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CHAPTER 1**Introduction to Property Valuation**

This chapter provides an introduction to the subject of Property Valuation.¹ A definition of the valuation requirement (i.e. the valuation subject, purpose and date, and the value to be estimated) is provided. In the sections that follow, a focus is made on the several basis of value, in particular distinguishing between Market Value, Investment Value and other commonly used definitions. Finally, a brief description is given of the leading associations that operate in the field of Property Valuation and aim to raise operating standards and standardise international valuation practices.

DETERMINING THE VALUATION REQUIREMENT

The valuation process consists of a sequence of activities which can be defined as follows and will be examined in detail in this book:

1. Preliminary phase:
 - a) Determining the valuation requirement, i.e. the nature of the property and the objectives of the valuation
 - b) Gathering and analysing the documentation and information required.
2. Operational phase:
 - a) Inspection of the property (unless it is exclusively a desktop valuation)
 - b) Identification of the applicable method and criteria
 - c) Gathering of market parameters
 - d) Calculation of the value using the chosen method
 - e) Writing of the valuation report.
3. Conclusion: checking of results.

Before considering the valuation methods and operational procedures to be used in carrying out the valuation, it is essential to identify all the elements that contribute to determine the valuation requirement unequivocally. Mostly, the valuer has to answer the following questions:

1. What is the subject of the valuation?
2. What is the purpose of the valuation?
3. What is the value definition to be estimated?
4. What is the valuation date?

The Subject of the Valuation

Without going into too much detail regarding the legal framework, which is outside the scope of this book, and even though the subject of the Property Valuation might also be security rights



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and limited use rights (*iura in re aliena*, such as surface rights or usufruct), throughout this book we shall refer exclusively to the full and exclusive right of ownership over a property, without going into the valuation of other cases, even though they are relatively frequent in professional practice.

We would also refer the reader to Chapter 2 for a detailed consideration of the economic characteristics and the classification of properties, as proposed by the authors.

Purpose of the Valuation

Concerning the purpose of the valuation, there are many circumstances that could result in a need (for regulatory compliance) or interest (for the client's reasons) in knowing the value of a property. Typically, however, the reasons stem from decisions of a financial nature which, being based on rational choices, require knowledge of the value of the asset itself. The most common purposes include, for example:

- Transfer purposes: M&A, inheritance transfers, court proceedings, sale and purchase of companies, transfer of companies and business branches, IPOs, and expropriation procedures.
- Strategic purposes: financing transactions, valuations for insurance purposes, tax compliance, statutory compliance, and compensation disputes.
- Economic feasibility: feasibility analysis, purchase or leasing decisions, and investment decisions.

In reality, as we shall see further on, where the Market Value is being determined, the purpose of the valuation has no impact on the value itself, which has to be unequivocal regardless of the client/Owner and his/her specific reasons.

Value to Be Estimated

The 'value to be estimated' is simply the 'basis of value' to be used for the valuation, details of which are given in the Section 'Definitions of Value' below. As stated in the Preface, this book focuses on valuations of the Market Value, but there are many 'types' of values to be estimated, including Investment Value or insurable value.

Valuation Date

Regarding the 'valuation date', a distinction should be made between:

- Report date: 'the date on which the valuer signs the report'²
- Valuation date (or 'date of valuation'): 'the date on which the opinion of value applies'³
- Date on which the investigations were carried out or were completed.

The valuation date is of particular interest as it can be in the present (at the time the valuation is requested) or in the past, but also in the future (in the hypothesis that, e.g. certain conditions will be satisfied).

While on the one hand a retrospective (or *ex-post*) valuation, i.e. referring to a past date, may seem easier, as there is typically a greater amount of information available to the valuer, on the other it is important to point out that the valuation has to be carried out as if one were



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living in the past and, therefore, without being aware of events that may have subsequently modified the value of the asset. A typical case in which a retrospective assessment may be required is that of tax, administrative or judicial litigations.

Conversely, a prospective (or *ex-ante*) valuation, referring to a future date, requires the valuer to base the estimate not just on current market expectations (as in the case of a valuation referring to the present), but also by incorporating events that have not yet occurred into its own forecasts. A typical case in which a prospective assessment may be required is that of a Development Project, where the value of the asset once completed needs to be appraised with reasonable accuracy, even though at present the development has not yet been completed. In fact, as detailed later on, valuations carried out with the Income Capitalisation Methods, for estimating the Present Value of a property, require an appraisal of the prospective value of the same (the so-called 'Terminal Value'), which is one of the main limitations of the same criterion.

It is particularly important to identify the valuation date correctly because it allows the valuer and users of the valuation to support and justify adequately the result achieved. In a broader sense, identifying the date can be viewed as an analysis of the conditions of the relevant market for the property and therefore of all the factors that positively or negatively influence its value. An accurate and comprehensive description of the contingent situation of the market in which the asset is located is an essential condition for correctly determining the estimated value.

