AN INTRODUCTION TO VALUATIONS

DEFINITIONS

Valuation has often been defined as the art and/or science of estimating values. We will come to see why this has been a common perception of the profession; more formally however:

Valuation means the provision of a written opinion as to capital price or value, or rental price or value, on any given basis in respect of an interest in property, with or without associated information, assumptions or qualifications. However, it does not include a forecast of value.

Valuation is simply a model to try to determine price. Value is the end result. It is the quantification of an understanding of the market; the legal impact; the physical constraints; the planning regime; the availability of finance; the demand for product and the general economy all influence the value of property.

Thus, in the property market, what is often called a 'valuation' is the best estimate of the trading or spot price of a building/land.

Appraisal means the written provision of a valuation, combined with professional opinion, advice and/or analysis relating to the suitability or profitability, or otherwise, of the subject property for defined purposes, or to the effects of specified circumstances thereon, as judged by the valuer following relevant investigations. It may incorporate a calculation of worth (see below).

It is worth (no pun intended) mentioning at this point that the nomenclature employed is often dependent upon the jurisdiction of use, for example both the terms valuation and appraisal are used invariably to mean the same thing in Jamaica, whereas in the USA, the term appraisal is all encompassing and would include the UK definition of valuation (above).

Worth is a specific investor's perception of the capital sum which he would be prepared to pay (or accept) for the stream of benefits [real or inferred] which he expects to be produced by the investment.

Price is the actual observable exchange price in the open market.

Value is the estimate of the price that would be achieved if the property were to be sold in the market.

Cost is a production-related concept, distinct from exchange, which is defined as the amount of money required to create or produce a commodity, good or service. Once the good is completed or the service rendered, its cost becomes an historic fact.

The difference between price, worth, cost and value is fundamental to valuation principles – a clear understanding of the difference between each is essential to the supportable estimation of value.

In the context of real estate, value should always be related to price (Value in Exchange) not worth (Value in Use). Price/value are market driven whereas worth is subjective and based on the particular requirements/circumstances of the individual.

Price/value in exchange is the outcome of the interplay of the respective value in use of market makers. In an open and free market, no transaction will be likely if the value in use/worth to the putative vendor is greater than the value in use/worth to the putative purchaser. Hence, where practitioners are providing purchase/sale advice, they should provide calculations of worth/value in use in order to advise as to whether a sale or purchase should proceed at any given level of price.

In a perfect market then, where all investors have the same information and the same requirements, ‘price’ and ‘worth’ should be the same figure.

However the property market is not perfect and there is a natural divergence between the two figures in certain markets. Indeed, depending upon the type of property, the valuation model may have its origin in comparing previous sale prices and thus deriving an investment value (value in exchange) by reference to observed payments in the market. Whereas other properties, which do not transact sufficiently often to produce reliable comparable information, need to use valuation models which reflect the thought process of the principal players; this relates to worth (value in use).

Market Value

The estimated amount for which an asset 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 compulsion.

It should be noted at this point that the concept of *Market Value* presumes a price negotiated in an open and competitive market, a circumstance that occasionally gives rise to the use of the adjective *open* before the words *Market Value*. The words *open* and *competitive* have no absolute meaning. The market for one property could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be characterised by a limited number of participants. The market in which the property is exposed for sale is not a definitionally restrictive or constricted market. Stated conversely, the omission of the word *open* does not indicate that a transaction would be private or closed.

The definition of market value has undergone some revision over the past several years, in an effort to arrive at an internationally accepted definition.

However, difficulties still remain with its interpretation. For instance, the only way one can find out what a property will fetch in the market is by putting it up for sale and accepting the best serious offer. **The valuer does not have this luxury**. He or she has to use all available evidence to arrive at a realistic opinion of what the property would fetch in the market. But it can only be an opinion. And certain assumptions will have to be made – and certain conventions observed – in arriving at this opinion.

This is where the layperson often begins to lose sight of the ball. Even people sophisticated in other financial and investment spheres, such as bankers and accountants, frequently fail to appreciate the element of convention implicit in any valuation and therefore risk misunderstanding what a valuation figure produced on a particular basis is telling them.

Some salient questions and observations:

- Does market value mean the best price that is likely to be obtained in the market at the time or is it an average price in current market conditions?

