

USAGE OF COST APPROACH IN COLLATERAL ASSESSMENT PROCESS IN UZBEKISTAN

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Abstract. *In analyzing the collateral valuation process, the researches of various scientists on collateral and valuation are studied. The collateral valuation process is learnt on the example of automobiles while using cost approach. Features of the usage of cost approach in the valuation are investigated and the value of the collateral is determined. Relevant conclusions are formed on the basis of performed analysis.*

Keywords: *collateral, valuation, valuation approaches, cost approach, appraiser, depreciation, types of collateral.*

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INTRODUCTION

In the development of Uzbekistan's economy, it is required to pay serious attention to aspects such as increasing the volume of financial resources, regulating relations between lenders and borrowers, and strengthening the ways of capital reimbursement in the organization of money circulation. In order to positively solve these issues, practices such as effective formation of collateral mechanisms, increasing the level of coverage of collateral provision, and quality organization of collateral evaluation processes are important. There are a number of problems in organizing the above-mentioned practices in our country. In particular, in the process of formation, assessment and regulation of collateral, there is a difference between the determined value and the real value of the collateral, and the incomplete functioning of regulatory mechanisms. For this reason, researching the collateral assessment process in our country becomes relevant.

LITERATURE REVIEW

It can be witnessed that many scholars have conducted studies on collateral evaluation. According to F.Mishkin and others, collateral is property provided by the borrower to the lender, which serves to reduce the risk of default. Because collateral reduces the lender's loss when the borrower becomes insolvent. In this case, the lender can sell the mortgaged property and cover his losses [1].

J. Niupays attention to the need for effective control over collateral as a result of credit growth in banks. In particular, credit growth can occur for various reasons. For example, banks seeking to increase their loan portfolio may lower collateral requirements, simplify contracts, and maintain a liberal credit policy in exchange for lending to borrowers rejected by other banks. In

this case, strengthening collateral and effective control will allow to reduce possible risks [2].

Collateral is a mechanism for balancing lending and eliminating problems caused by asymmetric information between borrowers and lenders [3].

J.A. Mensa notes that collateral plays an important role in credit relations, even though borrowers and lenders have the same information. In such circumstances, collateral provides information to the lender about the project's riskiness and financing prospects. There are two types of bail. The first is called internal collateral, in which the borrower uses an asset in the project to finance it as collateral; if default occurs, the lender owns the project. The second type is called external collateral: unused assets in the project are placed as collateral [4].

According to A. Amiri and others, two approaches are generally used in stock valuation. According to the first approach, the price of the company's shares is taken from the total price of its asset components (land, buildings, plants and machinery) after deducting debts. In the second approach, taking into account that companies operate over an uncertain period, the company's shares are equal to the discounted value of its cash income, which is the risk and associated with financing costs [5].

According to O. Lavrushin, the client's property pledge is a common method of bank loan repayment security. Pledge of property is formalized by a bilateral pledge agreement, and in case of default by the debtor represents the right to cover with the value of one's property [6].

G. Belaoglazova and L. Krolivetskaya focused on the fact that the creditor has the right to sell the mortgaged property in the event of failure to fulfill the obligation secured by the mortgage. In this case, the lender has the right to receive a satisfactory answer about the value of the mortgaged property in preference to other creditors in the process of selling the mortgaged property in case of default by the borrower. Collateral as a security of return should be acceptable and sufficient [7].

U. Azizov, T. Koraliev, Sh. Abdullaeva stated that property pledge is one of the most common forms of credit security. Property pledge is formalized through a pledge agreement. In case of non-fulfillment of the payment obligation, the bank can cover the loan by selling this pledge [8].

According to A. Kalandarov, one of the mechanisms for solving problem loans is to focus the loan payment on the collateral property. When it is implemented, the relationship between the bank and the customer is usually completely severed [9]. Taking into account the opinions and approaches of the above scientists, we can say that the qualitative organization of collateral assessment is important for the efficient operation of banks today.

ANALYSIS AND RESULTS

Currently, the use of borrower's vehicles as collateral is one of the most common practices of commercial banks in our country. In this process, the closer the appraisal value of motor vehicles is to the actual market values, the more the risks of commercial banks are minimized. For this reason, in the practice of our country, commercial banks often use the services of appraisal companies as experts to evaluate collateral. Below, we will analyze the evaluation process for the example of a vehicle in order to use the borrower's vehicles as collateral in the activities of commercial banks.

In our example, the following conditions are reflected. Based on the contract concluded between the customer and the appraiser company “A”, the work of determining the market value of the vehicle “Lacetti” belonging to the customer as a pledge is carried out by the appraiser company "A". The evaluation is done in a cost and comparative approach. In the cost approach, the appraised value of a motor vehicle is determined using a method of calculating its salvage value less physical wear and tear. In the comparative approach, evaluation works are carried out using the method of direct comparison with analogues based on market prices.

