1. VALUATION CONCEPTS & PRINCIPLES (6 hours)

1.1 Purposes of Valuation
1.2 Definition of Market Value
1.3 Principles of Valuation
1.4 The Role of the Valuer
1.5 Practices and Challenges in Valuation

Objectives

To enable students to:

1. Value a property on an appropriate basis for a given purpose of valuation.
2. Explain "market value" and "non-market value" bases of valuation.
3. Understand the principles of valuation.
4. Explain the role of the valuer.
5. Recognise valuation practices and challenges

1.1 Purposes and Bases of Valuation

Valuation may be defined as *the art or science of estimating the value of an interest in a property for a specific purpose at a particular point of time.*

Different valuers could give different values to a particular interest at a particular time. This is because they are making estimates, or opinions of value, which are allowed to differ within certain limits.

When a client asks, *"What is the value of a given property?"* the valuer needs to find out, *"Who wants to know?"* or *"What is the valuation for?"*

This is because a property can have a whole range of different values at one particular moment in time, depending on the **purpose of the valuation.**

> Different purpose may require different value

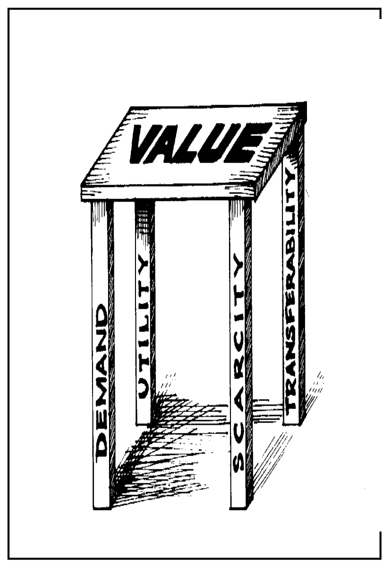
Once the purpose of valuation is known, the valuer would determine the appropriate basis of valuation. **The purpose** of valuation **must be clearly stated** in the valuation report. The basis of valuation for each purpose must comply with SISV's Valuation Standards and Guidelines, unless the client, statutory requirements or legal documents specify otherwise.

Some common examples:

Purposes of valuation	Basis of valuation
**** Sale & Purchase*** **** Financing / Loan Security*** **** Auditing / Accounting*** **** Merger / Reorganisation*** **** Court Proceeding***	***Market Value*** If the valuer provides any other value, he shall explain the basis and reasons for such a value.
Fire Insurance / Indemnification	***Reinstatement Cost*** or ***Insurance Value*** (i.e. such other basis as stated in a fire insurance contract or according to the Land Titles (Strata) Insurance Regulations).
Land Acquisition	According to the *Land Acquisition Act*.
Property Tax	According to the *Property Tax Act*.
Development Charge	According to the *Planning Act*.

So a property can have a whole range of different values (market value, reinstatement cost, annual value, etc) at any one time, but there is ***only one market value***.

1.2 Definition of Market Value



Concepts of Price, Cost and Value

Price is a term used to describe

- the amount asked (hence <u>asking</u> price),
- the amount offered (hence <u>offered</u> price), or
- the amount transacted (hence <u>transacted</u> price or simply price), for a good or service.

It is a historical fact.
It indicates the relative *value* placed on the goods or services by a buyer or seller under particular circumstances.

Cost is the *price* paid for the goods and services or the amount required to create or produce them.
It is a historical fact. The *price* paid for a good or service becomes its *cost* to the buyer.

> E.g. to find *Market value* is to estimate the *price* that a property can sell for in a market. It may or may not sell for that price eventually. So value is not a fact.

Value is an economic concept. It is not a fact.
It is an estimate of the worth of a good or service at a given time according to the particular definition of value. The worth reflects a market's or a person's view of the benefits that can be derived from the good or service.

A valuer arrives at a value, based on the client's terms of reference, by making adjustments to the historical price and cost available in the market.

> Similar properties were *sold* for so much, so the subject property should be *worth* so much….

Value is not intrinsic but results from estimates made subjectively by able and willing buyer of the benefit and satisfaction he will derive from ownership of the interest. What is valued is an interest in property, which gives legal rights of use and enjoyment to a property, and not the physical property per se. (**i.e. extrinsic value**)

> No benefit, no value, even though the property is physically there.

Value in use refers to the subjective value to the user and is measured in terms of utility which does not necessary have a monetary equivalent.

Value in exchange, on the other hand, is that agreed between two parties. In an open market context, this is objective value and in today's economy, is nearly always represented by a monetary value known as price.

Highest and Best Use
This is the most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

> The use that results in the highest value or the most productive use

It is important to forecast the most productive use of land; otherwise the owner may be faced with a situation of under-improvement or over-improvement when the project is completed. ***Over-improvement*** occurs when the capital invested leads to decreasing rate of return with high building cost outlay. On the other hand, ***under-improvement*** occurs when the sum invested is too little and thus did not tap the maximum power of the site.

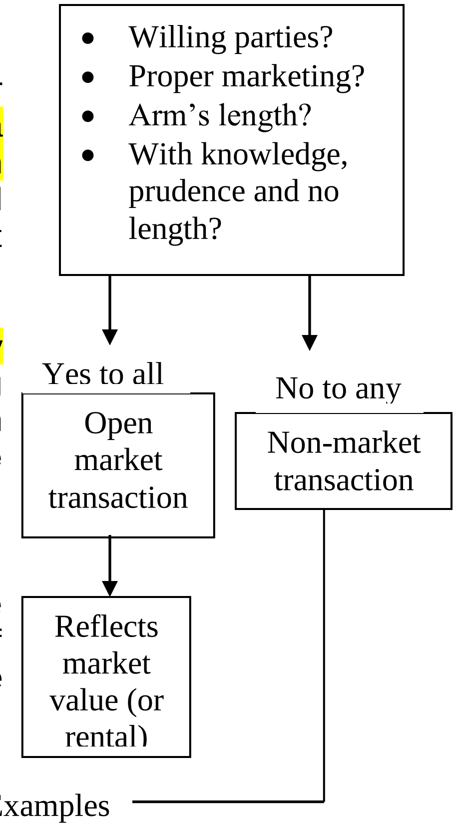
"Market Value"

This is the most common basis of valuation. To estimate Market Value, the valuer must first estimate the **highest and best use** for the property in question.

Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing where the parties had each acted knowledgeably, prudently and without compulsion.

Market Rental is the estimated amount for which a property would be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction after proper marketing where the parties had each acted knowledgeably, prudently and without compulsion.

Transactions which do not meet the above criteria therefore do not reflect open market value. The following categories of sales are examples of those transactions which may <u>not</u> be concluded at market value:



Forced sale
Purchase by an adjoining owner
Sale between members of a family
Inter-company transaction
Sale to a sitting tenant

Non-Market Value Bases of Valuation

Examples of non-market value basis:

Non-market value basis	What it means
Existing Use Value	The market value of a property based on continuation of its existing use, regardless of whether the existing use represents the highest and best use of the property
Insurance Value	The value of property on the basis as defined in the insurance contract or policy
Forced Sale Value	The amount that may reasonably be received from the sale of a property under conditions that do not meet all the criteria of a normal market transaction

Forced sale is a sale under extraordinary circumstances, usually involving an inadequate marketing period, inadequate publicity, inappropriate mode of sale, and sometimes involving an unwilling seller, or sale under compulsion or duress. For these reasons, the price associated with a forced or distressed sale does not represent market value.

It is generally not easy to predict a Forced Sale Value because of the subjective and conjectural assumptions that must be made in formulating such an opinion. Therefore, a valuer shall not provide a Forced Sale Value unless specifically requested by the client, in which case he shall provide the assumptions on which such value is based.

1.3 Principles of Valuation

The following are some of the important principles that set the foundation for property valuation:

Principle of Substitution
The value of any replaceable property tends to equal its cost of replacement or the cost of acquiring an equally desirable substitute.

Principle of Contribution
The value of a component part of a property depends on either how much it contributes to the value of the whole or how much its absence detracts from the value of the whole.

Principle of Surplus Productivity
Income that is available to land is the residual return, after payment to the other three factors/agents of production: labour, coordination and capital.

Principle of Anticipation
Property value is the present worth of future benefits, whether they are in the form of tangible benefits, such as income or capital gain; or intangible benefits, as in the case of home ownership and use.

Principle of Highest and Best Use
The highest and best use of a property means its most profitable or beneficial use.

1.4 The Role of the Valuer

A valuer is a member of the surveying profession who is primarily concerned with the estimation of the value of land and buildings for various purposes, for both open-market and statutory transactions.

The valuer does NOT convey properties. He is expressly prohibited from doing so by the Legal Profession (Amendment) Act 1979. Conveyancing is the task of the lawyer.

The valuer is not restricted only to the estimation of value. With his special knowledge, he is often involved in property management, property development, estate agency works and town planning.

The real estate valuation profession is well established in Singapore. Before one qualifies as a professional valuer or licensed appraiser, one has to complete a basic real estate undergraduate course or obtain an equivalent professional qualification.

Thereafter, exposure to the property market under the guidance of a qualified valuer is essential. In addition, he must be elected as a member of the Singapore Institute of Surveyors and Valuers (SISV). The Inland Revenue Authority of Singapore (IRAS) is the government body that assesses and issues licences to the individual to practise in Singapore under the **Appraisers Act.**

Valuers in Singapore have to abide by the code of ethics, professional standards and guidelines laid down by the SISV. In addition, they are also guided by the standards issued by the Royal Institution of Chartered Surveyors (RICS) and/or those issued by the International Valuation Standards Committee (IVSC). For instance, RICS members are required to abide by the standards/guidelines stated in the “Red Book” unless they can satisfy the RICS that an alternative approach is acceptable and not indicative of negligence of their part.

A professional valuer should endeavour to give an unbiased and fair value of a property, after proper investigation and due consideration of the factors affecting the value of a property.

1.5 Practices and Challenges in Valuation

Valuation of Green Buildings/Sustainable Developments

The green building movement started officially in Singapore with the launch of Building and Construction Authority (BCA) Green Mark Scheme in 2005. The scheme is a rating system which provides a comprehensive framework for assessing the overall environmental performance of new and existing buildings, to promote sustainable design, construction and operation practices in buildings. The assessment criteria cover key areas of energy efficiency, water efficiency, environmental protection, indoor environmental quality and other green features and innovation.

According to the BCA's Third Green Building Master Plan (2014), since the launch of Green Mark Scheme, the number of green buildings has grown remarkably, from 17 in 2005, to more than 2,100 in 2014. The Inter-Ministerial Committee on Sustainable Development (IMCSD) report's target for the built environment is to achieve at least 80% of the buildings in Singapore to be green by 2030.

Among the real estate practitioners, concerns have been expressed on how the sustainability and green movement impact property developments and values. Studies have shown that green buildings can achieve cost-effectiveness, energy efficiency, improve heath and productivity of their occupants, and lower environmental impact.

As it is, the concept of sustainability is relatively new to the valuation profession. It is only in recent years that sustainable developments were recognised to have possible significant impacts on property values.

Valuers should therefore be mindful of the common green features and/or design that are introduced to the developments, and their cost implications. A green building is likely to command a higher value than one which is not green. In the longer term, when every building will be green-certified, the difference in value would then likely be attributed to the extent of green features or design that has been incorporated.

Automated Valuation Models

An automated valuation model (AVM) refers to a computer software programme that analyses data for valuation. AVMs make use of statistical logarithms (eg. multiple regression analysis) to process data efficiently to assist valuers in the determination of the market value of a property. The Computer-Assisted Mass Appraisal (CAMA) system used by the Inland Revenue Authority of Singapore (IRAS) to automate the assessment of similar properties such as HDB flats, private apartments and others for the purpose of computing annual value and property tax payable, is a good example of AVM.

When applied to an individual property without the assistance of a valuer, the output of an AVM is not, by itself, an appraisal. This is because valuers are required to carry out proper investigations on all matters physically and legally about the property, as well as to interpret and rationalise market trends in order to determine its market value. Neither can the computer carry out these tasks nor can it take the place of humans.

Online valuation tools that provide indicative valuations are now available on many property portals. The Singapore Institute of Surveyors and Valuers (SISV) has issued clear advice to valuers members against the endorsement of such AVMs as valuations.

Desktop Valuation and Endorsement of Indicative Valuation Practices

Desktop valuation generally refers to estimating the market value of a property without undertaking a physical inspection of the property. The request for desktop valuations and/or endorsement of indicative valuations especially by financial institutions in Singapore has been rampant.

However, such practice, if allowed, will have grave impact on the professionalism, image and livelihood of the profession. To endorse on a value to an uninspected property is not a subscribed valuation practice. Valuers are advised to observe the SISV's Code of Ethics to uphold the high standards of practice as one to be synonymous with integrity and credibility.

Business Valuation

Business valuation is concerned with estimating the worth of an entity or a business concern. Unlike a real property, a business comprises both tangible assets as well as intangible assets such as patents, copy rights and others. Hence, the most significant value base of a business is not the location at which the business is operated but the expected profitability and future cash flow expected of the business operations.

The main challenge in business valuation is that, given the nature of a business, the valuation of its worth is subject to variations because of the composition of assets, purpose of valuation and methods of valuation used.

References

Singapore Institute of Surveyors and Valuers. (2015). Valuation Standards And Practice Guidelines. (2015 Edition). Candid Creation Publishing.

Building and Construction Authority. (2014). Third Green Building Masterplan. (http://ww.bca.gov.sg)