



STAGES AND INFLUENTIAL FACTORS OF COLLATERAL VALUATION OF BANK LOANS

Abdikarimova Dinara Rustamkhanovna

Associate Professor, Doctor of Philosophy in Economics (PhD), the Department of “Corporate Finance and Securities”, Tashkent Institute of Finance, Uzbekistan,

email: dinoraxon@mail.ru

Abstract

This article describes the significance of collateral valuation of bank loans, the stages and influential factors in this procedure. Opinions and approaches of various economists are given in order to show importance of this process. The stages and influential factors of collateral valuation of bank loans are analyzed in detail. Scientific conclusions and practical recommendations are provided by analyzing the stages and influential factors of collateral valuation of bank loans

Keywords: *valuation, collateral, collateral valuation, bank loans, collateral valuation participants, stages of collateral valuation*

Introduction

Analysis of the organization of the activities of appraisal organizations and appraisers, as well as foreign experience in the valuation of bank collateral shows that the procedure for valuing real estate and movable property on bank loans is almost no different from the valuation process for orders of other businesses. That is, the appraisal organization and the appraisers in both cases carry out the valuation process using the basic principles, approaches and rules of valuation. We analyze the stages of organization and implementation of the process of collateral valuation of bank loans and their influential factors.

Literature review

Different scientists pay attention to investigate collateral valuation of bank loans. It is advisable to make additional profit through the efficient use of financial capital in the market economy. Money received or paid over a period of time is very important in the process of assessing the security of a bank loan[1].



The pledge mechanism was first introduced into the economy by a foreign economist I.D.Mamonova, who sees this process as the preparation and execution of a pledge agreement [2].

As a result of the growth of credit in banks, there is a need for effective control over collateral. Credit growth can occur for a variety of reasons. For example, banks seeking to increase their loan portfolios may reduce collateral requirements, simplify contracts, and pursue liberal credit policies in exchange for lending to borrowers rejected by other banks. This will strengthen the collateral and effective control will reduce the potential risks [3].

Central banks face two major challenges in developing collateral policy. First, collateral rules need to be flexible enough to ensure that the central bank conducts its monetary policy effectively. Second, the rules should ensure that the collateral used by banks consists of high-quality assets, which should limit the central bank's impact on counterparties [4].

According to O.I.Lavrushin, the client's property collateral is a common method of securing a bank loan repayment. The pledge of property is formalized by a bilateral agreement on the pledge and expresses the right to reimburse the debtor with the value of his property in the event of default [5].

According to Bagaka Obuba Japhet and Florence Memba, collateral is a mechanism for balancing lending and overcoming problems caused by the presence of asymmetric information between borrowers and lenders [6].

Frederic S.Mishkin, Kent Matthews, Massimo Giuliodori argues that collateral is property that is provided by the borrower to the lender and serves to reduce the risk that may arise as a result of incorrect selection. This is because collateral reduces the lender's losses when the borrower becomes insolvent. In this case, the lender can sell the mortgaged property and cover its losses [7].

A group of Uzbek scientists have also studied the issue of collateral and its evaluation. In particular, mortgages are one of the most common forms of credit. The pledge of property is formalized through a pledge agreement. In case of default, the bank can repay the loan by selling the collateral [8].



The transfer of the pledged property to the bank's balance sheet must be made directly by the decision of the credit committee. It is also advisable to determine the use of this property. The bank can transfer, sell, lease or lend the property as part of its fixed assets. In this case, the commercial bank will need special software to obtain information about the property and keep records of it [9].

One of the mechanisms for resolving problem loans is to turn the loan payments into collateral. When this happens, the relationship between the bank and the customer is usually severed [10]. The above-mentioned approaches shows that collateral valuation of bank loans is very important for development of valuation in Uzbekistan.

Analysis and results

The process of assessing the collateral of the bank loans begins with the agreement between the appraiser and the client, as well as between any business entities. The contract agrees formally on the obligations of the parties, their rights, the duration of the valuation, as well as the amount and procedure for payment for the valuation service. Figure 1 describes the procedure and stages of collateral valuation of bank loans.

