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REA625
Real Estate Valuation

Lecture 1



Real Estate Management

Lecture 1

REA625

Real Estate Valuation

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Contents

- **Introduction to Real Estate Valuation**
- **The Concept of an Asset in Valuation**
- **Overview of Valuation Bases**
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Introduction to Real Estate Valuation

Real Estate Valuation is defined as:

*“a systematic process of determining the **estimated value** of a specific property at a given date, through the application of appropriate valuation methodologies, in accordance with the International Valuation Standards , taking into account the characteristics of the property, market conditions, and the purpose of the valuation”.*

Introduction to Real Estate Valuation

Valuation Standards:

International Valuation Standards (IVS, 1985)

International Valuation Standards Council (IVSC), 1981

Royal Institution of Chartered Surveyors (RICS, Red Book 1974)

Royal Institution of Chartered Surveyors (RICS), 1868

European Valuation Standards (EVS, Blue Book, 1977)

TEGoVA (The European Group of Valuers' Associations)

Introduction to Real Estate Valuation

➤ Comparative Table of Valuation Standards

Standard	Issuing Body	Scope	Main Objective	Sub-Objectives
IVS International Valuation Standards	International Valuation Standards Council (IVSC)	Global	To provide a unified global framework and methodology for valuation and enhance the reliability of valuations	• Promote confidence in valuation results used in financial and non-financial contexts
				• Provide internationally recognized methodologies applicable to all asset types
				• Support transparency and financial stability
				• Establish a common professional language among valuers, users, and regulatory authorities
RICS Red Book RICS Valuation – Global Standards	Royal Institution of Chartered Surveyors (RICS)	International / Professional	To ensure integrity, independence, and quality of valuation reports while building user confidence and protecting the public interest	• Promote ethical and professional conduct of valuers
				• Ensure consistency and quality in the preparation of valuation reports
				• Protect the public interest and end-users
				• Align professional practice with IVS while adding detailed professional requirements

Introduction to Real Estate Valuation

Standard	Issuing Body	Scope	Main Objective	Sub-Objectives
EVS European Valuation Standards	The European Group of Valuers' Associations (TEGOVA)	European	To align valuation practice with European legal and regulatory frameworks and enhance consistency and applicability	• Support consistency of valuations across European countries
				• Ensure compliance with European and national legislation
				• Facilitate practical application of standards by valuers and public authorities
				• Support regulatory, tax, and planning uses

Introduction to Real Estate Valuation

➤ The Definition of the Valuer:

An individual, group of individuals or individual within an entity, regardless of whether employed (internal) or engaged (contracted/external), possessing the necessary qualifications, ability and experience to execute a valuation in an objective, unbiased, ethical and competent manner.

Who
does it?

In some jurisdictions, licensing is required before one can act as a valuer.

Each valuation must provide an informed and independent opinion of value supported by a recognized basis or bases of valuation.

Introduction to Real Estate Valuation

➤ The Importance of Real Estate Valuation:

**Why do We need a
Real Estate Valuation?**

- ❖ **Real Estate Valuation as a Core Component of the Financial System**
- ❖ **The Role of Real Estate Valuation in Legal and Regulatory Contexts**
- ❖ **The Expansion of Valuation Applications Beyond Traditional Real Estate**

Introduction to Real Estate Valuation

➤ The Importance of Real Estate Valuation:

❖ Real Estate Valuation as a Core Component of the Financial System

The Real Estate Valuation is regarded as a fundamental component of the **financial and economic system**, as financial markets and various institutions rely on it for:

- ✓ The recognition and inclusion of asset values in financial statements.
- ✓ Supporting lending, financing, and investment decisions.
- ✓ Enhancing transparency and financial stability within the financial system.

The International Valuation Standards (IVS) emphasize that valuations are widely used in financial markets as well as in other contexts, and that the adoption of consistent and unified standards enhances confidence in valuation outcomes among users and regulatory authorities

Introduction to Real Estate Valuation

➤ The Importance of Real Estate Valuation:

❖ The Role of Real Estate Valuation in Legal and Regulatory Contexts

The RICS Valuation – Global Standards (Red Book) clarify that **real estate valuations** are required for a wide range of purposes beyond the scope of financial markets, most notably:

- ✓ Taxation purposes, including the accurate assessment of potential tax liabilities.
- ✓ Ensuring the fair distribution of assets in probate and inheritance cases.
- ✓ Matrimonial proceedings and matters involving joint ownership.
- ✓ Litigation and dispute resolution, where valuations support judicial decisions on professional and objective grounds.