  '*The estimated amount*'…refers to a price expressed in terms of money (normally in the local currency), payable for the property in an arm's length transaction. Market Value is measured as the most probable price reasonably obtainable in the market on the date of valuation in keeping with the market value definition. It is therefore not typically an average.

- Property is relatively illiquid and a reasonable marketing period is needed to achieve the best price. Do you assume that this marketing period has already taken place before the date of valuation or that it has still to take place? The

choice of time perspective could make a big difference to the end figure in a market where prices are moving rapidly up or down.

After '*proper marketing*…' means that the property would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the Market Value definition. The length of exposure time may vary with market conditions, but must be sufficient to allow the property to be brought to the attention of an adequate number of potential purchasers. **The exposure period occurs prior to the valuation date**.

- Do you assume that the vendor is under a particular time pressure to sell – as in a liquidation – in which case the price achieved might be a lot lower than that which would be produced with a reasonable marketing period.

  '*A willing seller*…' is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the property at market terms for the best price attainable in the (open) market after proper marketing, whatever that price may be. The factual circumstances of the actual property owner are not a part of this consideration because the 'willing seller' is a hypothetical owner.

  '*A willing buyer*…'refers to one who is motivated, but not compelled to buy. This buyer is neither over-eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present property owner is included among those who constitute 'the market'. **A Valuer must not make unrealistic assumptions about market conditions nor assume a level of market value above that which is reasonably obtainable**.

- Do you take account of any more profitable alternative use to which the property in question might realistically be put?

  Market-based valuations must determine the highest and best use (HABU), or most probable use, of the property asset, which is a significant determinant of its value.

(HABU) is defined as 'The most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value

- Do you take account of possible buyers with a special interest in the property, who might be prepared to pay well above the market's going rate?

  In an 'arm's length transaction…' is one between parties who do not have a particular special relationship (for example, parent and subsidiary companies or landlord and tenant) that may make the price level uncharacteristic of the market or inflated because if an element of Special Value. The Market Value transaction is presumed to be between unrelated parties, each acting independently.

- Does the valuation make allowance for selling costs.

  Typically no, however this can be varied by client instruction or market practice.

- 'Wherein the parties had each acted knowledgeably and prudently…' presumes that both the willing buyer and seller are reasonably informed about the nature and characteristics of the property, its actual and potential uses, and the state of the market as of the date of valuation. Each is further presumed to act for self-interest with that knowledge, and prudently to seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell property in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other purchase and sale situations in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.

- '…and without compulsion…' establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.

In all of these cases, the figure that the valuation produces could be very different depending on the answer adopted. So the definition of even a relatively simple concept like market value needs to give a firm answer on these and similar questions and thus pin down the conventions that the valuer will adopt.

Potential conflict between market value and estimate of value can arise, given that many purchasers are motivated by factors other than purely economic appraisals, however it is important to point out that Valuers do not make the market, they are observers and interpreters.

A potential purchaser, who proposes to tie up capital in land and building, may view the transaction from three positions, namely:

1. if for owner occupation, he will be concerned with any anticipated social or commercial benefit;

2. he may be concerned with the annual return in the form of income derived from property viewed as an investment; and

3. he may be into speculative purchasing, i.e. buying at one price with the hope of selling at a higher price in the future, thus having a capital gain.

The motives are not usually mutually exclusive and a transaction may be entered into with more than one motive in mind.

However, the price the purchaser will be prepared to pay at any given time, will be influenced by supply and demand for that particular type of property. Demand, here, must be effective, i.e. the desire to possess should be translatable into the action of purchasing.

MARKET AND NON-MARKET BASES OF VALUE

The concept of Market Value is tied to the collective perceptions and behaviour of market participants. It recognises diverse factors that may influence transactions in a market, and distinguishes these from other intrinsic or non-market considerations affecting value.

Market-based valuations must identify and include the definition of Market Value used in the valuation. They are developed from data specific to the appropriate market(s) and through methods and procedures that try to reflect the deductive

processes of participants in those markets. Market-based valuations are performed by application of the sales comparison, income capitalisation, and cost approaches to value. The data and criteria employed in each of these approaches must be derived from the market.

