venues either through an arbitrage process or on referral from the official civil court system.

It has been estimated that upwards of 80% of valuers in the country are not self-employed but actually enter service as employees of appraisal firms. Consequently, beside individual

² Aggregate mid-2008 estimate according to The Federal Reference book on Valuation Activities in the Russian Federation, М.: Центр стратегического партнерства, 2008 (p. 36)
membership based institutions with SRPO status, there exist a number of business associations of appraisal firms. The largest among those are the Partnership of the Russian Society of Appraisers (PRSA) and the Russian Board of Appraisers (RKO).

The demand for valuation products is ensured by the incorporation into national legislation of 20+ “obligatory cases of valuation” in which the services of recognized professional valuers are to be called into use. Historically, these cases evolved from legal stipulations to engage independent valuers in the contexts of privatization of state properties and eminent domain that date back to the first edition of the Federal Valuation Law in 1998. Subsequently, a number of other obligatory cases of valuation have been arrayed alongside them to include such instances as mortgage deals (above a certain de minimis threshold), foreclosures, bankruptcy liquidations and multiple instances from property and business valuation in corporate management context. Notably, though, some important valuation services with public aspect, such as investment-financial valuation of public stock, are still left outside of the scope of regulated professional valuation practice.

Given such abundance of valuation purposes, it would seem fair to expect the specialization of SRPO societies on particular areas of expertise. However, all SRPOs are operating as general-purpose valuation societies, embracing business, property and technical assets appraisers. Therefore, the economies of scale accrue on the side of one or two big nationwide SRPOs.

This is not yet reflected in the constitution of the National Valuation Council (NVC) representing SRPO institutions with virtually equal weighting of their votes, while 1/3 of its seats are reserved for the government, academic advisors and banking industry quota. NVC is a coordinating body of valuers’ SRPO organizations intended to be not unlike The Appraisal Foundation in the United States and entrusted with standard-setting activities, accreditation of education providers in the valuation area, and regulation of valuation tariffs (on the basis of unit costs per man-hour of valuation-related labour). However, the unfolding of NVC’s activities in these directions has been proceeding at a glacial speed and any substantive results from them are yet awaited.

To this day, a set of national valuation standards (termed “The Federal Valuation Standards” – FSOs) in force represents a legacy of the principles that prevailed in pre-self-regulatory days, having been produced in 2007 within the Ministry for Economic Development in the dying days of the previous regulatory approach. Nominally compliant with the International Valuation Standards, this set of “obligatory for compliance” FSO standards includes the following texts: FSO 1 «General concepts and principles of valuation»; FSO 2 «Types of Value»; FSO 3 «Requirements to the content of valuation reports». As can be seen from their titles, these are general valuation standards for all types of assets (with which professional valuers are engaged
on the regular basis, such as commercial and residential property, PP&E items, invested capital and equity stock of private companies and some other financial assets, like debt and accounts receivable), not applications for any specific purposes or subject-specific guidance. None in the latter categories have been finalized as yet by the NVC, though some have already been in the pipeline for long.

Generally speaking, valuation scheme underlying the FSO standards is the coordination-of-the three-approaches-to-value doctrine. The use of all the three approaches is accorded preference over the choice of any single best one, albeit the option of motivated rejection to apply any of the approaches is left in.

Of practical consequence is also the last standard of the set which imposes a significant compliance burden by stipulating a uniform structure for all valuation reports. The only format of reports recognized is a self-contained paper-based format and, generally, FSOs are much stricter on the content of valuation reports than respective provisions in the European or International Valuation Standards. As a guiding principle of reporting, it should be possible to replicate exactly the analytical deductions of the original valuer based on the information contained in his report. A particular ordering of the sections of the report is also prescribed, together with the attachment of all supporting primary evidence at the end of the report.

The Federal Valuation Law provides for the promulgation of second-tier valuation standards developed by SRPOs for the compliance by their respective members. Such standards should not be contradictory to the Federal Valuation Standards. However, the risk of mutual contradiction between the standards of different SRPOs systemically handicaps the efforts to develop and harmonize such standards. The only valuation society that is known for the coherent set of its own standards is the Russian Society of Appraisers which chose to directly incorporate IVSs 2007 into its own corpus of valuation standards (“Svod standardov Ocenki ROO 2010”) -- with minimal modifications to ensure compliance with FSOs.