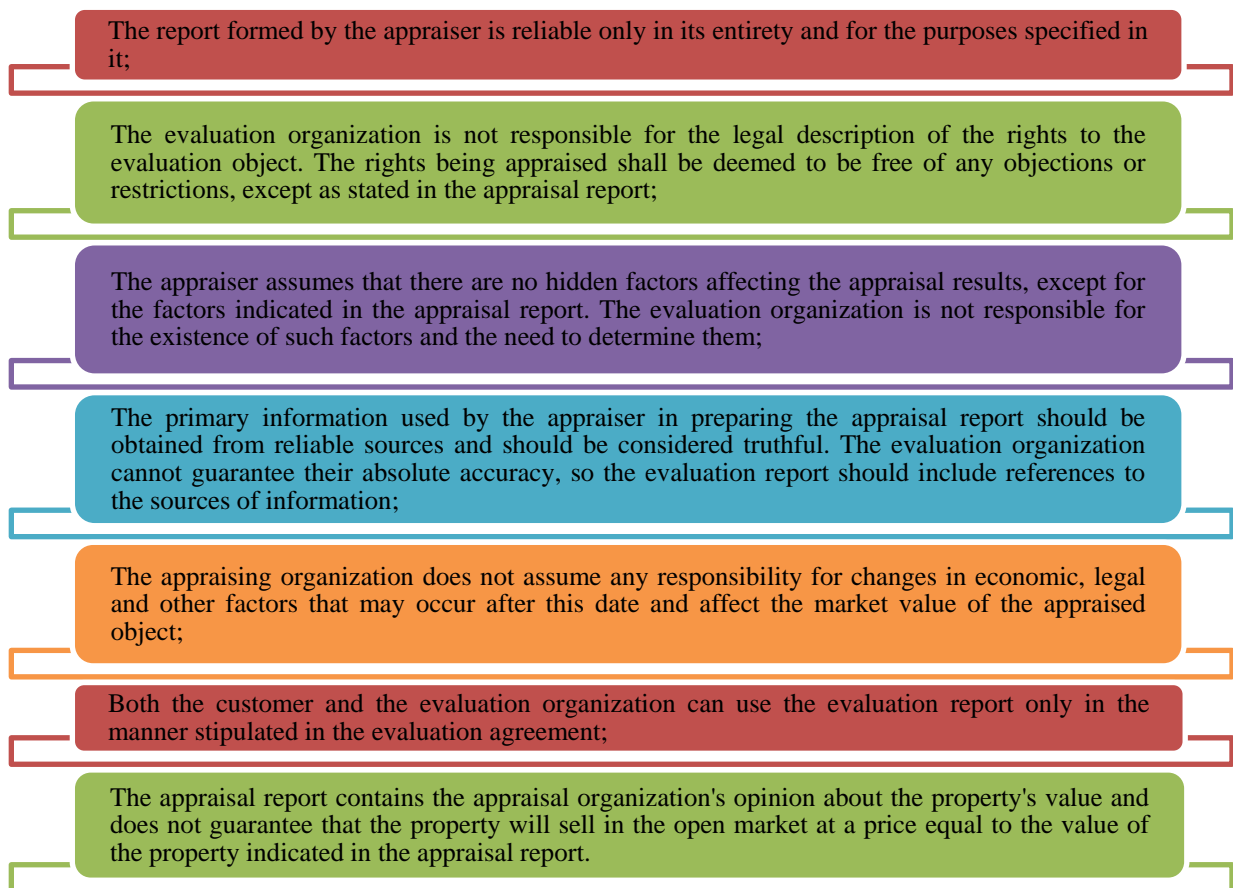



Figure 1. List of assumptions and limiting conditions regarding the valuation¹

During the evaluation process, a list of specific assumptions and limiting conditions regarding the evaluation is formed, and they may consist of the following (Figure 1).

Appraisals are carried out on the basis of full ownership of the relevant property. According to the Civil Code of the Republic of Uzbekistan, the full right of ownership provides for the fulfillment by the owner of legal complexes, in particular, the right of ownership, management and use by the state, on the basis of certain conditions, within the limits of the norms for private property. The documents giving the right to own the property under evaluation, i.e. a copy of the technical passport of motor vehicles, are examined. The right of ownership of the appraised object,

¹The rating was formed by the author based on the reports of the companies

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including property rights, is considered to be formalized in accordance with the requirements of the current legislation.

In order to identify the object of assessment, this object is seen, studied and photographed. As a result of on-site inspection and study of the motor vehicle, the available information provided in the technical passport provided by the customer is compared with the engine, body and other parts of the motor vehicle, and as a result of the comparison, it is determined that the condition of the motor vehicle is satisfactory.

