CHAPTER 4

A New Simple Classification of Valuation Methods

Theory[1] and practice usually agree on identifying three different approaches to Property Valuation, which have been summarised as follows by RICS (2017):

1. A market approach, 'based on comparing the subject asset with identical or similar assets (or liabilities) for which price information is available, such as a comparison with market transactions in the same, or closely similar, type of asset (or liability) within an appropriate time horizon.'
2. A cost approach, 'based on the economic principle that a purchaser will pay no more for an asset than the cost to obtain one of equal utility[2] whether by purchase or construction.'
3. An income approach, 'based on capitalisation or conversion of present and predicted income (cash flows), which may take a number of different forms, to produce a single current capital value.[3] Among the forms taken, capitalisation of a conventional market-based income or discounting of a specific income projection can both be considered appropriate depending on the type of asset and whether such an approach would be adopted by market participants.'

Each approach has its methods with different application criteria:

1. Market Approach Methods[4]:
   a) Direct Comparison Approach[5]
   b) Hedonic Pricing Model
   c) Multipliers and Rules of Thumb.[6]
2. (Depreciated) Cost Approach Methods:
   a) Replacement Cost Approach[7]
   b) Reproduction Cost Approach[8]
3. Income (Capitalisation) Approach Methods:
   a) Direct Capitalisation Approach
   b) Discounted Cash Flow Approach[9] (DCFA).

The traditional repartition above, although widely used in practice and literature, has at least two limitations:

1. The (Depreciated) Cost Approach Methods,[10] which are not only severely limited in their applicability but often also fail to provide a Market Value, resulting instead, in some cases, in the maximum price obtainable from a potential sale of the property.

2. Both the Market Approach and the Income Approach Methods are based on market data, so both should be defined as 'comparative', with the sole difference being the subject of comparison.