RICS further emphasizes that accurate and impartial valuations are essential to ensure fairness, legal and regulatory compliance, and public confidence in valuation outcomes.

Introduction to Real Estate Valuation

➤ The Importance of Real Estate Valuation:

❖ The Expansion of Valuation Applications Beyond Traditional Real Estate

The application of international valuation standards is not limited to residential or commercial real estate; rather, it extends to include:

- ✓ Commercial buildings and industrial complexes.
- ✓ Plant, machinery, and equipment for insurance, sale, or restructuring purposes.
- ✓ Financial instruments, including securities and derivatives.
- ✓ Intangible assets such as goodwill, trademarks, and intellectual property.

This broad scope of application contributes to the development of a common valuation language across industries and geographical regions, and supports compliance with International Financial Reporting Standards.

The Concept of an Asset in Valuation

What do
We
evaluate?

Asset

- The concept of an **Asset** constitutes a cornerstone of **valuation practice**.
- **An Asset** is defined as “**The right to an economic benefit.**”
- **This definition** deliberately **does not focus** on the **physical object itself**, but rather on the **legal or economic right associated with it**.

What Is
Meant by
“Right”?

Right

- A legal or contractual entitlement
- A right that can be held, transferred, or restricted
- A right that is enforceable and protected by law

The valuer does not value the **building or the land as a physical object**, but rather the rights attached to that property.

The Concept of an Asset in Valuation

What Is
Meant by
“Economic
Benefit”?

**Economic
Benefit**

- Income generation (e.g. rental income)
- Cost savings
- Disposal or sale Potential
- Anticipated future value growth.

Examples

- Vacant land → future economic benefit
- Income-producing property (rented building) → current income stream
- Easement right → operational or functional benefit

The Concept of an Asset in Valuation

Easement Right	An easement is a right to use or benefit from property owned by another party. In real estate valuation, this right is assessed as an asset representing an economic benefit, as it affects the property's value, either in the form of a direct benefit to the beneficiary or as a restriction on the property owner.
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Property	Type of Easement	Impact on Value
Industrial land parcel	Pipeline easement crossing the site	Reduces the value of the land for the owner, while providing an operational benefit to another party
Commercial building	Right of way to access a parking area	Generates an operational benefit for the tenant or another property owner

Why Is an
Asset Not
Defined as
a Physical
Object?

The Concept of an Asset in Valuation

An asset may be intangible, and May consist of rights such as:

- ✓ Usufruct or rights of use
- ✓ Leasehold interests
- ✓ Development rights
- ✓ Trademarks or other intellectual property

Asset = an economic right and not necessarily Asset $\equiv$ a tangible object

The Concept of an Asset in Valuation

➤ Illustrative examples

Scenario	Subject of Valuation
Freehold land ownership	Ownership right
Income-producing building	Leasehold or rental rights
Long-term lease contract	Right of use
Land subject to planning restrictions	Restricted property right
Development project	Development right

The Concept of an Asset in Valuation

➤ Implications for the Valuer's Work

The valuer should clearly identify the asset being valued

The valuer should explicitly define:

✓ The nature of the right

✓ Its duration

✓ Any legal or regulatory restrictions

Since **differences** in rights result in **differences in value**, even where the physical property remains the same.

The Concept of an Asset in Valuation

In valuation, an asset should **not** be **understood** as a **physical object**, but as a **right to an economic benefit**.

Consequently, **valuation** focuses on **the economic rights associated with real estate** rather than **the property itself**. This explains why **different values** may arise **for the same property depending on the type of right held or the restrictions imposed upon it**.

Overview of Valuation Bases

➤ Meaning of Basis of Value:

A Basis of Value is defined as:

“A statement of the **fundamental assumptions** made for the **purposes of a valuation** for a **define purpose**.”

A **basis of value** represents the **fundamental premise** on which a **reported valuation is, or will be, based**.

It defines **the type of value** being estimated and provides the **conceptual framework** that governs **how the valuation is undertaken**.

According to RICS and IVS, a **basis of value** is **not the value itself**, but rather the **underlying assumption that determines how the value is derived**.

Overview of Valuation Bases

➤ Meaning of Basis of Value:

It is **not possible** to discuss “value” **unless** the **basis** on which that **value** is estimated is clearly identified and understood.

