Bases of Value

Introduction to IVS

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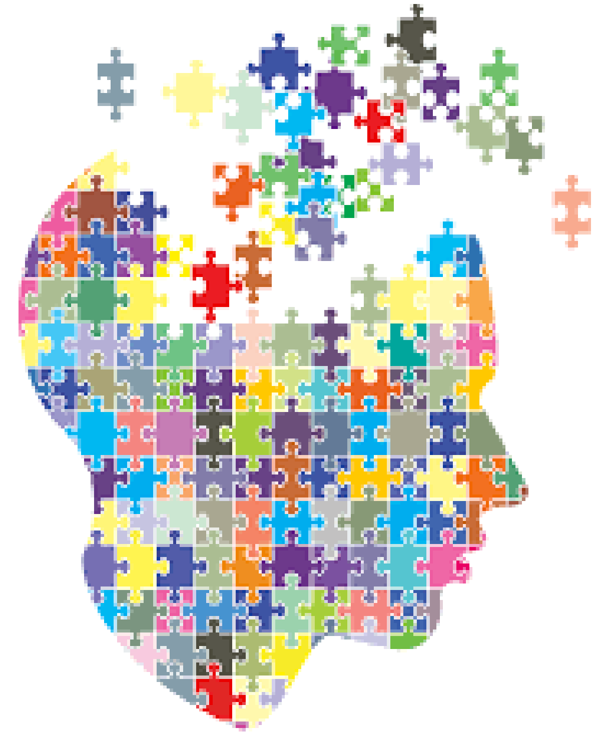
Lectures

Time	What	Who
Mon 15/4 16-20	Introduction & Why we need REV & Course assignment handout	Eero Valtonen & Vitalija Danivska
Mon 29/4 16-18	Bases of value	Vitalija Danivska Mikko Kuusela, JLL
Thu 2/5 16-18	Market approach	Eero Valtonen
Mon 6/5 16-18	Income approach	Eero Valtonen
Thu 9/5 16-18	Cost approach	Vitalija Danivska
Mon 13/5 16-20	Selection of the valuation approach & Use of multiple approaches	N.N, Newsec
Thu 16/5 16-18	Legal valuations/compensation valuations	Kirsikka Riekkinen
Mon 20/5 16-20	Valuation ethics (panel discussion with industry specialists)	Eero Valtonen Panel members

Today's plan:

- **Understanding the concept of Value**
- **Familiarizing with the bases of value, premises of use and valuation uncertainty**
- **Understanding the differences between bases of value and premises of use**



What is value? (IVS 2001)

Value is not a fact but an opinion of either

(a) the most probable price to be paid for an asset in an exchange

(b) the economic benefits of owning an asset

The value (price) reflects the market view of the benefits to the recipient on the valuation date.

The concept of value (1/2)

- Value is largely a subjective concept. There are as many values as people
- The importance of the asset and its benefits vary from case to case, depending on the characteristics of the product, the type of commodity and the strength of the needs.

The concept of value (2/2)

- The value of a commodity cannot be objectively determined; There is no definition that contains all the features and could always have the same meaning for everyone
- There is no absolute value (price), but only the most likely value (price) that can be expressed within certain (error) limits

Determinants of value

1. **Location**
2. **Legal rights**
3. **Physical characteristics, including specification, deterioration and obsolescence**
4. **Environmental attributes**

- **Quality of tenant**
- **Lease terms**
- **Use**
- **Development potential**

The value of a property reflects its capacity to fulfil a function. The value of shop, e.g. will be influenced by trading position, length of frontage, accessibility, planning restrictions and tenure

Bases of Value

Bases of Value

Otherwise called *Standards of Value* – fundamentals on which reported values are based.

Basis of Value may influence valuer's selection of methods, inputs and assumptions

CRITICAL POINT – TO SELECT SUITABLE BASIS OF VALUE!

