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Evaluating Valuations

Against a background of an inactive property market and discussions about the appropriate pricing for the transfer of property backed loans to NAMA, an issue clearly arises about whether another concept of 'value' other than 'market value' is required for current conditions. Amongst Chartered Valuation Surveyors, a debate is also taking place about whether in a challenging market it is appropriate to 'mark to market' or 'mark to model' in order to arrive at a property valuation. For the uninitiated in property economics, all this jargon is difficult to comprehend.

The ongoing valuation debate is of utmost importance given the approach of our current policy makers as set out in the draft legislation to enable the establishment of the National Asset Management Agency (NAMA). However, the concept and methodologies of property valuation is not easily understood by many.

To understand valuation concepts, it is necessary to start by distinguishing between concepts of price, worth and value – terms which are frequently misunderstood and confused. *Price* can be taken to mean the actual observable exchange price achieved in the market. *Worth* is best understood as an assessment of the advantages of property ownership based on perceived benefits by a particular person or company at a particular time and for a particular purpose.

The concept of *value* is more problematic. Chartered Surveyors use a concept of market value to arrive at an opinion of the likely exchange price at a particular time prior to or as a proxy for a sale on the open market. The definition for this used by Chartered Surveyors is the estimated amount for which a property should exchange on the date of the valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion

Conventionally, Chartered Valuation Surveyors undertake valuations using the 'mark to market' approach. Mark to market means using the definition of market value and basing the assessment on observed transactions and activity in the market.

It is a well tried definition developed over forty years and is set out in the RICS Valuation Standards, colloquially known as the Red Book. The Red Book contains mandatory rules, best practice guidance and related commentary for all Chartered Surveyors undertaking asset valuations. It was first published in the 1970s, against a background of a property crash and a recession in the UK and has been updated many times since then. It is recognised as the international standard of choice in property valuation.

It appears that the intention of NAMA is to carry out valuations in accordance with the Red Book although the precise definition is not used in the draft legislation.

Market value uses assumptions about markets, sellers and buyers to allow a rational approach to valuation. In normal conditions adequate transactional evidence is available to allow a sufficient degree of confidence in a valuation using this definition. In a time of rapid transition or in market hiatus, such evidence may be limited or become dated rapidly, or indeed be absent for some time as we are currently experiencing, thereby leaving valuers to rely on their own experience and feel for the market.

Sentiment is, however, not regarded as scientific and in the absence of hard transactional evidence the uncertainty of valuation is increased with a resultant reduction in confidence. Nevertheless in current conditions to ascertain the market value of a property the definition used by experienced Chartered Surveyors with intimate knowledge of the market is the best way of estimating a reasonable valuation.

There are many other concepts of value, though they need not concern us here. All have their positives and negatives, are suitable for particular purposes and can greatly assist with decision making. No matter what model is used all valuations will exhibit a degree of uncertainty.

However, the concept of *'long term economic value'* used in the proposed NAMA legislation presents a greater challenge. This new concept is being developed as an alternative or an addition to *'market value'* to fulfil an identified purpose - which in this context is to be used as a formula to extract non performing loans backed by property collateral from the banks. It would appear that the proposed *'long term economic value'* model will use demographic, economic and financial forecast inputs as well as market value in order to determine a guide for what a particular property might achieve if sold on the market at the date of the transaction or indeed subsequently, under 'normal' conditions. The reliability of such a valuation model is difficult to assess and from a Chartered Surveyors point of view cannot be upheld as a conventional valuation.

Whether or not the development of this new model of long term economic value as set out in the draft NAMA legislation is appropriate will continue to be the subject of much ongoing debate over the coming weeks. From a Chartered

Surveyors point of view, it will represent a departure from conventional valuation that has been developed and well tested over a period of forty years.

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