Non-market based valuations use methods that consider the economic utility or functions of an asset, other than its ability to be bought and sold by market participants, or the effect of unusual or atypical market conditions.

Non-market based valuations must include the definition of value applied in the valuation, e.g., value in use, going concern value, investment value or worth, insurable value, assessed or rateable value, salvage value, liquidation value, or special value.

The valuation report should ensure that such defined value will not be construed as Market Value.

Non-Market Valuations

Value in Use. The value a specific property has for a specific use to a specific user and therefore non-market related. This value type focuses on the value that specific property contributes to the entity of which it is a part, without regard to the property's highest and best use or the monetary amount that might be realised upon its sale. The accounting definition of Value in Use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. (See International Financial Reporting Standard 5, Appendix A [IFRS 5, Appendix A].)

Investment Value, or Worth. The value of property to a particular investor, or a class of investors, for identified investment objectives. This subjective concept relates specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. The investment value, or worth, of a property asset may be higher or lower than the Market Value of the property asset. The term investment value, or worth, should not be confused with the Market Value of an investment property. However, Market Value may reflect a number of individual assessments of the investment value, or worth, of the particular property asset. Investment value, or worth is associated with Special Value. (See para. 3.8 below.)

Going Concern Value. The value of a business as a whole. The concept involves valuation of a continuing entity from which allocations, or apportionments, of overall going concern value may be made to constituent parts as they contribute to the whole, but none of the components in themselves constitutes a basis for Market Value. Therefore, the concept of Going Concern Value can apply only to a property that is a constituent part of a business or entity.

Insurable Value. The value of property provided by definitions contained in an insurance contract or policy.

Assessed, Rateable, or Taxable Value is a value that is based on definitions contained within applicable laws relating to the assessment, rating, and/or taxation of property. Although some jurisdictions may cite Market Value as the assessment basis, methods used to estimate the value may produce results that differ from Market Value as defined in IVS 1. Therefore, assessed, rateable, or taxable value cannot be considered to comply with Market Value as defined in IVS 1 unless explicitly indicated to the contrary.

Salvage Value. The value of a property, excluding land, as if disposed of for the materials it contains, rather than for continued use without special repairs or adaptation. It may be given as gross or net of disposal costs and, in the latter case, may equate to net realisable value. In any event, components included or excluded should be identified.

Liquidation or Forced Sale Value. The amount that may reasonably be received from the sale of a property within a time frame too short to meet the marketing time frame required by the Market Value definition. In some States, forced sale value in particular may also involve an unwilling seller and a buyer or buyers who buy with knowledge of the disadvantage of the seller.

Special Value. A term relating to an extraordinary element of value over and above Market Value. Special value could arise, for example, by the physical, functional, or economic association of a property with some other property such as the adjoining property. It is an increment of value that could be applicable to a particular owner or user or prospective owner or user, of the property rather than to the market at large; that is, special value is applicable only to a purchaser with a special interest. Marriage value, the value increment resulting from the merger of two or more interests in a property, represents a specific example of special value. Special value could be associated with elements of going concern value and with investment value, or worth. The Valuer must ensure that the criteria used to value

such properties are distinguished from those used to estimate Market Value, making clear any special assumptions made.

Mortgage Lending Value. The value of the property as determined by the Valuer making a prudent assessment of the future marketability of the property by taking into account long-term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property. Speculative elements may not be taken into account in the assessment of mortgage lending value. The mortgage lending value shall be documented in a transparent and clear manner.

THE PURPOSE OF VALUATIONS

Valuation matters. It underpins a major proportion of financial decisions in mature economies, especially where it serves as collateral for loans or as an important element in the published company accounts. Failure to ensure assets are properly valued risks financial exposure for wide range of stakeholders:

- Banks that use property as collateral for loans;
- Shareholders that have invested in quoted companies and the companies themselves that become vulnerable to take-overs and asset stripping if the properties they own are not regularly and correctly valued in the balance sheet;
- House-buyers;
- Future pensioners whose savings are invested by funds;
- Whole economies that depend on stable banking systems.

An estimate of value may be required for a number of purposes. Several are common and provide what is often considered the 'bread and butter' of valuation firms. Others are specialist in nature and require the skill and training of the valuer to be directed towards the specific nature of the valuation process and interest being considered.