Common elements in most of bases of Value

- **An assumed transaction**
  - Hypothetical transactions
  - Actual transaction
  - Purchase transaction
  - Sale transaction
  - Transaction in a particular or hypothetical market with specified characteristics
- **An assumed date of the transaction**
  - Date influences what information valuer considers in a valuation
  - Often it is prohibited to use information or market sentiment that would not be known with reasonable due diligence on valuation date by participants
- **The assumed parties to the transaction**

Most valuations provide some description of the involved parties with, e.g. these kind of characteristics:

  - Hypothetical
  - Known or specific parties
  - Members of a described group of potential parties
  - Whether the parties are subject to particular conditions or motivations at the assumed date
  - Assumed knowledge level

Choosing suitable bases of value

According to the terms and *purpose of the valuation* assignment

Basis of value MUST be appropriate for the purpose

Source of the definition of basis of value MUST be cited or explained

Valuer should consider instructions and *input* from the client

Assignment

In groups of 2-3 people, discuss all bases of value that you read about.

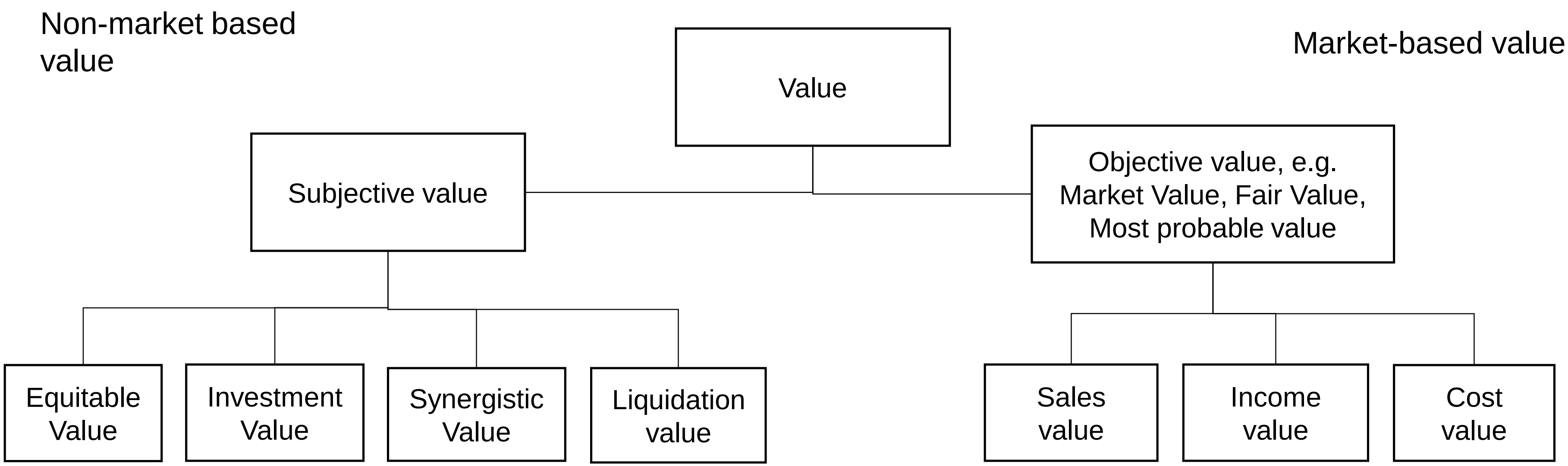
Answer the questions:

- **What are the differences in these values?**
- **How can these values be categorized?**

Time: 10 mins

	Market Value	Fair Value	Market Rent	Equitable Value	Investment Value	Synergistic Value	Liquidation Value
Definition (shortene d)	The most probable price reasonably obtainable in the market on the valuation date	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	Estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee at appropriate lease terms	Estimated price for the transfer on an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.	The value of an asset to a particular owner or prospective owner for the individual investment or operational objectives.	The result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values.	The amount that would be realised when an asset or group of assets are sold on a piecemeal basis.
Market	Open & Competitive	Open market	Open market	Estimates price that is fair between between two specific, identified parties.	Specific to entity	Open market	Open market
Specifics	Reflects highest & best use of an asset	User for financial reporting purposes (or international tax purposes)	Excludes special terms, considerations and concessions	Takes into account matters that are disregarded	Does not involve a presumed exchange	Might differ from Market Value if synergies are available for only one specific buyer	Can be determined under two different premises: Orderly transaction and Forced transaction
	Does not reflect owner/buyer-specific attributes		Used when valuing lease or an interest created by lease	Broader concept than Market Value	Used for measuring investment performance		Should take into account the costs of getting the assets into saleable condition and costs of the disposal activity
	Sales Value, Income Value & Cost Value						

Different kinds of values (IVS 2017)



Market Value

The nature and source of valuation inputs MUST be consistent with the basis of value, which in turn MUST have regard to the valuation purpose.