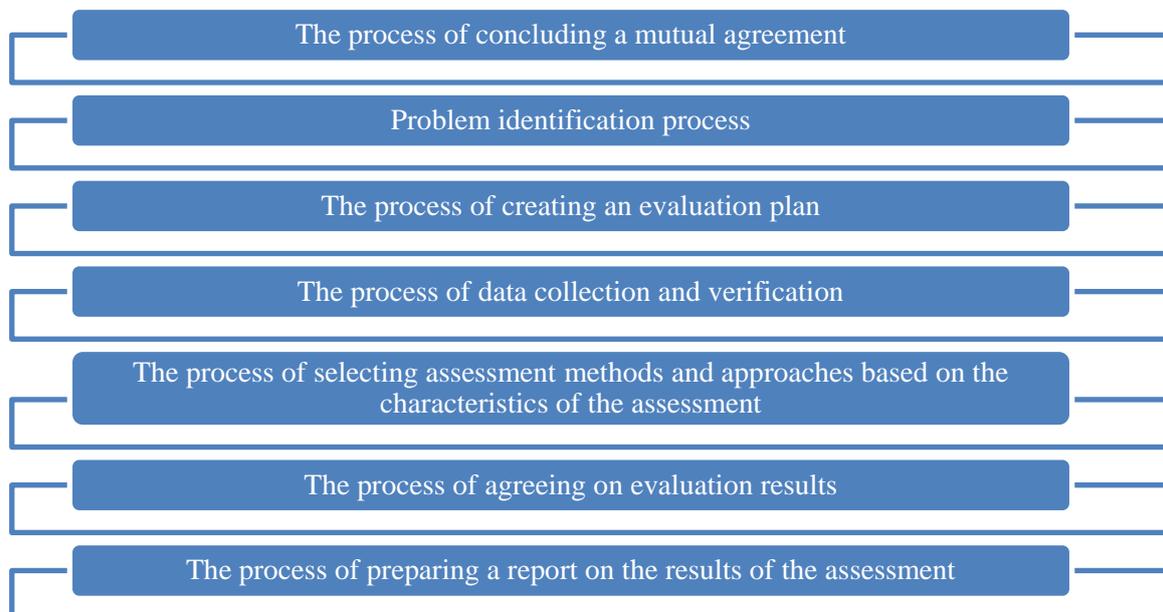


Figure 1. Collateral valuation procedure of bank loans¹

¹Done by the author



It should be noted that in international practice, the bank participates as a third party in the signing of the loan collateral valuation agreement and, after reviewing the entire valuation process, makes recommendations and comments on the appraiser's report.

Before assessing the collateral of the bank, it is necessary to pay attention to the fact that the documents drawn up on the object being assessed meet the requirements of the relevant legislation. In particular, it should be determined that the object being assessed is legally owned by the borrower, and that there are no problems with ownership in the process of selling it when it is necessary to repay the loan and its interest at the expense of collateral.

It is known from practice that when real estate pledged as bank collateral is put up for sale in order to cover problem loans of banks, there are problems with the right of ownership. In some cases, this conflict situation occurs even before the loan expires. In particular, the state cadastral projects of the mortgaged property are not fully registered, the construction is of state importance, the construction is planned to be violated or the right of ownership is revoked.

For example, as a result of political factors, ie the acquisition of land on which the project is carried out, or the implementation of a project that plays an important role in the socio-economic life of the country, conflicting issues arise when the mortgaged objects are located in these areas.

As can be seen from Figure 1, the third step in assessing a bank's collateral is to plan the valuation process. The period for planning the evaluation process should not exceed the period specified in the contract. In doing so, it is first necessary to determine how many days it will take to complete the evaluation process. To do this, it is advisable to develop an initial evaluation plan, indicating the dates of the evaluation.

The plan for the implementation of the evaluation process provides for:

- Factors influencing the valuation are identified, the general condition of the object and the value of the property located in it, as well as the circumstances that lead to their change;
- The plan should clearly define the sequence of evaluation activities in order not to overspend and waste time in the evaluation process.