The **basis of value** is **distinct** from **valuation approaches**

The **basis of value** represents the **assumptive framework of the valuation**.

It defines the **underlying assumptions**, including:

- ✓ Who the parties to the transaction are,
- ✓ How they are assumed to act,
- ✓ The nature of the market,
- ✓ The relevant time horizon

Overview of Valuation Bases

➤ Meaning of Basis of Value:

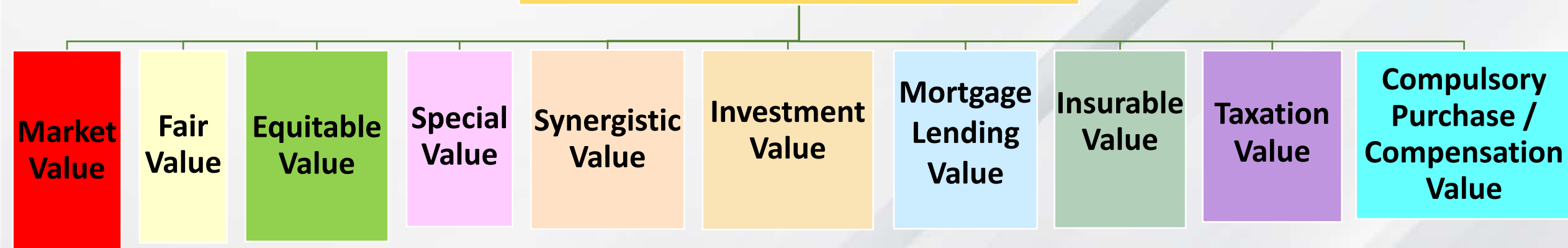
The valuation approach (or method) refers to the **technical and analytical tools**—including financial, mathematical, and market-based techniques—**used by the valuer** to arrive at a **numerical value conclusion**.

The **basis of value** establishes **what type of value is being estimated**, while **the valuation approach** determines **how that value is calculated**

Overview of Valuation Bases

➤ Types of Valuation Bases :

Types of Valuation Bases



Overview of Valuation Bases

➤ Relationship Between Basis of Value and Purpose of Valuation:

RICS emphasizes that **the valuer** must ensure that the **basis of value** adopted is **appropriate** for and **consistent** with the **purpose of the valuation**.

The selection of a basis of value must never be arbitrary or based solely on professional habit; instead, it must be driven by the **intended use of the valuation**.

Overview of Valuation Bases

➤ Relationship Between Basis of Value and Purpose of Valuation:

Market Value

Valuation for sale or purchase

Investment Value

Valuation for a specific investor's decision-making

Fair Value

Valuation for financial reporting

Overview of Valuation Bases

➤ Use of Internationally Recognized Bases of Value:

Where a **basis of value** defined in the **International Valuation Standards (IVS) or RICS Global Standards** is adopted, the **valuer must**:

- ✓ Apply the basis strictly in accordance with its formal definition.
- ✓ Follow the relevant guidance.
- ✓ Adopt all appropriate assumptions or special assumptions associated with that basis

Consistency

Reliability of valuation outcomes

Comparability

Overview of Valuation Bases

➤ Use of a Basis of Value Not Defined in the Standards:

RICS permits the use of a **basis of value not defined** in **the global standards only** under **strict conditions**. In such cases, **the valuer must**:

- ✓ Clearly define the basis of value adopted in the valuation report.
- ✓ Explicitly state that its use represents a departure from the standards, where its adoption is voluntary rather than mandatory.
- ✓ Explain why a recognized basis of value is considered inappropriate for the particular valuation assignment.

The use of an unrecognised or bespoke basis of value without proper justification may result in a valuation report that is ambiguous or misleading, and may constitute a breach of professional standards.

Overview of Valuation Bases

➤ Professional Responsibility of the Valuer:

RICS places clear responsibility on the valuer to ensure that:

- ✓ The basis of value adopted is appropriate to the purpose of the valuation.
- ✓ All mandatory legal or regulatory requirements are complied with.
- ✓ The basis of value is discussed and confirmed with the client at the outset of the valuation assignment, particularly where the choice is not straightforward.

Overview of Valuation Bases

The basis of value is the **cornerstone** of any **professional valuation**.

It determines the **nature of the value being estimated** and **the relevance of the result**.

Valuers must adhere to internationally recognised bases of value or provide full and transparent disclosure when departing from them, in order to maintain clarity, credibility, and professional integrity.