Only after having answered these questions fully will it be possible to identify the most appropriate valuation method, apply the most appropriate approach for estimating the value, and, finally, verify the results of the valuation.

DEFINITIONS OF VALUE

The objective of the valuation activity is to estimate the value of an asset. In the broadest sense, the term 'valuation' involves a judgement on the equivalence between a property (the one being valued) and an amount of money (unit of measurement), given certain conditions and within a specified period. Valuing a property, therefore, means expressing its value in an amount of money, which is why choosing the right definition of value is of primary importance.

Market Value

There is currently no unequivocal definition of Market Value. There are as many definitions as there are national and international associations, entities or bodies (see also Section 'Valuation Associations, Codes, and Standards') determining the standards for Property Valuation. Among the most frequently used are the definitions adopted by the Appraisal Institute, Royal Institution of Chartered Surveyors (RICS) and The European Group of Valuers' Associations (TEGoVA).

- Appraisal Institute (2002): 'The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress'.
- RICS (2017): '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,



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after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion’.

- TEGoVA⁴: ‘The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion’.

Albeit with a few different nuances, all the definitions include the same basic concepts:

1. A certain amount of money has to be estimated by a competent person as being the consideration payable for the sale of the property.
2. The date as of which this consideration must be estimated is the valuation date.
3. There must be two distinct and independent players: a seller willing to sell at the best price achievable on the market and a buyer willing to buy, but without paying a higher price than he/she could pay for a similar asset.
4. The transaction must only take place following adequate marketing, i.e. the property must remain on sale for a sufficient time to ensure that it can be assessed by a sufficient number of potential buyers.
5. Both the seller and the buyer must act with full knowledge of all the information concerning the property, and both must be willing, and not obliged or forced, to complete the transaction.

Furthermore, according to the authors, the Market Value implicitly considers in its definition the Highest and Best Use (HBU), namely any use of the property that is physically possible (i.e. technically achievable), financially sustainable, legally permitted (or allowed by town planning regulations), economically convenient (which offers the best profitability) and which therefore allows the value itself to be maximised. Therefore, according to the authors, there is a single Market Value for each property, not a Market Value ‘as is’ and a Market Value in the event of it being used in a way that maximises its value. This better use of the asset should not be viewed in absolute terms. It has to be the best reasonable use attributed to the property by a typical player on the market. There may be a particular use that only some players are able to identify and achieve, the value of which (in this case the Investment Value, as defined in greater detail in the next section) is greater. In other words, one assumes that if there is a better use than the current one, which all players can reasonably identify, the asset should be valued with this prospect in mind.

To give an example, imagine a property located in the centre of a large city, the ground floor of which is currently used as a car park but could be converted for retail use. Presumably, in the event of a conversion, a higher rent⁵ could be achieved and, therefore, a higher sale price for the property. If the capital gain achieved is higher than the conversion cost, the Market Value of the property will not be the value of the property in its current state, but the value resulting from the conversion of the ground floor, as it is reasonable to believe that the best offer will be made by someone who intends to pursue such a strategy. In other words, in the second case, in order to achieve a higher value, an investment has to be made. However, it is reasonable to assume that, if this investment is profitable, most of potential buyers will value the asset with this in mind. Conversely, if there was another particular use which only some players were able to identify, and which created a higher value (e.g. the Owner of a property that stands



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beside a hotel which might be interested in acquiring this property to create a restaurant), this use would not necessarily have to be considered in the valuation scenarios.

In summary, therefore, without wanting to give a new definition, one can reasonably say that Market Value is understood to be ‘the estimated amount of money, or equivalent means, for which a property should be sold or purchased, as of the valuation date, by a seller and a buyer with no particular ties and both interested in the transaction, on a competitive basis, following an appropriate marketing activity in which both have acted in an informed, conscious and unrestricted way. This amount, subject to certain limits, must reflect the Highest and Best Use of the asset which is physically possible, financially sustainable, legally permitted and economically convenient for ordinary players.

Finally, it is worth mentioning that:

- The concept of Market Value is similar, but does not necessarily coincide with that of fair value, which is understood to be ‘The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (IFRS 13)’.
- Equivalently to the definition of Market Value, there is also a definition of Market Rent. For simplicity, only the following definition is provided: ‘The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion’.⁶

Investment Value

A second very frequently used basis of value is the Investment Value. Again, we have provided below the definitions adopted respectively by the Appraisal Institute, RICS and TEGoVA.

- Appraisal Institute (2002): ‘The specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from Market Value, which is impersonal and detached’.
- RICS (2017): ‘The value of an asset to the owner or a prospective owner for individual investment or operational objectives (may also be known as worth)’.
- TEGoVA (2016): ‘Value of a property to a particular identified party for investment, owner-occupation or operational purposes’.

While the focus of this book on Market Value, given that the assessment investments and their respective financial convenience, in addition to relying on different principles, also requires the use of other criteria not detailed here, it is worth highlighting the main differences between the two definitions previously given.