To that extent, it can be said that the system of valuation standards in the country is internationally compliant and mirrors the best practice. The European Valuation Standards 2009 (and their previous versions) are also widely known in the country, having been translated by the Russian Society of Appraisers, and their use is encouraged in conjunction with EU-related valuation assignments and for valuers obtaining or aspiring to obtain the TEGOVA’s REV designation. Currently, more than a hundred valuers in the country have been awarded the REV mark of distinction through certification programs administered by the Russian Society of Appraisers and other organizations.
Definitions and methods of real estate valuations

Property valuation for the majority of obligatory cases of valuation is mandated on the basis of the market value. Definition of this basis of value takes after the market value definition that USPAP standards (and Appraisal Institute’s Dictionary of appraisal terms) contained circa 1990 and had been incorporated into the Federal Valuation Law in 1998 where it remained immutable since that time. The Market value is regarded as a positivist (market-reflecting), not a normative (commercially or socially optimizing) concept. Nevertheless, great emphasis is laid in the national valuation practice on the highest and best use (HABU) principle on which the market value is presumed to be based. The absolutist maximizing standing of this principle is not impugned, except for business capital valued on the basis of existing management projections and business plans, and rigorous application of the HABU analysis is prescribed by the FSOs for all types of property.

Standard techniques are used for the valuation of real property and their results are coordinated on the basis of the-three-approaches-to-value doctrine.

Office and industrial properties are valued by reference to the sales comparison, income capitalization and costs approaches, where the latter is applied by recourse to the Developer’s, not Contractor’s method, i.e. its results are coordinated with observable market freehold prices via appropriate allowance for developer’s incentive, even if it reached abnormal speculative rates up to 100% per annum, as at the height of the property boom in Russian capital cities.

As to the income approach, DCF analysis and direct income capitalization via rental multiplier both appear in wide use. To a first approximation, overall estimates for gross rental multipliers are comparable with similar readings in European markets, whereas the magnitude of nominal discount rates for property cashflows is almost always upwards of 20% per annum because of the rate of general price inflation in the country settling at the level above 10%, and also high cost of capital in real terms (bank interest in lending is hardly ever short of 20%, showing but a moderate tendency towards declining).

Sales comparison approach for commercial and residential property is, for the most part, based on asking prices in brokerage listings, not on cash actually passing in the transactions. Since asking prices are often set opportunistically, there is always a scope for bargaining process in the interest of buyers. Consequently, it is conventional to see discounts applied to asking prices to translate them into most likely transaction price estimates. Current distress on property markets accentuates the likely magnitude of such bargaining-down allowances into double-digit percentage figures in many freehold transactions events (but usually much less than that for
rental transactions). In principle, it is possible to make use of official transaction price records for comparable sales, since such statistics is collected by state agencies, but it is not shared with the public and appraisers but rarely have access to it. In similar vein to asking prices, it is also not a reliable guide to cash actually passing in a comparable transaction, as tax minimization incentives of transacting parties cause such statistics to be recorded on contractual ‘shadow price’ basis (organically underpriced).

In the context of commercial property valuations, both sales comparison and income approaches are usually accorded equal or comparable reconciliation weightings when the final result is being developed. The contribution, or weighting significance, of the cost approach lags slightly behind in many typical cases.

Freehold land is valued using any of the applicable approaches recognized by GN 1 in the International Valuation Standards. Given the prominence of long-term leasehold interests in the ownership pattern for land in cities, it should be noted that the land element applications of cost approach to valuation of commercial property or stand-alone valuations of leasehold land for corporate purposes usually follow the course of capitalizing a projected difference between the current short-term market rent and contractual rent. In most of the cases, this difference is a surplus, yielding capitalized positive value of leaseholds -- since municipal long-term leases of land were concluded at normative rates scarcely related to market considerations and still fall short of current market rents, or economic rents justified on analytical grounds. However, the leasehold review policy of the state is changing markedly in this respect toward greater recognition and extraction of real economic rents, aiding optimization of land use or its placement into most commercially effective of uses.

Apart from the Market value, FSOs provide for the use of Liquidation value, Investment value, and “Cadastral value” – the latter one for taxation purposes as described. Banking regulation also operates with the notion of Fair value of mortgages or other collateral, usually equating it to their Market value.

Liquidation value is a value-in-exchange similar to the market value concept, but subject to “restricted” marketing/exposure periods -- of lesser duration than normal marketing period which underpins the market value concept. It is usually estimated by asset liquidators in a bankruptcy context on the basis of market value of a property by using liquidation discount adjustments (LDAs) applied to previously determined market value. Multiple techniques exist to develop LDAs, the most recognized of those being the Galasyuk method and Michaletz analysis. In some instances, such as banking foreclosure and auctioning process, the size of applicable LDAs is normatively established by relevant regulations.
The Investment value concept in FSOs is interpreted in line with EVS’s and IVS’s provisions regarding it. It would seem strange, but the concept of Fair value for individuated exchanges not related to the market context that presupposes negotiation of the two distinct investment perspectives/values of the buyer and the seller (such as the one introduced in IVS 2007, distinct from fair value in accounting sense) has no traction in the national valuation standard-setting process, despite the flowering of academic interest associated with it (e.g. Smolyak approach to fair value of illiquid assets, Michaletz Model of Transactional Assets Pricing for illiquid assets, etc.). To this day, a greater portion of property and business exchanges in the country happens in the illiquid and individuated bargaining contexts than in countries with developed competitive property markets. Because of this, a transaction pricing and valuation approach based on negotiation of individual investment values of the parties into single fair value appraisal for individuated exchange is called into use (especially with specialized properties and other illiquid assets) as a superior method to assessments relying on the averaging of widely discrepant prices observed on inefficient and inactive markets where the law of one price does not hold. Thus, the new concept of Fair value in IVS 2007, distinct from its accounting sense, has been received with enthusiasm by the national valuation community.