Requests for valuation will include the following:

1. Sale
2. Purchase
3. Mortgage
4. Insurance
5. Lease/Rental
6. Financial Reporting
7. Statutory Purposes
   a. Probate
   b. Property Tax
   c. Land Acquisition
   d. Rent Restriction
   e. Transfer Tax

f. Hotel Incentives

The Valuation Report

The term valuation suggests that it is a mathematical process, however; a large part of the valuation process depends on the valuer forming his own opinion. Notwithstanding, much of this 'intuitive' process is based on professional training and experience gathered over the course of his/her career. Having said this, a valuation for the determination of market value cannot be devoid of transactional or other derived market data.

The Valuation/Appraisal Report is the formal presentation of the valuer's opinion in written form. At minimum it must contain:

1. A sufficient description to identify the property without doubt;
2. A definition of value;
3. A statement as to the interest being valued and any legal encumbrances present;
4. The effective date of the valuation;
5. Any special features of the property;
6. The name of the Valuer.

Valuation Accuracy and Standardisation

The difference of opinion, which can occur between competent valuers, should not vary much in times of stable market conditions, provided market information is available to all and is not under-reported. There should be little difference too between the valuation and subsequent sale price of properties – provided the sale took place within a short period of time after the valuation was undertaken.

A few celebrated cases have noted wide variations (in excess of 10%) between valuations commissioned for the same property, but undertaken by different valuation firms. The 'Queens Moat Case' in the UK being a notable example.

In that country the financial and property crash of the 1970s was largely blamed on a wide variation in the approach to valuations '…which [threw] up vastly different – and often completely unrealistic – figures for similar assets.

As is often the case, it took a market bust to reveal some inconsistencies and abuses that had been going on during the boom. The Royal Institution of Chartered Surveyors

(RICS) responded by developing and publishing its Red Book, which sought to set standards for the valuation process in the UK and to codify the basis on which valuations could be produced.

Here in Jamaica, the Real Estate Dealers and Developers Act was passed in 1989 and sought to address some of the failings of the local market as identified by the Duffus report of the 1970s. While the Act introduces a minimum qualification for Valuers to practice, there is no regulation of the profession, although there is a local professional body, The Association of Land Economy and Valuation Surveying (ALEVS). See also *'White Paper: Valuation in Emerging Markets', ISVC*.

Increased cross-border trading resulting from the impact of globalisation has spurred the need for an international way of communicating – an international set of standards. The International Valuation Standards Committee (ISVC) has recommended the formation of National Standards bodies and has revised practice statements in accordance with national bodies such as the RICS. These standards are aimed at meeting various international accounting and capital adequacy regulations.

The Role of the Valuer

The service of a valuer may be sought by anyone with an interest in, or contemplating a transaction involving land and buildings. For example, a valuer may be required to advise a vendor on the price he should pay, a mortgagee (lending institution) on the value of the security and a person dispossessed under compulsory powers, on the compensation he can claim.

It might be reasonable to ask next what are the special characteristics of landed property which make the services of a person with special knowledge desirable, or in many cases essential, in dealing with it? There are several reasons.

Some features of the property market

Imperfections in the property market: The nature of landed property, the method of conducting transactions, the lack of information generally available on the transactions, all contribute to the imperfections of competition in the property market.

The heterogeneity of landed property and the interests which can exist therein:
Apart from structural differences in any building, each piece of landed property is unique by reason of location. The majority of transactions in the property market are conducted privately and even if the results of the transactions were available they

would not be particularly helpful in the absence of detailed information on such matters as the extent and state of the buildings and the tenure.

The degree of imperfection does, however, differ in different parts of the market. Retail units in shopping centres and offices in purposes built business parks as well as town houses and apartments, for example, are fairly homogenous, and this will increase the comparability of these units with each other.

It is important to note that the property market is not a single entity, and could be described as being composed of a number of sub-sectors; local, national and international; residential, commercial, agricultural etc. For example, residential properties required for occupation would normally form part of the local market. A person looking for a house to live in is rarely indifferent to its location because it must be conveniently situated usually in relation to his/her place of work and perhaps that of his/her spouse, and to educational facilities for his/her children.

The property market will also categorise property transactions by various property types, for example, residential market with its sub-market of townhouses, detached units and low-rise terraces.

Government Intervention: Various pieces of legislation will have impact on the ownership of land/property as an investment and could erode property values after purchase. For example, Rent Restriction legislation or the Land Acquisition Act when enacted would have significant impact on the value of the property investment.

The professional valuer addresses the problem posed by a client who requires knowing the value of a particular interest in land. To do this the valuer has to follow a process. The process will consist of:

- Defining the property and interest to be valued;
- Determining the purpose for which the valuation is required;
- Inspection of the property;
- Investigating the legal rights and restrictions, easements, tenancies, etc.;
- Determining planning requirements and considerations
- Classification of comparable transactions;
- Adjusting of price established from comparable evidence to reflect any locational or physical differences in the property, as well as any pertinent trends in the economy.

METHODS OF VALUATION

There are three main methods of valuation; namely

1. ***The Comparable or Sales Comparison Method***: Used for most types of property where there is good evidence of previous sales. Non-specialised property.

2. ***The Investment Method***: Used for most commercial (and residential) property that is producing, or has the potential to produce, future cash flows through the letting (renting) of the property or through the operation of a business. Non-specialised property.

3. ***The Cost Approach also called the Contractor's Method***: Used for only those properties not bought and sold on the market and for technical (accounts and statutory) purposes only. Specialised property.

Two other methods of valuations are recognised in UK practice, though the residual method is general considered to be a combination of the other methods, and the profits (accounts) method to be an investment method.

4. ***The Residual (Development) Method***: Used for properties ripe for redevelopment of for bare land only. Determines the value of the asset undeveloped relative to the potential sale price of the completed development. Non-specialised and specialised property.

5. ***The Profits Method also called the Accounts Method***: Used for trading properties (other than normal shops) where evidence of rents is slight as they tend not to be held as investments. The accounts method determines an appropriate rent, which is then used in the investment method.

The manner in which property would ordinarily trade in the market distinguishes the applicability of the various methods or procedures of estimating *Market Value*. When based on market information, each method is a comparative method. In each valuation situation one or more methods are generally representative of (open) market activities. The valuer will consider each method in every *Market Value* engagement and will determine which methods are most appropriate.

The adoption and application of the respective method of valuation by the valuer often depends on the following:

a) The purpose of the valuation
b) The property and type of interest
c) Physical and other features of the property
d) The availability of relevant data, and
e) Government regulations

Generally however valuations can be grouped into two main sub-classes hinged essentially on the relative complexity of the property type to be valued. Thus, we have ***specialised*** and ***non-specialised*** valuations. With non-specialised property there is sufficient trading activity to observe the level of prices without the need to interpret the underlying fundamentals. ***Price is determined by comparison***. However, given that price should reflect the thought process of a potential purchaser, it is not unreasonable that where there is no established trading market, then cost of replacement or an analysis of the property as an asset to the business will become the principal forms of pricing. This, then, is the basis of the valuation models used for the valuation of specialised property.

The Sales Comparison Method

The method entails making a valuation by directly comparing the property under consideration with similar properties, which have been sold, finding its value from these transactions.

Although this sounds simple and straightforward, there may be many pitfalls to trap the unwary. In using this method, it is desirable that the comparison should be made with similar properties situated in the same area, and with transactions, which have taken place in the recent past.

The less the comparative property complies with these requirements, the less valid will be the comparison, or, put another way, the greater the number of subjective adjustments that need to be made, the less defensible the valuation will become. Often a valuer is able to get evidence of sales that do accord with the requirements, e.g. an apartment or townhouse complex will have properties that are similar.

However, the more uncommon the property is, and the more specialised the type of property, the less likely it is that the valuer will be able to find a good comparable, and it is not unusual for there to be a complete lack of evidence of sales of comparable properties.

Even when properties appear to be similar, close inspection often reveals that they are in fact different. A row of physically identical houses may on internal inspection prove to have differences, and the skill and experience of the valuer will be required to make allowances in monetary terms for such differences. Similarly, a skilled valuer will be able to quantify the difference in value based on the valuer's assessment of empirical data. The procurement of data is therefore of utmost importance:

- Source of Data – Office of Titles, Stamp Office, etc. However, information is difficult and costly to obtain and only regular experience in the type of property and the market concerned will really satisfy the need for detailed knowledge of the market;

- Details of transactions – Full details of sales will not always be known. Caution must therefore be exercised when such transactions are being relied upon. The use of a range of comparables should provide a reasonable base;

- There may be time lags between agreement and final conveyance, during which the market can change. The date of the agreement is important in a fluctuating market;

- Where rental values are known, capital values can usually be derived by the use of the investment method of valuation;

The Investment Method

This is based on the principle that annual values and capital values are related to each other and that, given the income a property produces or its annual value, the capital value can be found. The method is widely used by valuers when properties which produce an income flow are sold to purchasers who are buying them for investment. That is, the property is purchased primarily for its income bearing capacity. The method involves the determination of net rental income multiplied by a years purchase factor at the appropriate rate of interest over the time period concerned. This time period should normally be equal to the life of the investment and the method is similar to that employed by the equities market where valuations of stocks are undertaken with reference to their price earnings ratio p/e.

Rental income can be actual or notional. Actual rental income exists when the property is let on lease and the tenant pays a rent for use and occupation. Notional rental income occurs when the property is owner-occupied – the notional rent being

the rental that would otherwise be paid for the use and occupation of a similar property.

Many types of property are let (rented) on terms, which require the landlord to bear the cost of certain outgoings, that is expenses related to the property, that are essential to the property maintaining its full value. To arrive at the net income in such cases, outgoings must be deducted from the rent paid. Landlord's outgoings are usually classified as:

a) Repairs
b) Insurance
c) Management
d) Rates and Taxes

Note that service charges are not part of landlord's outgoings.

The Years Purchase (Capitalisation Rate) or multiplier is derived from the rate of yield (rate of return) that an investor decides he will require from a property. This yield reflects the quality of the investment in comparison with other property investments and other investments generally. Consideration has been given to factors, which influence the investor in his choice of yield and the valuer will obviously need to be conversant with these when using the investment method. It should be noted that as with most investments the yield reflects the attendant risk attached to the investment and in the case of property would be representative of the attractiveness of the investment to the purchaser in the market in general, with specific regard to:

a) Capital security (in real terms);
b) Income security;
c) Income growth;
d) Ease of sale and management;
e) Return on other investments.

It will be noticed that an analysis of previous transactions is a pre-requisite of the investment method and the comparative principles are at the heart of this process. Hence, this method involves estimating future income flows and converting this income flow to capital values.

The Profits (Accounts) Method

This is sometimes referred to as the accounts method and it is based on the assumption that the values of some properties will be related to the profits or annual returns which can be made from their use. The method is not used where it is possible to value by means of comparison and is generally only used where there is some degree of monopoly attached to the property. This monopoly may be either legal or factual. A legal monopoly exists where some legal restraint exists to prevent competition to the property user from the user of other property.

Such a situation may occur when a licence is required for the pursuit of a particular trade, such as a licence to sell alcoholic liquor or to run a betting shop or a gas station or casino. A factual monopoly may arise when there is some other factor, other than a legal restraint, which restricts competition. An instance of factual or natural monopoly is Dunn's River Falls or marina facilities at Port Royal, where there is no other property to offer competition and where none is likely to be built.

Whenever there is an element of monopoly, it is obviously not possible to use the comparative method of valuation, as there could be no true comparison to a property, which enjoys a monopoly. It is also a reasonable assumption that only rent, which would be paid for the use of such property, would relate to the earning power in that use. It should be noted that with this method the valuer attempts to estimate the rental value of a property in order to derive a capital value. Profits are made on an annual basis, and any figure obtained from them will be on an annual basis. The basic equation on which the profits method is based is as follows:

	Gross Earnings
less	Working Expenses
is equal to	Gross Profit
less	Tax
is equal to	Net Profit Per Annum

Allowances must be made out of net profit to account for tenant salary, risk taking and enterprise and interest on capital expended. The figure derived can be related to

annual rating or converted to a capital sum. The annual sum is converted to a capital sum using a multiplier, which should be market derived.

