VALUATION APPROACHES APPLIED TO VALUATION OF LANDS WITH SPECIAL DESTINATION

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Abstract: The purpose of this article is to emphasize if a valuer can obtain relevant results by applying each of valuation approach – as they are defined in the valuation standards on specialised properties: the market approach, the cost approach, the income approach. For a proper understanding according to the valuation of the specialised properties, it is essential for the entire valuation process. Valuing those types of properties we will obtain an increase of interest from owners or investors.

Keywords: *lands with special destination, valuation, market approach, cost approach, income approach, valuation standards*

1. Introduction

This article suggests a study about the advantages and the disadvantages of the valuation approaches application to lands with special destination. The issue is to define the valuation purpose of this type of lands and to emphasize the advantages that state institutions may obtain from valuing those types of lands. What are the benefits which the institutions can obtain from assessment of lands with special use?

Under the cadastre laws , the properties with special destination (or TDS) are lands used for roads, for air and naval transportation including the related buildings and installations, for hydrotechnic, thermic and nuclear buildings and installs, for transportation of electrical and thermic power and natural gas, for telecommunications, for the mining and oil exploitation, for pits, for defense purposes, beaches, natural reservations and monuments, archaeological and historical sites the assemblies etc..

In valuation, a specialised property is a property that is rarely if ever sold in the market, except by way of sale of the business or entity of which it is part, due to uniqueness arising from its specialised nature and design, its configuration, size, location or otherwise[1] (for example: schools, buildings owned by government, airports, conference rooms, parks, golf course, cemeteries, churches etc).

The lands on which special arrangements are made can be lands under the state ownership, or which have been obtained by a legal transfer between the state and private

[1] IVSC Glossary

owners. Valuation of those lands takes into account location, the nature of the right, the destination (use) etc.

2. The valuation process and valuation standards

The valuation process means a succession of stages, necessary for the activity of valuing properties. The valuation process is conditioned by eight stages, arranged in this order: defining the valuation problem, planning activities necessary to solve the problem defined, collecting data necessary for valuation, their analysis, interpretation and transformation in a reasonable estimate of the value[2].

No matter of their destination the real estates are valuated according to current ANEVAR Standards . According to these standards, there are three valuation approaches which can be applied by the valuers, to obtain a conclusion about the market value: the market approach, the cost approach, the income approach.

The market approach is the most used and involves the comparison between the subject property and similar or identical properties, at the valuation date. But, if the real estate is trade related property (by example, rented), then we can apply the income approach taking into account the collected rents, case in which the property must satisfy the following conditions:

- The entire property must be rented;
- The rent value must be in accordance with market rents of similar properties.

To obtain the market value of a real estate, the valuer must pass over the border between the hopes of the sellers (each seller wants to receive a larger transaction revenue) and the negotiations of the buyers (each buyer wants to obtain a smaller price). This is a test of trust to obtain the market value of a real estate.

3. Valuation approaches

- **Market approach**

This approach can be applied by the valuers, having the purpose to estimate the value of real estates, but only in cases of the existence of market data about comparable real estate transactions, enough as a number. In case where the conditions are accomplished, the market approach is the most safe and efficient method, giving relevant market values[3].

In the valuation activity there are nine economic principles that apply, the most important fundamentals economic principles for the market approach, being: principle of supply and demand, principle of substitution, principle of stability and principle of external factors.

The market approach is the most sensitive method at changes on the market about supply and demand. This approach is based on existence of comparable properties according to which the determination of the subject property value is possible.

But, in the case of specialized properties, this approach represents a solution for the valuation activity?

[2] Evaluarea proprietatii imobiliare, editia a 13-a, editia in limba romana, Appraisal Institute

[3] Evaluarea bunurilor imobile, Irina Ana-Maria Bene, ed. Conspress, 2012

The market value can be determined from the market prices analysis of comparable real estates. It is known that specialised properties, no matter if we talk about lands or buildings, are transacted very rarely or never on the real estate market, and from this reason, the market approach can not be applied by the valuer.

- **The income approach**

In the case of lands with special destination, the income approach is applied by the valuers with purpose to estimate the market value, by calculating present value of anticipated benefits. The income approach applies to the property which generates income at the valuation date.

The income approach contains two usual methods:

- The direct capitalization;
- The Discounted Cash Flow Analysis.

The first method, the direct capitalization, consists in dividing a representative level of income with a capitalization rate or multiplying it with an income multiplier in order to transform the income into value. Remember that, in practice, the estimated income can be the gross income (before tax) or the net income (after tax), and the capitalization rate must be appropriate to the form of income used.

The second method, Discounted Cash Flow Analysis, is used for real estates for which is estimated that the incomes and costs are changing over time. When this method is used, the valuer must process this income into value by applying a discount rate. The discount rate must be appropriate with the definition of discounted cash flow used.

The income approach requires the estimation of capitalization rate, in those situations when the income is capitalized to transform him into value.

The economic principles of substitution and anticipation are the ones that emphasize the income approach.

- **The cost approach**

The cost approach is based on the principle of substitution. That is a process of obtaining the subject real estate value by deducting from the new cost of buildingthe total obsolescence of the building and adding to the result the land value, estimated at the valuation date[4].

This approach takes into account – as a substitution element in case of buying the subject property - the possibility to buy an equivalent property with the same features. The acquisition cost of a comparable land and the building cost of a new equivalent building are taken into account.

According to the ANEVAR Standards, the cost approach can be applied when the subject real estate contains new buildings or relatively newly constructed buildings. Anyway the cost estimations are the maximum of what the buyers should pay for this type of buildings. It is important to have enough and adequate information to estimate the obsolescence of those

[4] Standardele de evaluare a bunurilor din Romania, ANEVAR, ed. 2014

buildings, which are in the project phase or those buildings which are forming a part of specialized properties.

There are situations when the property is rented, and the valuers must apply corrections to emphasize leasehold interest for valuation.

The cost estimation methods for real estate valuation, are:

- The comparative-unit method;
- The unit-in-place method;
- The quantity survey method.

The types of depreciation which a building may have:

- Physical deterioration:
  - Deferred maintenance;
  - Unrecoverable – elements with short life;
  - Unrecoverable – elements with long life.
- Functional obsolescence:
  - Recoverable;
  - Unrecoverable;
  - External obsolescence.

The methods the valuer choose to estimate the obsolescence must be described in the valuation report and also it is necessary to present the arguments which he based on.

4. Conclusions

The purpose of valuing specialized properties, and thus of lands with special destination – as they are defined in cadastre laws - is to establish the assessed value and also their value in situation of expropriation, transfer of leasehold interest or financing the property.

According to the ANEVAR Standards, there are three valuation approaches which can be applied by the valuers for estimating the real estate value: the market approach, the cost approach and the income approach.

After analyzing the applicability of each approach in to lands with special destination (TDS), it can be concluded that :

a) The market approach is not to be used in this case, because it is necessary to have a market for the subject property – specialized property which, as defined, is not a property traded on the market, case in which the valuer can not find transactions with comparable properties;

b) The cost approach can be applied for the value estimation of lands with special destination, provided that there are information about building costs of comparable special buildings; the recommended method for new cost estimation in case of these buildings is the quantity survey method;

c) The income approach can be applied by the valuers for value estimation of lands with special destination, provided that subject property should be a trade related property (leased); in this situation we can apply one of the two methods of this approach - the direct capitalization and the discounted cash flow analysis; attention must be given to the forecast of income and also to the estimation of necessary capitalization/discount rate.

No matter if the valuer applies the cost approach or the income approach for value estimation of specialized properties, he/she will provide in the valuation report the data or information used in valuation activity and also their sources and all the arguments based decisions -that he/she took in order to obtain the value conclusion.

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