The Mortgage lending value (MLV), or Sustainable asset value, concept has not yet received official recognition within the FSO standards. Conceptually, like in the case with Fair value, this is connected with the fact that FSO standards are predicated on the assumption – in Russian context a rather special assumption -- of effective markets, with which the three-approaches-to-value doctrine is consonant. Another reason is that any historic MLV concept after a German fashion would require vast arrays of price and market data going decades back in time, and this is not statistically feasible in the Russian context where property and other markets are not two decades old. But sustainable value modeling and research on business and property markets is ongoing and takes the form of prospective-looking analytic concepts, such as Sloutsky-Michaletz sustainable asset value analysis for commercial property markets. Some banks already import the results of such analytical modeling techniques into their decision-making process, and the concept of MLV is gaining wider prominence by the day. Its incorporation into the FSO standards and recommendation for use in mortgage banking and other contexts (including in property and business ratings) is being widely discussed.

Professional Valuers in Russia tend to specialize on valuations of particular types of property; however, there exist no legal restrictions for this convention. According to the legislation, SRPO members are permitted to value all types of property. Business valuers are also allowed to do property valuations and trained for this specialism according to the content of standard business valuation curriculum. It usually doesn’t work in reverse, as property valuers are not qualified
enough to undertake business or intangible assets valuations. They are authorized to practice plant and machinery valuations, though.

Such practice conventions have evolved because basic professional training on the basis of higher education majors is designed to educate two broad categories of valuers – business or property valuers. Such training is offered by 80 or so universities that were previously accredited by the State to conduct training of valuers according to nationwide standard higher-education valuation curriculum (developed circa 2002). The training can take up to 4-5 years of residential courses to obtain higher-education diploma in either property or business valuation. Those already having higher-education training in unrelated disciplines and wanting to join valuation profession can commit themselves to various post-graduate re-training university level courses that take under two years to complete (about 800 hours of study time, including graduation project work). Having a higher education diploma in either general, property or business valuation (certified by the State) is a prerequisite to becoming an SRPO member and entering valuation practice. Valuers who are already SRPO members are bound to commit themselves to Continued Professional Development (CPD) training with minimum requirement of 100 study hours for every 3 years of service. Such CPD training shall increasingly be administered by SRPOs themselves via distance learning techniques in partnership with distance education providers.

Valuation research activities and methodological studies are concentrated in a number of centrally located universities affiliated with SRPOs. Some premier valuation research centers affiliated with the Russian Society of Appraisers are the International Academy of Valuation and Consulting (MAOK) and the Economic Measurements Department of the State University of Management (GYY) – both located in Moscow. Between themselves they publish such nationwide peer-reviewed professional valuation periodicals as “Voproci Ocenki/Issues in Valuation” (quarterly, since 1996) and “Imushestvennye otnosheniya v Rossiiskoi Federatsii/Property relations in the Russian Federation” (monthly, since 2003).

Outlook for Professional Valuation

Valuation profession has an excellent platform from which to consolidate its pro-active economy-wide pricing authority and emerge as a regulatory profession with macroeconomic import and public interest status. As has been noted, projects are floated on the legislative level to the effect of placing land rating administration for taxation purposes within its purview and methodological guidance. Other areas of microeconomic administration are also poised to benefit from the extended or synergistic services of Professional Valuers. Such promising directions for professional expansion include: 1) creation of national public rating agencies for industry-specific equity and debt capital plus property markets, administered on the legislated
public-utility principles of professional valuation (with a number of alternative projects being publicly discussed to this effect). These projects also envision charging the network of such agencies with estimating sustainable value of indices of assets traded in the markets they would monitor and alerting investors to the likelihood of markets deviating from their sustainable value trajectories. 2) Estimation or review of fair utility tariffs in the energy and petroleum sectors on the Regulatory Assets Base (RAB) principles by bodies affiliated with publicly-accountable professional valuation institutions, such as the rating agencies or SRPOs; 3) Expansion of Professional Valuation or its administrative principles into the area of unregulated investment consulting services with public dimension, e.g. writing of investment “prospectuses” (publicly distributed buy/sell/hold recommendations of equity or debt analysts) can be legislated to fall within the reach of the Federal Valuation Law principles.

Such floated projects, and a number of un-discussed minor ones, attest to the vibrancy of unified national Professional Valuation scene and optimistic prospects for its development.

Suggestions for further reading in English: