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REA625
Real Estate Valuation

Lecture 4



Real Estate Management

Lecture 4

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Recap - Lecture 3

Special Value

The Definition of the Special Value:

Detailed Practical Examples:

Reporting Requirements

Comparison Table: Market Value vs Special Value

Synergistic / Marriage Value

The Definition of the Synergistic / Marriage Value:

Classification Based on Availability of Benefit:

Practical Example/General Synergy/:

Practical Example/Special Synergy/:

Reporting Requirements

Comparison Table: Market Value vs Synergy Value

Recap - Lecture 3

Investment Value / Worth

The Definition of the Investment Value / Worth:

The Characteristics of Investment Value:

Illustrative Examples:

Reporting Requirements

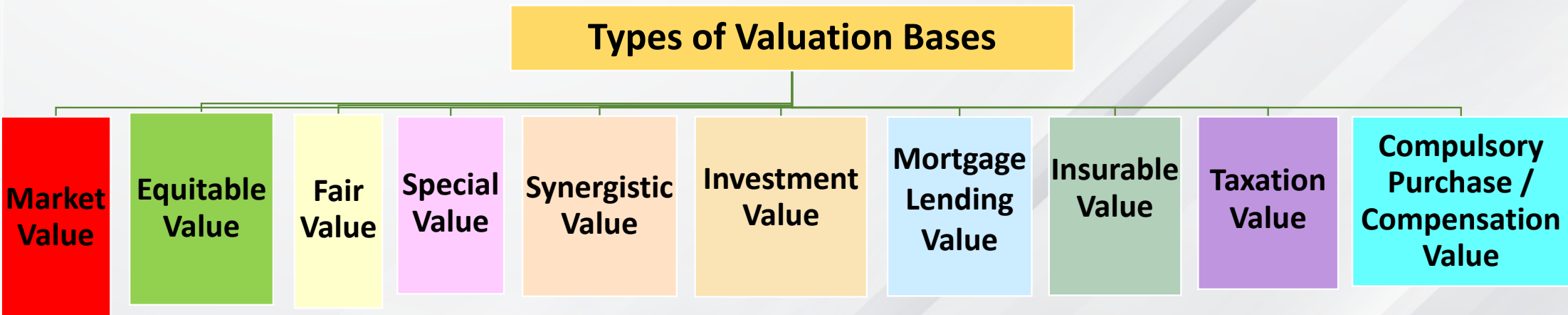
Comparison Table: Market Value vs Investment Value vs
Special Value

Contents

- Liquidation Value
- Mortgage Lending Value (MLV)
- Insurable Value
- Taxation Value
- Compensation Value

Overview of Valuation Bases

➤ Types of Valuation Bases :



Liquidation Value

➤ The Definition of the Liquidation Value:

“The **amount** that would be realized when an asset or group of assets is **sold under forced sale conditions**, where **the seller is under compulsion to sell** and cannot wait for an optimal marketing period.”

Scenario	Description	Marketing Period	Percentage of Market Value
Orderly Liquidation	Structured and managed sale with a reasonable exposure period	3–6 months	70–90%
Forced Liquidation (Forced Sale)	Urgent sale under severe compulsion and time pressure	30–90 days	40–70%

Liquidation Value

➤ Key Characteristics:

- ✓ **Compulsion:** The seller is obligated to sell (not a willing seller), such as in cases of insolvency, bankruptcy, or court-ordered execution.
- ✓ **Time Constraint:** The marketing period is limited and shorter than the normal exposure period; optimal marketing may not be feasible.
- ✓ **Stigma Effect:** The market may perceive the asset negatively because it is a “forced sale.” Purchasers are aware of the seller’s weakened bargaining position.
- ✓ **Below Market Value:** Liquidation value is generally lower than Market Value.
- ✓ **Market and Asset Sensitivity:** The level of discount depends on the asset’s nature and market liquidity.

Liquidation Value

➤ Factors Affecting Liquidation Value:

Factor	Impact on Value	Example
Asset Type	More liquid assets = smaller discount	Residential apartment vs. specialised factory
Market Conditions	Active market = higher realization	Boom period vs. recession
Marketing Period	Longer period = higher value	6 months vs. 30 days
Portfolio Size	Bulk sale = greater discount	Entire real estate portfolio
Location	Prime locations = lower discount	City centre vs. peripheral area

Liquidation Value

➤ Practical Example:

Scenario

- A distressed factory.
- The normal marketing period for such an asset is 12 months.
- The court orders its sale within 60 days to satisfy outstanding debts.

Numerical Data

- **Market Value (MV)** assuming a 12-month exposure period: SAR 5,000,000
- **Forced Sale Discount:** The valuer estimates that an accelerated sale would require a 30% discount to attract opportunity buyers (typically cash purchasers).

$$\text{Liquidation Value} = 5,000,000 \times (1 - 30\%) = 3,500,000 \text{ SAR}$$

$$\text{Liquidation Value} = 3,500,000 \text{ SAR}$$

Liquidation Value

Reporting Requirements

1) Clear Statement of the Basis of Value

- ✓ Explicit declaration of the nature of compulsion and its cause (e.g., court-ordered realisation, insolvency proceedings, enforcement action).
- ✓ Identification of the type of liquidation (Orderly Liquidation / Forced Sale).
- ✓ Specification of the assumed marketing period (e.g., sale within 30 days).
- ✓ Disclosure of any Special Assumptions in accordance with IVS and the RICS Red Book (e.g., assumed restricted exposure period).

Liquidation Value

Reporting Requirements

2) Market Analysis

- ✓ Assessment of the asset's level of liquidity.
- ✓ Identification of the likely purchaser pool.
- ✓ Analysis of comparable transactions conducted under similar forced or constrained sale conditions (where available).

3) Applied Discounts

- ✓ Clear justification for each discount applied.
- ✓ Benchmarking against comparable forced sale evidence.
- ✓ Explanation of the impact of special circumstances (e.g., stigma, limited exposure, bulk disposal).

Liquidation Value

Reporting Requirements

4) Costs to Realize

- ✓ Selling and marketing costs.
- ✓ Legal and enforcement costs.
- ✓ Management, security, and holding costs (if applicable).

5) Risk Analysis

- ✓ Risk of non-disposal within the assumed marketing period.
- ✓ Risk of further value deterioration due to continued distress or market decline.
- ✓ Legal or title-related risks affecting salability.

Market Value/Liquidation Value

Comparative Table: Market Value vs. Liquidation Value

Element	Market Value (MV)	Orderly Liquidation Value	Forced Liquidation (Forced Sale) Value
Seller	Willing seller (not under compulsion)	Compelled to sell	Under severe compulsion and time pressure
Purchaser	Typical willing buyer	Opportunistic buyer	Distressed / bargain-seeking buyer
Marketing	Adequate and reasonable exposure	Limited (3–6 months)	Urgent (30–90 days)
Negotiation	Balanced bargaining position	Weakened seller position	Minimal or negligible negotiation leverage
Price Level	100% – Best price reasonably obtainable under MV assumptions	70–90% of Market Value (reflecting constrained conditions)	40–70% of Market Value (reflecting severe compulsion)
Terms	Normal market terms	More flexible in favour of purchaser	Highly favorable to purchaser

Mortgage Lending Value (MLV)

➤ The Definition of the Mortgage Lending Value (MLV):

The **value** of immovable property as determined by a **prudent assessment** of the **future marketability of the property**, taking into account its **long-term sustainable aspects**, **normal and local market conditions**, **the current use and appropriate alternative uses**.

“The **long-term sustainable value of a property**, excluding **speculative elements** and focusing on **stable income** achievable over **a full economic cycle**.”

Conceptual MLV Formula:

$$\begin{aligned} \text{MLV} = & \text{Sustainable value over a full economic cycle} \\ & - \text{Speculative elements} \\ & - \text{Short-term volatility} \\ & + \text{Additional prudential margin} \end{aligned}$$

Mortgage Lending Value (MLV)

➤ Key Characteristics:

- ✓ **Prudence:** Excludes speculative elements and short-term market exuberance.
- ✓ **Through-the-Cycle Approach:** Not based on peak or trough market conditions, but on a stabilized long-term value across an economic cycle.
- ✓ **Risk Management Objective:** Designed to protect the lender in the event of borrower default and potential future disposal under adverse market conditions.

Mortgage Lending Value (MLV)

➤ Practical Example:

Scenario

- A residential apartment located in a market experiencing a property bubble (rapid price inflation driven by speculation).
- **Current Market Value (MV):** SAR 2,000,000 (reflecting strong speculative demand).
- **Sustainability Analysis:** Long-term stabilized prices and sustainable rental income support only SAR 1,600,000.

Market Value: SAR 2,000,000
Mortgage Lending Value (MLV): SAR 1,600,000
(SAR 400,000 excluded as **speculative excess**.)

Mortgage Lending Value (MLV)

Reporting Requirements

1) Front Page – Formal Declaration

- ✓ Explicit statement: “Valuation prepared on the basis of Mortgage Lending Value (MLV)”
- ✓ Reference to IVS ,RICS and EVS
- ✓ Valuation date
- ✓ Professional license number

Mortgage Lending Value (MLV)

Reporting Requirements

2) Executive Summary

- ✓ Mortgage Lending Value (numerical figure)
- ✓ Market Value (for comparison) /MLV is typically lower than Market Value due to its prudential nature/
- ✓ MLV/MV ratio
- ✓ Key assumptions

3) Detailed Analysis

- ✓ Long-term market analysis (typically 10-year perspective).
- ✓ Review of previous economic cycles.
- ✓ Assessment of long-term sustainability.
- ✓ Identification of potential downside risks.

Mortgage Lending Value (MLV)

Reporting Requirements

4) Calculations and Financial Basis

- ✓ Sustainable income assessment
- ✓ Conservative capitalization / discount rates
- ✓ Justification of each material assumption

Market Value/ Mortgage Lending Value (MLV)

Comparison Table: Market Value vs Mortgage Lending Value (MLV)

Aspect	Market Value (MV)	Mortgage Lending Value (MLV)
Time Perspective	Spot value — “as at the valuation date”	Long-term sustainable value
Speculation	Reflects current market expectations, including speculative elements	Completely excludes speculative elements
Purpose	Sale, purchase, exchange, financial reporting	Bank risk management, regulatory capital, covered bond eligibility, loan security assessment

Market Value represents the **best price reasonably** obtainable in an open market under standard assumptions.

Mortgage Lending Value, by contrast, is **not a market-based value** but a **prudential, regulatory value concept rooted** in long-term sustainability and lender protection.

Insurable Value

➤ The Definition of the Insurable Value:

“**Insurable Value** (often referred to as **Reinstatement Cost**) is the cost of **replacing or reinstating a damaged asset so as to restore it to its original condition**, using materials of similar kind and quality, **without deduction for depreciation** (in the case of comprehensive “new for old” insurance cover”

Under the cost approach recognized in the International Valuation Standards and the RICS Valuation – Global Standards, **this basis reflects the current cost of construction** rather than **an exchange price in the market**.

➤ Key Characteristics:

Exclusion of Land Value: Land is not subject to destruction by fire or similar perils; therefore, insurance typically covers the building only.

Cost-Based Measurement: The valuation is based on construction cost methodology rather than sale price or Market Value.

Additional Allowances: The assessment normally includes:

- ✓ Debris removal costs
- ✓ Professional fees (architects, engineers, surveyors)
- ✓ Site clearance and compliance costs
- ✓ Contingencies (where appropriate)

Insurable Value

➤ Practical Example:

Scenario

- An old luxury villa located in a low-value neighborhood.
- **Market Value (MV):** SAR 500,000 (land and building combined, reflecting weak location value).
- **Reinstatement Cost:** Construction cost to rebuild the villa to the same luxury specifications today:
 - ✓ Debris removal :SAR 800,000
 - ✓ Professional fees: SAR 50,000

Insurable Value = SAR 850,000

This figure is significantly **higher than Market Value** because it reflects **construction cost rather than market exchange value**.

Insurable Value

Reporting Requirements

- ✓ Clearly state that land value is excluded.
- ✓ Specify whether the basis of assessment is:
 - **Reinstatement (Replacement) Basis** – no deduction for depreciation (“new for old”)
 - **Indemnity Basis** – replacement cost less depreciation.
- ✓ Transparency regarding assumptions, scope of works, and cost sources is required in accordance with IVS and RICS reporting standards.