Data collection and ensuring authenticity is an important issue in object evaluation. Having accurate information about the object being evaluated and preparing an evaluation report based on them will increase the quality of evaluation and the efficiency of their use. If

the information used in the evaluation process is unreliable and of poor quality, it reduces the importance and level of the evaluation report.

The appraiser should clarify the following issues before proceeding with the evaluation of the object being evaluated in accordance with the mutual agreement with the client (Figure 2).

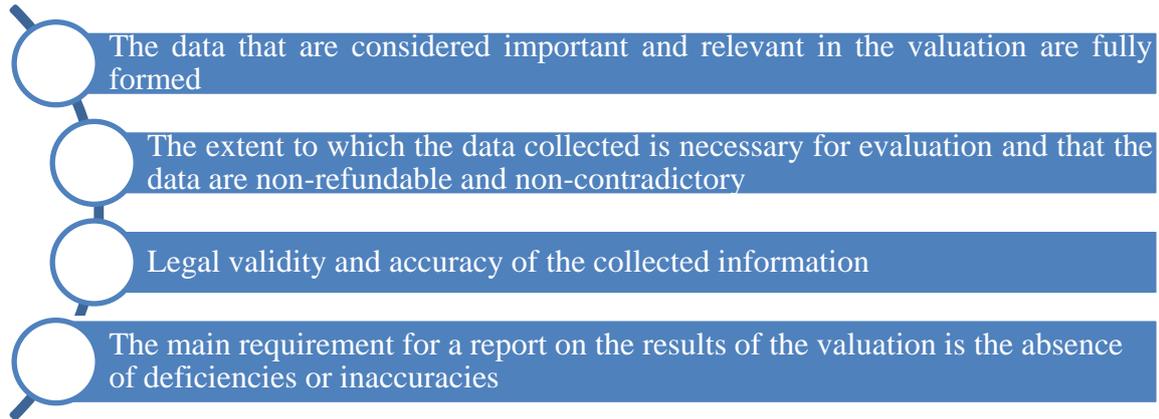


Figure 2. The issues which should be clarified by the appraiser

When starting the evaluation process, it is first necessary to determine what methods and approaches to implement it. In particular, in choosing the method and approach to the valuation, it is important to know for what purpose the object being assessed is intended and for what purpose the valuation work is carried out.

In turn, one of the main stages of the valuation process is the implementation of mutual agreement with the relevant steps in determining the market value of the object being valued. In the process of negotiation, the opinion and conclusions of the appraiser will of course take precedence, but in this process, the views and opinions of the customer and the responsible officer of the bank, who accepts the loan collateral, must be taken into account.

When studying the practice of valuation of bank collateral in our country, the bank's officials do not participate in the valuation process. As a result, in most cases, this leads to negative consequences. In particular, the right of ownership in the sale of collateral, the registration of its cadastral documents.

The main purpose of the appraisal process is to ensure the process of fair valuation of the mortgaged object, to monitor whether the object is valued at real market value, to determine the possibility of further reducing the credit risk of the object. The main focus of the borrower is to get the maximum amount of credit at the expense of the collateral being



assessed. Therefore, he is interested in and will strive for a higher valuation of the object being valued.

The appraiser is an impartial person between the bank and the borrower in terms of valuation of the collateral. In this regard, the appraiser must take into account the needs of the borrower and the interests of the bank, find the "gold center" of the object being valued and set the real market value. The main purpose of the appraiser's participation in the lending process is to protect the commercial interests of all, as well as to ensure the transparency of loans secured by the bank.

Determining the real market value of the collateral by independent appraisers allows you to establish a fair balance between the value of the collateral and the loan. At the same time, when it is necessary to repay a problem loan with collateral, the real market value of the collateral will prevent the occurrence of various disputes and disputes between the bank and the borrower.

As a result of a significant reduction in discount rates in the valuation of property secured by bank loans, unreasonable overstatement of rental rates in the income approach, overestimation of the similarity of the assessed object in the comparative approach is not realistic. All this does not allow to repay the problem loan at the expense of collateral. This, in turn, has a negative impact on the financial condition of the bank and, ultimately, on the development of the national economy through its customers and depositors.

