WHAT EXACTLY IS PROPERTY VALUE?

MOST BUYERS AND SELLERS IN THE PROPERTY MARKET HAVE a different understanding of what the value of a property actually is, regardless of whether it’s vacant land or an improved property. Of course, a buyer usually thinks the value is less and the seller thinks the value is more, but that’s a natural part of the market’s operation. So, what is the actual value? Simply looking at the amount exactly halfway between the price set by the buyer and the seller won’t provide the answer here. The only solution is to find out what the value is today in the marketplace, which of course comprises many buyers and sellers. To correctly assess the value of a property, the best approach is to ask yourself, ‘if this property sold today, how much would it actually sell for?’ This raises some major challenges with assessing value, starting with the fact that every parcel of land is different from another.

THE CHALLENGES

The first major challenge is that no two parcels can be identical – each lot has a unique location on the planet and also a unique identifier or description. This is completely different to other assets, such as shares or cash, where each item is identical. Even though some land characteristics may be similar, such as the area and/or shape, the street address or topography may differ. For example, there’s a large difference between the value of a lot with ocean views, in comparison to a neighbouring, directly adjoining lot with no ocean views. The actual street address may affect value as well, with certain ‘landmark’ streets or roads commanding higher value or two nearby parcels could be in different suburbs with varying levels of demand according to varying perception.

The second challenge is that properties don’t sell very often, certainly not on a daily basis. Most properties sell infrequently due to a number of factors, therefore to find a recent sale of a similar property can be challenging. How recent does the sale have to be? Ideally it would be on the same day as the day you are assessing value, but this is very rare. Also the concept of ‘recent’ depends on how quickly the market is changing. In a stagnant market a sale from 12 months prior may be relevant, however in a fast-changing market a sale from six months earlier may be out of date. The key here is to ensure the market conditions are ‘similar’. A rapidly changing market also creates many challenges for working out the correct value.

Another major challenge is the operation of the market. Unlike other markets, there’s no central property marketplace where buyers and sellers come together to trade. Therefore, a property may be sold ‘off the market’ or sold quickly when the property comes onto the market, but this information remains private to the parties in the transaction and may not be released. If it isn’t possible to access this information from the buyer, seller or real estate agent, the only option is to wait until the transfer is settled and then the relevant government body releases the information when the title for ownership purposes is transferred. However, this may be many months after the contract was initially signed.

There are many challenges with working out how much a property may sell for, which is why the property market is often considered to be inefficient. Access to reliable information is one way to find out market trends. Another approach is to work closely with real estate agents, who are at the ‘coal face’ and communicate with buyers and sellers each day. They will know what type of property is in demand and what the upper limits of value are. But the starting point will always be a hypothetical sale of a property on a given day.

The challenge for the seller is to remove the additional premium added to the property because it’s their property and they feel it’s superior to others. The challenge for the buyer is to ‘meet the market’ and pay the true value for the property rather than seeking a discount. In many cases a property may already be for sale at its true value today, so a discount may not be applicable. The task for every stakeholder is to assess the value and be as efficient as possible in negotiations and planning. However, it’s usually easier said than done.

DIFFERENT TYPES OF PROPERTY VALUE

Generally speaking, there are three main approaches to assessing value depending on the type of property (e.g. residential, office building), the type of use (e.g. to live in, to rent) and the purpose of assessing the value. It’s important to consider market value, which is defined by the International Valuation Standards Committee as “the estimated amount an asset 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 COMPARISON METHOD

The first method is the ‘comparison’ approach, which is based on comparing ‘like with like’, then making adjustments for any differences. Since no two parcels of land are identical, and also many buildings differ in date of construction or design features, it’s important to make allowances for differences. For example, a recent sale property may be considered superior to your property and in that case, according to the market, your property is worth less than this recent sale.

A similar scenario occurs for a property that has recently sold but is overall inferior – your property would likely be worth more. The amount of time elapsed since the date of sale is a major consideration if the market is changing quickly. An added complication is the different values for the land and the building component. For example, the location and land area of the recent sale property may be superior but the building structure may be older and inferior.
An overall judgment must be made, such as the similarity to your property. There are other considerations here, but the final call will be based on comparing all attributes of the recent sale with your property. This can be harder than it seems, since some attributes are better and some are inferior.

THE COST METHOD
Another method is the ‘cost’ approach, which is often used to support another approach to assessing the value. This method commences by looking at what a property would cost new. For example, most buyers in the market would know how much a new house and a parcel of land would cost new. Most often, the assessed value of an existing property would therefore be less depending on factors such as how old the building is. Therefore an allowance is normally made using depreciation such as a decreased proportion of value. This approach would work best in a new housing estate that's partly completed with new houses. However, not all buildings lose value as they age, with exceptions such as historical houses that far exceed the value of today’s homes.

THE INCOME METHOD
The ‘income’ method is the third approach but is reserved for income-producing property such as a retail shop or an office. The focus is placed on how much income the property will make or the tenant will pay, as a ratio to the overall capital value of the property. This ratio is taken from the market and therefore if you can work out the current level of market rent and outgoings associated with a property, based on a market ratio it's possible to work out an assessed likely value. There are lots of conditions associated with this approach and it can be very complex, but it does recognise that a basic ‘comparison’ approach won't work.

CONCLUSION
The underlying principle when looking at value is to consider what the hypothetical value is. Of course, it's impossible to know exactly what the decisions by humans are going to be, which is why a range of values (rather than one exact value) often results. The assessment of value can be quite complex or simple depending on the requirements. It's best to reduce the number of assumptions or guesses made, although this isn't always possible as there are often gaps in information. Many of the challenges with assessing value are what make the task very interesting. There are many markets within markets, yet comparing 'like with like' is always the starting point. Nobody knows everything about every market so it's best to become an expert in one location or property type, or both.

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