Market Value/ Insurable Value

Comparison Table: Market Value vs Insurable Value

Aspect	Market Value (MV)	Insurable Value (Reinstatement Cost)
Subject Matter	Land + Building	Building only (in most cases)
Basis	What a buyer is willing to pay (exchange value)	What a contractor would charge (construction cost)
Role of Location	Primary determinant of price	Influences only logistics, labour, and transport costs

Market Value reflects an exchange-based concept under open market conditions.

Insurable Value reflects a cost-based concept focused on physical replacement, independent of land appreciation or market sentiment.

➤ The Definition of the Taxation Value:

“The value determined in accordance with definitions and methodologies prescribed in local legislation for the purpose of levying property-related taxes (e.g., property tax, municipal tax, transfer tax).

Under the framework of the International Valuation Standards and the RICS Valuation – Global Standards, this is classified as a statutory or regulatory basis of value, as it is defined by law rather than by market principles.

➤ Key Characteristics:

Not Necessarily Market-Based: It may rely on fixed formulas, zonal value schedules, or statistical mass appraisal models rather than individual market valuation.

Temporal Rigidity: It may be based on a historic base year (e.g., a 2018 assessment remaining valid until 2023).

Non-Negotiable: The value is imposed by the statutory authority (Assessor) and is not determined through open market negotiation.

➤ Comparative Tax Systems:

System	Country / Region	Basis of Assessment	Update Cycle	% of Market Value
Mass Appraisal	United States / Canada	Statistical valuation models	1–4 years	70–100%
Banding System	United Kingdom	Value bands	Irregular	Variable
Cadastral Value	Continental Europe	Area-based cadastral value	5–10 years	50–80%
Transaction-Based	Middle East	Declared transaction price	At transfer	100%+

➤ Practical Example:

Scenario

- In a certain jurisdiction, property tax is calculated based on a “book value” updated every five years.
- **Current Market Value:** SAR 1,000,000
- **Municipal (Tax) Records:** Property registered at SAR 600,000 (based on an outdated assessment).

Taxation Value = SAR 600,000

This amount constitutes the basis for **calculating property tax**, irrespective of the **property's current market price**.

Taxation Value

Reporting Requirements

- ✓ Clearly state that the purpose of valuation is taxation only.
- ✓ Reference the statutory method of calculation adopted by the relevant tax authority.
- ✓ Clarify that the value may differ materially from Market Value as defined under IVS.

Taxation Value

Comparison Table: Market Value vs Taxation Value

Aspect	Market Value (MV)	Taxation Value (Assessed Value)
Methodology	Individual, property-specific valuation	Mass appraisal models or statutory formulas
Reference Basis	Current market conditions	Statutory regulations and government schedules (registered cadastral value)
Update Frequency	As at valuation date (current)	Periodic (may be every several years)

Market Value reflects **an open-market exchange concept** under IVS and RICS assumptions.

Taxation Value is a **statutory construct** determined by **legislation, administrative policy, and public finance considerations** rather than **direct market evidence**.

Compulsory Purchase / Compensation Value

➤ The Definition of the Compensation Value:

“The monetary amount intended to place the dispossessed owner in the same financial position as if the acquisition had not occurred (Principle of Equivalence).”

The objective of compensation is therefore to ensure that the claimant is neither better nor worse off as a result of the compulsory purchase.

Under the International Valuation Standards and the RICS Valuation – Global Standards, compulsory acquisition valuations are treated as a statutory basis of value, governed by the relevant expropriation or land acquisition legislation.

Compensation Value

➤ Key Characteristics:

Full Indemnity: Compensation is not limited to the value of the real property interest alone.

No-Scheme World Assumption: The property is valued disregarding any increase or decrease in value attributable to the public project for which the land is acquired.

Components of Compensation:

- Value of the land and buildings taken
- Disturbance compensation
- Severance and injurious affection (where only part is acquired)

Compensation Value

➤ Fundamental Principles of Just Compensation:

Comprehensive Compensation Formula:

$$\begin{aligned} \text{Compensation} &= \text{Value of the Land Taken} \\ &+ \text{Injurious Affection (damage to the remainder)} \\ &\quad + \text{Disturbance} \\ &+ \text{Additional statutory entitlements} \end{aligned}$$

Compensation Value

➤ Practical Example:

Scenario

- Compulsory acquisition of a successful restaurant for road widening.
- **Market Value of the property (land and building):** SAR 2,000,000
- **Business interruption losses:** Closure for 3 months during relocation = SAR 150,000 (loss of profits)
- **Relocation costs:** Dismantling and reinstalling equipment = SAR 50,000

Total Compensation = 2,000,000+150,000+50,000=2,200,000 SAR

Compensation Value

Reporting Requirements

- ✓ Clearly itemize each head of claim separately.
- ✓ Refer explicitly to the relevant expropriation or land acquisition statute.
- ✓ Include calculation of operational or business losses (where applicable).
- ✓ State the valuation assumptions, including the application of the No-Scheme World principle.
- ✓ Transparency and legal compliance are essential, as compensation assessments are frequently subject to judicial review.

Compensation Value

Comparison Table: Market Value vs Compensation Value

Aspect	Market Value (MV)	Compensation Value
Components	Real property interest only	Property value + personal and business losses + relocation costs
Owner Assumption	Hypothetical willing seller	Actual dispossessed owner
Governing Principle	Exchange price under open market conditions	Principle of equivalence (“making the claimant whole”)

Market Value reflects a **hypothetical transaction** between willing parties.

Taxation Value reflects a **statutory, claimant-specific assessment** designed to achieve **fairness and financial equivalence** following **compulsory acquisition**.

Comparative Overview of Value Bases

Element	Liquidation Value	Mortgage Lending Value	Insurable Value	Taxation Value	Compensation Value
Nature	Forced sale basis	Prudential long-term value	Replacement cost basis	Administrative/statutory value	Just compensation principle
Basis	Restricted or constrained market conditions	Sustainable market value over full economic cycle	Cost approach	Statutory/legal framework	Market value plus compensable losses
% of Market Value (Indicative)	40–90%	60–80%	80–180%	50–100%	100–250%
Time Horizon	Very short-term	Very long-term (through-the-cycle)	As at date of loss	Periodic assessment cycle	At date of acquisition
Includes Land	✓ Yes	✓ Yes	X No (typically building only)	✓ Yes	✓ Yes

Comparative Overview of Value Bases

Element	Liquidation Value	Mortgage Lending Value	Insurable Value	Taxation Value	Compensation Value
Primary Purpose	Debt recovery / asset realisation	Loan security & regulatory risk mitigation	Risk transfer / insurance coverage	Public revenue generation	Social justice & financial equivalence
Mandatory Nature	Judicial / contractual	Regulatory (banking supervision)	Contractual (insurance policy)	Legal/statutory	Constitutional / statutory
Update Frequency	Case-specific	Periodic (often annual review in banking practice)	Periodic (often annual indexation)	Periodic (multi-year cycles)	Upon compulsory acquisition
Level of Complexity	Moderate	High	Moderate	Low	Very high

Comparative Overview of Value Bases

Element	Liquidation Value	Mortgage Lending Value	Insurable Value	Taxation Value	Compensation Value
Primary Purpose	Debt recovery / asset realisation	Loan security & regulatory risk mitigation	Risk transfer / insurance coverage	Public revenue generation	Social justice & financial equivalence
Mandatory Nature	Judicial / contractual	Regulatory (banking supervision)	Contractual (insurance policy)	Legal/statutory	Constitutional / statutory
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Level of Complexity	Moderate	High	Moderate	Low	Very high

Lecture Summary: Quick Review

Liquidation Value

The Definition of the Liquidation Value

Key Characteristics:

Practical Examples:

Reporting Requirements

Comparison Table: Market Value vs Liquidation Value

Mortgage Lending Value (MLV)

The Definition of the Mortgage Lending Value (MLV)

Key Characteristics:

Practical Examples

Reporting Requirements

Comparison Table: Market Value vs Mortgage Lending Value

Lecture Summary: Quick Review

Insurable Value

The Definition of the Insurable Value

Key Characteristics:

Practical Examples:

Reporting Requirements

Comparison Table: Market Value vs Insurable Value

Taxation Value

The Definition of the Taxation Value

Key Characteristics:

Practical Examples

Reporting Requirements

Comparison Table: Market Value vs Taxation Value

Lecture Summary: Quick Review

Compensation Value

The Definition of the Compensation Value

Key Characteristics:

Practical Examples:

Reporting Requirements

Comparison Table: Market Value vs Compensation Value

Comparative Overview of Value Bases



Thank You