The appraiser uses income, cost and comparative approaches in the appraisal to determine the value of the appraised item. The applicability or limitation of applicability of any approach shall be justified by the appraiser in the appraisal report.

The income approach is not used in this example, as there is no information on individual incomes and expenses from the motor vehicle in the markets and on the Internet within the income approach.

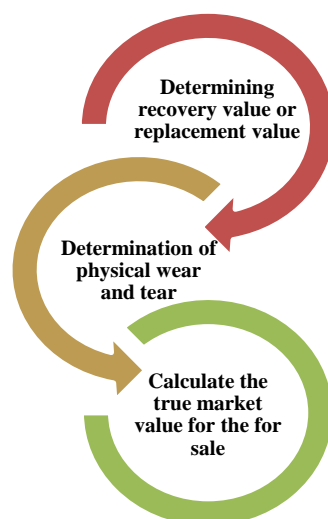


Figure 2. Steps in calculating the value of a motor vehicle in the cost approach²

In the cost approach, the valuation of motor vehicles is based on the calculation of the costs of creating an exact copy of the object of valuation or replacing it with a similar one, minus physical wear and tear. In the cost (property) approach, the calculation of the value of a motor vehicle is carried out in a specified sequence (Fig. 2).

The recovery value is calculated using one of the following methods:

- method of calculation based on the price of a similar object;
- element-by-element calculation method;
- index method.

When determining the restoration value, in cases where the sale price of the same (new) vehicles is known by the method of direct price determination, this information is taken as basic information for determining their restoration value.

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Since the manufacturers and dealers have the Lacetti vehicle in production today and they know the selling price, the direct pricing method can be used to calculate the Lacetti vehicle using the cost approach.

The cost of recovery is determined using the price lists of dealers and suppliers operating in Uzbekistan. After determining the salvage value of vehicles, their depreciation values are determined.

Depreciation value is calculated using one of the following methods:

- wear method determined by an expert;
- the method of wear determined by the distance traveled.

In order to determine the value of motor vehicles, the physical wear and tear of the objects of evaluation is determined by an expert in accordance with the indicators presented in Table 1.

Table 1


Physical wear and tear indicators of evaluation objects³

Condition assessment	Technical condition description	Depreciation
New	New (including installed but not used), excellent condition.	Till 5%
Very good	Equipment that works without malfunctions, has been used for a short period of time, and no defects and malfunctions have been detected.	5% - 20%
Good	Equipment with minor usage defects that do not limit functionality. Equipment in good condition after overhaul.	20% - 25%
Satisfactory	Equipment in satisfactory condition. When choosing operating modes, there may be some restrictions that can be overcome during servicing or current maintenance between repairs.	25% - 50%
Conditionally valid	Malfunctions that require unscheduled repairs are observed in the operation of the equipment. There are restrictions on the choice of operating modes and maximum loads. Major repairs or replacements are required.	50% - 75%
Unsatisfactory	Equipment in poor condition that often breaks down and requires major repairs.	75% - 90%
Unusable	Essentially unusable equipment. There are no options other than selling at cost of the underlying materials still in operation.	Over 90%

Due to the fact that the vehicle is working without malfunctions, it has been used for a short period of time, and no defects and malfunctions have been detected, the rate of wear and tear of the vehicle was taken by the appraiser as 40%.

The appraised value of the vehicle is determined by deducting the level of physical wear and tear from its recovery value (Table 2).

³The author formed based on the reports of rating companies

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Table 2

Determining the appraised value of the vehicle⁴

Name	Recovery value	Final depreciationrate	Depreciation value	Appraisal value
Lacetti	38 126 000,00	40%	55 250 400,00	82 875 600,00

In our example, the final result determined by the cost approach is that the customer's Lacetti motor vehicle, the estimated value of the vehicle determined by the cost approach was 82,875,600 (eighty two million eight hundred seventy five thousand six hundred) soums.

CONCLUSION

The following can be concluded by analyzing the collateral evaluation process.

First of all, the use of collateral in the regulation of debt relations, including in the practice of bank loans, helps to reduce the probability of non-repayment of debts and problem loans in banks in the future. Also, it is possible to get loans at a lower interest rate due to the use of collateral.


Second, special attention should be paid to the valuation approaches used in collateral valuation. In particular, it is necessary to use all assessment approaches when assessing collateral. Unfortunately, we must note that this is not always possible in our national practice. In order to solve this issue, it is necessary to effectively form the state intervention as a macro regulator and to strengthen the collateral evaluation mechanisms.

Thirdly, serious attention should be paid to the processes of training and professional development of evaluators. Because today, in the practice of our country, it is one of the most common cases that there are large differences between the collateral value determined as a result of collateral assessment and the collateral's market value. Serious attention by the state to the above-mentioned issue of personnel training will help to solve this problem.

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⁴Formed by the author

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