Market approach – by definition uses market-derived inputs

Income approach – should use inputs and assumptions that would be adopted by participants

Cost approach – cost of equal utility and depreciation should be determined by the analysis of market-based costs and depreciation

Market Rent

Contract Rent is the rent payable under the terms of an actual lease. It MAY be fixed for the duration of the lease or variable. The frequency and basis of calculating variations MUST be identified and understood in order to establish the total benefits.

In some circumstances, **Market Rent** MAY have to be assessed based on terms of an existing lease

When calculating **Market Rent**, valuer MUST consider:

- In regard to a **Market Rent** that is subject to a lease, the terms and conditions of that lease are the appropriate lease terms unless those terms and conditions are illegal or contrary to overarching legislation, and
- In regard to a **Market Rent** that is not subject to a lease, the assumed terms and conditions are the terms of a notional lease that would typically be agreed in a market for the type of property on the valuation date between market participants

Premise of Value

Premise of Value/Assumed Use

A **Premise of Value** or **Assumed Use** describes the circumstances of how an asset or liability is used.

Different bases of value may require a particular Premise of Value or allow the consideration of multiple Premises of Value.

Common premises of Value/Assumed Use

	Highest & Best Use	Current/Existing Use	Orderly liquidation	Forced Sale
Definition	Producing the highest value from a participant perspective	The current way an asset, liability, or group of assets and/or liabilities is used.	The value of a group of assets that could be realized in a liquidation sale, given a reasonable period of time to find a purchaser. ,	Often used in circumstances where a seller is under compulsion to sell and that, as a consequence, a proper marketing period is not possible and buyers may not be able to undertake adequate due diligence.
Specifics	MUST be: physically possible, legally allowed financially feasible,		The seller is compelled to sell on an as-is, where-is basis	The price will reflect the particular circumstances of the seller rather than a willing buyer (in Market Value def.)
	MAY be same as other premises of value	MAY be, but is not necessarily, also the highest and best use.		A "forced sale" is a description of the situation under which the exchange takes place, not a distinct basis of value.
Applied to	Most frequently applied to non-financial assets	Applied to all assets and liabilities	Applied to all assets and liabilities	Applied to all assets and liabilities

Valuation Uncertainty

Valuation Uncertainty

The **possibility that the estimated value may differ** from the price that could be obtained in a transfer of the subject asset or liability taking place **on the valuation date on the same terms and in the same market.**

Fluctuations ca be caused by factors such as differences in the objectives, knowledge or motivation of the parties

Arising in valuations on the basis of **Market value** or **Fair value.**

Risk vs Uncertainty

- Risk is normally reflected in market prices
- Risk may be thought of as a measure of future uncertainties
- Risk can often be quantified

- Uncertainty is concerned only with uncertainties that arise as part of the process of estimating value on a specific date
- Valuation certainty and market risk are independent of each other.
- Should not be confused with stress testing

Only ***material*** uncertainties are considered in valuations

2 aspects:

- **Whether the potential impact is significant**
  - Potential magnitude of any “margin of error”
  - (Quantifying is difficult, often based on sensitivity analysis, not common to non-financial assets, does not involve forecasting a worst case scenario)
- **Whether it is relevant to an intended user of the valuation**
  - Judged based on context of the purpose

A good test for considering if uncertainty is material is to consider whether failure to disclose the uncertainty in the report would lead a reasonable person to take action that relies on the reported valuation that they may not have taken if the uncertainty had been disclosed.

- If uncertainty meets the materiality criteria, the **qualitative description** should always be included in the valuation report
  - Explaining the source of uncertainty and effect it has on the market or/and valuation process.

Causes of Valuation Uncertainty

Main categories include:

- **Market disruption**
  - Macroeconomic or microeconomic
- **Input availability**
  - Due to market disruption
  - Unique asset
  - Illiquid market
- **Choice of method or model**

Not mutually exclusive

Correlation between the causes of uncertainty are likely to exist and should be taken into account

Thank you!