IOV RVF the Valuer Bi- Monthly Journal, Vol. 04 , Issue-03 May - June 2024, PP. 15 - 17

BHUPENDRA PRATAP SINGH

Registered Valuer
L&B IBBI/RV/02/2019/11959

Chartered Engineer, MBA (Real Estate), MIE, FIV

UNVEILING REALIZABLE VALUE: A PARADIGM SHIFT IN BANKING PRACTICES

SYNOPSIS:

This article delves into the transformation of asset valuation within the banking sector following the introduction of Realizable Value by the Reserve Bank of India (RBI) in July 2015. The preface highlights the absence of Realizable Value in pre-July 2015 banking practices and the subsequent regulatory initiatives aimed at enhancing provisioning norms against Non-Performing Assets (NPAs).

This article traces the emergence of Realizable Value post-July 2015, wherein banks began seeking Realizable Value from valuers for provisioning against their advances. However, due to the lack of clarity surrounding the term, banks faced challenges in determining the true Realizable Value. A transition in banking perception is observed, with some bank officers' misconceptions about asset valuation. The advocacy for a defined Realizable Value, spearheaded through various forums and media channels, is explored in depth which culminated in persuading banks to define Realizable Value as "***Market value less Cost of Sale"***, with some public sector banks adopting this definition in their internal guidelines.

This article concludes by emphasizes the need for clarity and standardization in defining and applying Realizable Value across the banking sector. Despite the progress made, challenges remain, particularly regarding determining the appropriate discount factor for the cost of sale and ensuring uniform application of Realizable Value.

Preface: The Absence of Realizable Value in Pre-July 2015 Banking Practices

In the era preceding July 2015, the banking sector functioned without acknowledging the concept of Realizable Value for Immovable/Fixed Assets, which served as security against their advances. It wasn't until July 1st, 2015, when the Reserve Bank of India (RBI) introduced the term Realizable Value in a *circular addressing asset classification and provisioning norms against Non-Performing Assets (NPAs). Despite its introduction, the RBI refrained from furnishing a precise definition for this term. The primary objective behind its inclusion was **to evaluate the realistic market value, thereby evading inflated or asking prices that frequently exceeded the market value.** This strategic shift aimed to facilitate accurate provisioning against loans.

Emergence of Realizable Value: Post-July 2015 Banking Reforms

Following the regulatory mandate, banks commenced seeking "Realizable Value" from valuers for provisioning against their advances, commencing from the Financial Year 2015-16. However, due to the ambiguity surrounding the term "Realizable Value" at that juncture and the backdrop of numerous NPA cases where banks grappled to secure buyers for properties listed for sale under SARFAESI at previously assessed values, a presumption ensued. It was inferred that the value realized at the time of sale constituted the realizable value, which often trailed significantly behind the market value.

Transition in Banking Perception: Realizable Value vs. Market Value

Consequently, a prevailing perception emerged among bank officers that the asking prices or the prices listed on property portals mirrored the market value. Consequently, certain banks began citing the prices listed on property portals as a basis for market value, believing that the eventual transaction values reflected the realizable value, often considerably lower. However, it's imperative to note that the accepted definition of market value predicates on a **value at which a buyer is available.**

The Advocacy for a Defined Realizable Value: Author's Persistent Efforts

Through unwavering advocacy across various forums, **articles, and ***debates on national business TV channels, surrounding the definition of Realizable Value. eventually banks delineate Realizable Value as “***Market value less Cost of Sale”*** (comprising costs of publicity & brokerage, etc.). Some public sector banks promptly adopted this definition and disseminated internal circulars to their credit officers, stipulating a 10% discount over market value to account for the cost of sale. However, considering industry standards, this discount rate should not surpass 5%.

Conclusion: Redefining Realizable Value: A Call for Clarity and Standardization

The integration of Realizable Value into banking practices marked a pivotal paradigm shift, aiming to fortify accurate provisioning against loans and mitigation risks inherent in non-performing assets. However, the absence of a precise definition and standardized methodology for ascertaining Realizable Value gave rise to ambiguity and inconsistencies across valuation practices within the banking sector. Despite the tpersistent advocacy, challenges persist, particularly concerning determining the appropriate discount factor for the cost of sale and ensuring uniform application of Realizable Value across banking institutions.

Moving forward, regulatory authorities must furnish clear guidelines and standardize the definition and application of Realizable Value to bolster transparency, consistency, and reliability in asset valuation and lending practices. By addressing these challenges, the banking industry can effectively mitigate risks, safeguard against losses, and foster sustainable growth and stability in the financial ecosystem.