➤ The Definition of the Market Value:

According to the International Valuation Standards (IVS 102), **Market Value** is defined as:

Market value is the **estimated amount** for which an asset and/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** and where the parties had each acted **knowledgeably, prudently** and **without compulsion**.

✓ The most widely used definition globally in professional valuation practice.

✓ Used as a primary reference in real estate and financial transactions.

✓ Must be applied in accordance with the detailed conceptual framework set out below.

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 1: Estimated Amount	
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This refers to a **price expressed in monetary terms**, payable for the asset in a market transaction conducted on an arm's-length basis.

Market value represents the **most probable price** reasonably obtainable in the market as at the valuation date.

Key Characteristics

- ✓ **Best price for the seller:** the most advantageous price reasonably obtainable by the seller.
- ✓ **Most advantageous price for the buyer:** the most favourable price reasonably obtainable by the buyer.

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 1: Estimated Amount	
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Items Excluded from the Estimate:

- ✓ A price inflated or deflated by special terms or special circumstances.
- ✓ A typical or non-standard financing arrangements.
- ✓ Sale and leaseback arrangements.
- ✓ Special considerations or concessions granted by anyone associated with the sale.
- ✓ Any element of value available only to a specific owner or purchaser.

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 2: Should Exchange	
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Market value represents an **estimated amount**, rather than a predetermined number or an actual transaction price.

It refers to the **price in a transaction** that **satisfies all the elements of the market value definition** as at the **valuation date**.

Estimated Value	Actual Price
A neutral professional estimate	The outcome of actual negotiations
Assumes ideal market conditions	May be influenced by special or non-market circumstances
May differ from the actual price achieved	A real price agreed between the parties

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 3: On The Valuation Date

Market value is time-specific as at a particular date.

An **estimated value** may be **incorrect or inappropriate** if applied **at a different point in time**.

✓ The **valuation** amount reflects **market conditions and circumstances as they exist on the valuation date only**.

✓ Markets and market conditions are subject to change.

✓ A valuation **must not be relied upon for a different date** without revaluation.

Example

- *Valuation of a property on 1 January 2024 = USD 1,000,000*
- *An economic crisis occurs in March 2024*
- *The value of the same property on 1 April 2024 may be USD 850,000*
- **✗** *The value as at 1 January 2024 cannot be used for 1 April 2024*

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 4: A Willing Buyer	
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- ✓ Is motivated to purchase, but is neither over-eager nor unduly enthusiastic.
- ✓ Is not compelled to complete the transaction.
- ✓ Makes the purchase decision in accordance with prevailing market conditions and reasonable market expectations.
- ✓ Does not pay a price higher than that required by the market as at the valuation date.
- ✓ Is assumed to act rationally and independently, consistent with the behaviour of a typical market participant.
- ✓ The concept includes the current owner among those who constitute “the market”.

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 4: A Willing Buyer

A Willing Buyer	Not a Willing Buyer
✓ Motivated to purchase	✗ Over-eager or excessively enthusiastic
✓ Not compelled to buy	✗ Determined to buy at any price
✓ Purchases in accordance with current market realities	✗ Purchases based on an imaginary or hypothetical market
✓ Pays only what the market requires	✗ Pays more than the market requires
✓ Includes the current owner as a potential market participant	✗ A special purchaser with exceptional or unique circumstances

➤ *In the concept of **Market Value**, **no specific buyer** is assumed. Rather, the valuation assumes the **presence of a hypothetical willing buyer** who represents the rational behaviour of typical market participants.*

➤ *Any price that reflects **the motivations or circumstances of a particular or special purchaser** does **not constitute Market Value**, but instead falls within **Special Value or Synergistic (Marriage) Value**.*

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 5: A Willing Seller	
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- ✓ Motivated to sell on market terms
- ✓ Seeks the best price achievable in the open market
- ✓ A hypothetical seller
- ✓ Not constrained by personal circumstances

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 5: A Willing Seller

A Willing Seller	Not a Willing Seller
✓ Motivated to sell on market terms	✗ Over-eager to sell
✓ Seeks the best price achievable in the open market	✗ Forced or compelled to sell at any price
✓ A hypothetical seller	✗ Prepared to hold out for an unreasonable price
✓ Not constrained by personal circumstances	✗ Personal circumstances influence the decision

➤ *The willing seller is a hypothetical owner, **not** the **actual owner of the asset**.*

➤ *The factual or personal circumstances of the actual owner are **disregarded in this context**.*

➤ *The willing seller is prepared to sell at the best price obtainable in the open market, whatever that price may be.*

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 6: Arm's-length Transaction

A transaction between parties **who do not have any special or particular relationship** that might result in a price not being market-determined or being inflated.