In seeking a Market Value, the valuer takes an objective approach: in other words, his task is not to determine a value for a particular person or entity, but the value which the market is prepared to attribute to the asset, given that the Market Value is the highest price one could reasonably expect to achieve on the market, taking all the potential types of buyers into account. Consequently, the data used to determine a Market Value must be the most probable data you can get from the market, without referring to a specific person or entity. Conversely, when



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determining an Investment Value, one has to identify a specific person or entity and look at the asset from the latter's point of view, given that the Investment Value is the highest price a specific buyer may offer considering his investment requirements, his knowledge and his strategy.

VALUATION ASSOCIATIONS, CODES AND STANDARDS

As previously stated, there are numerous associations which, at international or national level, have been created and have developed with the primary objective of providing the real estate sector and, in particular, all those operating in the field of Property Valuation, with ethical and professional standards (rules of professional conduct and skills) to increase market transparency and objectivity in the valuation process to ensure, ultimately, greater protection of the various players involved (from simple savers and citizens to professional investors and lending institutions). The following passage is an example:

Consistency, objectivity and transparency are fundamental to building and sustaining public confidence and trust in valuation. In turn their achievement depends crucially on valuation providers possessing and deploying the appropriate skills, knowledge, experience and ethical behaviour, both to form sound judgments and to report opinions of value clearly and unambiguously to clients and other valuation users in accordance with globally recognised norms.⁷

The most important international associations undoubtedly include the Appraisal Institute, RICS and TEGoVA.

- Appraisal Institute⁸: founded in 1932, this is a global organisation of property valuers that includes more than 18,000 professionals in nearly 50 countries around the world. Its mission is to advance professionalism and ethics, global standards, methods and practices in the field of property.
- Royal Institution of Chartered Surveyors⁹: established in 1868, this 'is the global professional body promoting and enforcing the highest international standards in the valuation, management and development of Land, real estate, construction and infrastructure'. Currently, there are 125,000 qualified and trainee property professionals around the world accredited with RICS. Based in London, RICS has regional offices in Brussels, Dubai, Hong Kong, Delhi, New York and Sydney and is currently present in 46 countries.
- TEGoVA¹⁰: created in June 1997 from the previous EUROVAL, The European Group of Valuers' Associations is a non-profit association currently consisting of 72 associations of property valuers in 37 countries, representing over 70,000 valuers in Europe. The primary purpose of the association is to create and disseminate harmonised standards for valuation practice, education and certification, as well as for corporate governance and ethics among valuers. TEGoVA supports its members in introducing and implementing these standards, particularly through the publication of the European Valuation Standards (EVS) since the early 1980s.

Although they are not always necessarily implemented by the jurisdictions of the individual countries, the professional assessment standards drawn up by these associations are



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indeed one of their most significant contributions, with which all members working both individually and through valuation firms are required to conform. Of particular interest are the RICS Professional Valuation Standards, better known as the 'Red Book', which comply fully with the International Valuation Standards (IVS) published by the International Valuation Standards Council¹¹ (IVSC) and the 'Blue Book' of the European Group of Valuers' Associations (TEGoVA), which instead contains the European Valuation Standards¹² (EVS).

NOTES

1. In the book, the words 'valuation' and 'valuer' are sometimes substituted by the words 'appraisal' and 'appraiser'. Similarly, many other specific terms may often be identified synonymously. The theory relating to real estate valuation is indeed pretty wide and sometimes different words are used to express the same concepts (simply think about different terms in British English and American English).
2. RICS (2017).
3. RICS (2017).
4. EVS1 referring to Regulation 575/2013/EU, art. 4, paragraph 1, point 76.
5. The terms 'rent', 'rental' and 'lease' are often used as synonyms in common practice. However, they refer to different things and they might assume different definitions in different countries due to different legislative frameworks. Indeed 'rental' might refer to 'an arrangement to rent something for a period of time, or the act of renting something' as well as to 'the amount of money that you pay to rent something for a period of time' (online Cambridge Dictionary). Moreover, a 'rental agreement' is usually referred to a tenancy of a short period (less than 30 days), that is automatically renewed at its end unless the tenant or the Owner (who has the right of changing the terms of the agreement with proper written notice) ends it by giving written notice, while a 'lease agreement' is usually referred to a set term (6 months, 1 year or even longer periods), where the tenant pays the 'rent', the amount of which cannot be raised by the Owner (who cannot change the conditions), unless the tenant agrees. For the sake of simplicity, in the book the term 'rent' has been used to indicate the amount of money corresponded for the Use of Space, the term 'rental' has been used as an adjective (such as 'rental market', 'rental sector', 'rental level', etc.) and, finally, the term 'lease' has been used to identify the contractual relationship between the tenant and the Owner ('lease agreement').
6. Definition adopted by RICS (2017).
7. RICS (2017).
8. www.appraisalinstitute.org
9. www.rics.org
10. www.tegova.org
11. www.ivsc.org
12. www.tegova.org/en/p4912ae3909e49