The Contractor's Or Cost Method

This method is used to value properties for which there is little or no sales evidence, and where property cannot be valued by reference to its trading potential. It is applied to the valuation of the types of properties, which seldom change hands and for which there are few comparables. It must, at this point, be reiterated that cost and value are rarely the same, but this method of valuation is based loosely on the assumption that they are related. It should therefore be appreciated that this is a method used only infrequently, and is something of a method of last resort.

The basic theory of the contractor's method is that the cost of the site plus the cost of the building will give the value of the land and building as one unit. The types of properties for which the method could be appropriate are:

(a) Hospitals;
(b) Town halls;
(c) Schools and churches;
(d) Libraries, and;
(e) Police stations and other such buildings.

It will be noted that the list comprises principally public buildings, although the use of the method is not necessarily restricted to public buildings alone. Cost is normally only one factor of many which may affect supply and demand and which therefore affects value, but it is probably true that with these types of building, it is a predominant factor. It would always be possible for the would-be users of such buildings to acquire alternative sites and to construct new buildings, rather than purchase an existing property at a greater overall cost. Competition between rival potential users would be unlikely and it is therefore reasonable to assume that cost and value are not unrelated with such specialist buildings.

However, consideration must be taken of the fact that the structure being valued is not a new building, and therefore, adjustments must be made for wear and tear resulting from its previous use and there might also be a degree of obsolescence, which has arisen since original construction. In using the contractor's method, the valuer must therefore make a deduction to allow for both depreciation of the buildings and obsolescence of design. The basic valuation approach then becomes as below:

	Basic Cost of Building
Plus	Professional Fees, inclusive of GCT
Plus	Finance Charges
Plus	Allowance for Profit and Contingencies
is equal to	Cost of Building New
Less	Allowance for Depreciation and Obsolescence
is equal to	Value of Existing Property
Plus	Site (land) value of existing property using sales comparison approach.
is equal to	**Market (Capital) Value**

An adapted version of this method is used for the valuation of properties for insurance purposes. The method is used to determine the cost of replacing the perishable good (the buildings/structure) as new.

	Basic Cost of Building
plus	Professional Fees, inclusive of GCT
plus	Contingences
is equal to	Cost of Building New

Note that there are no finance charges as it is assumed that the insurance funds will be paid up in total up front. The structure will be valued having consideration for the construction technology to be employed in its replacement except in the case of heritage buildings where the structure will be replaced using elements similar to those

originally used in the development of the structure of alternate elements approved by the relevant authority.

The Residual (Development) Method

This method is most commonly used to determine the value of properties with development potential. Alternatively, it is used to determine the viability of development schemes. Although all valuers will have their own way of setting out a residual valuation, the basic approach is straightforward and the method is simple to use. Difficulties arise not in the method itself, but in estimating the values of the many variables that go into the valuation. Development schemes may comprise the development of new buildings on Greenfield or cleared sites, redevelopment of built sites involving the demolition of existing buildings.

There are essentially three main purposes for which a residual valuation may be undertaken:

a) To calculate the maximum a developer can afford to pay for a development site, this is for sale in the open market; This amount would then be compared with asking price to see whether it's worthwhile for the developer to acquire the site and proceed with the development; a sort of first phase feasibility study if you like.
b) To calculate the expected profit from undertaking development where the developer owns the site.

c) To calculate a cost ceiling for construction, where land has been acquired and is therefore a known cost and a minimum acceptable profit margin can be decided on.

In its simplest form, when used to assess the development value of land, the residual valuation will estimate the maximum purchase price of a site, by deducting the expected totals costs of development, including an allowance to cover risk and profit, from the expected price that the completed development could be sold for in the market. The residual valuation could therefore be expressed thus:

Sale price of completed development (Gross Development Value)	**A**
Less Total cost of development (incl. Profit allowance)	**B**
Equals residue for site purchase	**C**

Residual site value = **Gross development value (GDV) – total development costs** (including profits)

This produces the value of the site after the development has been completed. In order to determine the value of the site at today's date, the residual value has to be discounted for the time value of money.

For teaching purposes only: Not to be quoted.

Recommended websites: Royal Institution of Chartered Surveyors: http://rics.org

The International Valuation Standards Committee: http://www.isvc.org

eLandjamaica: http://www.nla.gov.jm/eland01.html

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