Assumptions

✓ Market value transaction is presumed to occur between unrelated parties

✓ Each party acts independently

No party exerts influence or pressure on the other

Examples of Special Relationships:

- Parent company and subsidiary
- Owner and tenant
- First-degree relatives
- Companies under common management

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 6: Arm's-length Transaction

Arm's-Length Transaction	Not an Arm's-Length Transaction
Completely independent parties	Parties with a special relationship
No shared interests	Shared or intertwined interests
Price reflects market conditions	Price may be preferential
Genuine competition	Pre-arranged arrangement possible

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 7: After Proper Marketing

The asset has been exposed to the market **in the most appropriate manner** to achieve **the best price reasonably obtainable**.

Method of Sale:

- ✓ Market value transaction is presumed to occur between unrelated parties
- ✓ In the market accessible to the seller

Exposure Period:

- ✓ Not fixed; varies according to the type of asset and market conditions
- ✓ The only criterion: sufficient time to attract a reasonable number of market participants
- ✓ Important: exposure period occurs before the valuation date

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 7: After Proper Marketing

Type of Asset	Typical Exposure Period	Influencing Factors
Standard residential property	3–6 months	Location, price, market conditions
Large commercial property	6–12 months	Complexity, investment size
Specialized industrial property	12–24 months	Limited pool of potential buyers
Luxury property	6–18 months	Limited target market

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 8: Knowledgeably, Prudently

Knowledgeably

Both the willing buyer and seller are presumed to have reasonable knowledge of:

- ✓ The nature and characteristics of the asset
- ✓ Its actual and potential uses
- ✓ Market conditions at the valuation date

Prudently

- ✓ Each party is presumed to use that knowledge wisely
- ✓ Seeks the most favorable price for their position in the transaction
- ✓ Prudence is assessed **with reference to market conditions at the valuation date**, not retrospectively

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 8: Knowledgeably, Prudently	
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Example of Prudence in a Declining Market:

- Previous property price: \$1,200,000
- Current market price in a declining market: \$950,000
- **✗ Incorrect:** Considering \$950,000 as imprudent because it is below the previous price
- **✓ Correct:** Selling at \$950,000 is prudent if it represents the best price reasonably obtainable

Prudence is measured based on information **available at the time of the decision**, not from later hindsight

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

	Element 8: Knowledgeably, Prudently	
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Aspect	Prudent Buyer	Prudent Seller
<i>Knowledge</i>	Understands property characteristics and potential	Understands market value of property
<i>Market Analysis</i>	Studies comparable prices	Knows current supply and demand
<i>Timing</i>	Assesses suitability of purchase timing	Determines suitability of sale timing
<i>Negotiation</i>	Seeks lowest reasonable price	Seeks highest reasonable price
<i>Decision</i>	Based on current market information	Based on current market reality

Market Value

➤ The Conceptual Framework of The Nine Elements of The Definition:

Element 9: Without Compulsion

✓ Each party is motivated to enter the transaction

✓ However, no party is **forced or unduly pressured** to complete it

Seller Compulsion	Buyer Compulsion
Court-ordered sale	Forced purchase to complete a project
Severe financial distress	Strict deadline for purchase
Bankruptcy liquidation	Regulatory acquisition pressure
Government expropriation	Binding contractual obligation

✓ **Motivated to buy/sell:** acceptable and presumed

✗ **Compelled or coerced:** negates the assumption of market value

Lecture Summary: Quick Review

Introduction to Real Estate Valuation

The Definition of the Real Estate Valuation

Valuation Standards

The Definition of the Valuer

The Importance of Real Estate Valuation

The Concept of an Asset in Valuation

Asset

Right

Economic Benefit

Implications for the Valuer's Work

Lecture Summary: Quick Review

Overview of Valuation Bases

Meaning of Basis of Value

Types of Valuation Bases

Relationship Between Basis of Value and Purpose of Valuation:

Use of Internationally Recognized Bases of Value:

Use of a Basis of Value Not Defined in the Standards:

Professional Responsibility of the Valuer:

The Definition of the Market Value:

The Conceptual Framework of The Nine Elements of The Definition:



Market Value



Thank You