It should be noted that no matter how transparent and high-quality the valuation report is, if there is any doubt about the value of the object being evaluated, it will be necessary to re-examine, perform an alternative calculation to determine the real value of the object.

In our view, in order to prevent the above-mentioned cases and adequately protect the interests of those involved in the credit relationship, it is advisable to follow the following sequence between the appraiser and the bank in the valuation process.



Table 1

Stages of organizing the evaluation process²

Stages	The meaning of the stage	Works to be done
Stage 1	Agree on the technical aspects with the authorized officer of the appraisal bank and the borrower	The object to be assessed is determined, the process of its assessment requires the amount of data required and the order of their formation, the errors and limitations that can be made in the assessment process, as well as the timing of the assessment.
Stage 2	Making a contract	The contract can be bilateral or tripartite. Under the tripartite agreement, the bank will also have the right to receive and sign the evaluation report as a customer.
Stage 3	Current advice	The appraiser warns the authorized employee of the bank about possible problems that may occur during the term of the collateral loan, as well as discusses some issues together.
Stage 4	Submit a brief report to the appraisal bank	The appraiser, after submitting a brief report to the bank on the value of the object being pledged as collateral, begins to prepare a report in the absence of objections to it.
Stage 5	Delivery to the customer	Provides a report on the evaluation of the object to the customer.

As can be seen from Table 1, the appraiser acts as an “arbiter” between the client who owns the object and the lending bank that pledges the object.

In our view, the participation of an authorized employee of the bank in the organization of the evaluation process is very important. This is because it is very important to eliminate this risk at the expense of collateral when there is a problem with the repayment of the loan. It is known from practice that in some cases, when commercial banks are forced to repay problem loans with collateral, a number of problems arise, such as collateral ownership, cadastral approved project, accessibility. All this, in our opinion, will be resolved to some extent with the participation of an authorized employee of the bank in the evaluation process and the conclusion of a tripartite agreement. However, in the practice of our country,

²Done by the author



the authorized employee of the bank is not directly involved in the valuation of the borrower's collateral. In our opinion, it is expedient to establish the direct participation of the authorized responsible officer of the bank in the valuation of the collateral by making relevant additions and amendments to the legislation and regulations governing this process.

Prior to the preparation of the market value valuation report, the responsible officer of the bank involved in the process of assessing the collateral on the bank loan should pay special attention to the following:

- ✓ when and at what price the collateral can be sold on the open market;
- ✓ the extent to which the value of the collateral changes during the period specified in the bank loan agreement;
- ✓ the amount of the bank loan and the amount of interest accrued on it, how much it will be sold when it becomes necessary to repay the collateral;
- ✓ how they affect the value of collateral in the event of the sale of the collateral at auction and other unforeseen costs;
- ✓ These include issues such as the extent to which the collateral is needed by the borrower and what role it will play in the business.

Conclusion

As a result of research and studies on the approaches and application of collateral valuation of bank loans, we have been able to formulate the following conclusions and recommendations.

1. The comparative approach is based on market demand and supply valuations of the movable or immovable property being valued. In this approach to valuation, the market value of a similar movable or immovable property of the object being valued is compared.

2. We believe that it would be expedient to expand the practice of financing projects under the security of securities by the banks of the Republic. The current state of development of the stock market allows it.

3. Active financial markets in the country, the availability of specialized financial services, market transparency and data openness are the main conditions for a comparative approach to the valuation of bank collateral.



4. At present, the appraisal acts of independent appraisers are of a recommendatory nature, and the obligation of the appraiser is not significant. In our opinion, it is necessary to increase the responsibility of appraisers in the evaluation process. Through this, it is possible to assess the supply of bank loans and achieve an objective approach to its market value.

In short, the collateral assessment processes of banks and the factors influencing them are multifaceted, and the intended effect can be achieved by ensuring their openness, fairness and transparency.

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