



Paper 2696V6-0  
Methods of valuation

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## [Summary](#)

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### 1 Introduction



The purpose of a valuation determines the definition or basis of valuation to be applied, and the valuer can then select an appropriate method. There are five methods of valuation which have been recognised for a century and a half or more. The principles on which they are founded have not changed, although there have been some developments of detail.

The five methods or principles are:

- The Comparative Principle
- The Investment Principle
- The Residual Principle
- The Profit Principle
- The Cost Principle.

Actual examples of use of these methods are covered in Paper 2705 '[Case Studies](#)'.

## 2 The comparative principle



This principle rests on the assumption that:

- valuation is an estimate of what the market will pay;
- what has been paid for a **similar** interest in **similar** accommodation under **similar** economic conditions is the best indicator of market value.

The principle is a simple one, but is fundamental to the practice of valuation. An English judge has said:

'It is a fundamental aspect of valuation that it proceeds by analogy. The valuer isolates those characteristics of the object to be valued which in his view affect value and then seeks another object of known or ascertainable value possessing some or all of those characteristics with which he may compare the object he is valuing.'

Prices which have actually been paid should:

- reflect the balance of supply and demand for that type of property;
- reflect the competition between buyers;
- indicate the price at which vendors are willing to sell rather than leave the property empty.

When there are a number of transactions which can be analysed, and they lead to consistent results, there will be more confidence about the evidence. Consistency will indicate that transactions are conforming to the principles of an open market and are signalling market value as we have defined it.

We have already noted that the property market does not fully meet the conditions of the perfect market of economic theory, in part because of weakness of information flows, and in part because of the uniqueness of each unit. The problem of unique units is a potential weakness for the comparative principle, but it can be answered, at least in part, by analysing prices paid to units such as \$ per metre squared or other units. Other differences can be adjusted for by comparing analogous situations and identifying the added value from different features such as building or site qualities.

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This process reaches its full potential when there is sufficient data to be processed in computer models and regression techniques applied. A model can then be used and properties over a wide geographical area can be valued, for example for local tax purposes.

### 2.1 Strengths and weaknesses of the comparative principle



## Strengths

- The principle reflects the balance of supply and demand by using prices determined in the local market for similar property interests.
- It complies with the definition of market value as the price the market will pay.
- It is an objective test (subject to what is said later about subjectivity in adjusting for differences).
- It reflects the behaviour of buyers and sellers. In the context of selling or leasing for occupation, sellers or landlords will expect comparable rents for similar accommodation, whilst the potential occupiers will tend to base their offers on market evidence after some 'comparison shopping', not unlike that applied in other buying decisions.
- It is very well established in British and British Commonwealth practice particularly, and is becoming dominant in the USA. The USA has made more use of cost approaches in the past, a practice which reflects the freer market and more abundant land supply in that country.

## Weaknesses

The weaknesses of the principle are of two kinds: matters of principle and practice.

- The equation of value with price in the market came under attack after the UK property collapse in the early 1990s and the SE Asia currency crisis of 1997, as it had in previous slumps. Value at the top of the market is over-inflated by market expectations, and when these are not fulfilled, prices tend to drop sharply as a reaction. As a result the only transactions that take place are forced or distress sales. These may be the only evidence of value in the market, but they do not conform to the willing seller rule.

By equating value with price and using the comparative principle, valuers will follow irrational behaviour of markets. They will appear to have been reckless or negligent when a high market subsequently collapses.

- For some types of property there is not a market except as part of the total business, as is the case with specialist industrial plant, or the assets are part of the public sector or other non-profit enterprises.
- There is the tendency for prices to be in some degree influenced by the special needs of purchasers or vendors. The former may have very restricted choice due to the combination of tenure, space and locational requirements, so that when they find what they want they may overbid the second best offer by a significant margin. The price may not be repeatable in an analogous situation.
- Not all purchasers and vendors are well advised when they strike deals.
- Economic circumstances can change quite quickly, making past sales and leases unreliable without some adjustment for changed conditions in the market. Such adjustments are necessarily subjective.

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- In practice, evidence can be scarce or difficult to obtain. There tends to be informal exchange of information between agents, although such exchanges may not reveal all the information relevant to the deal, such as side letters allowing concessions of various kinds. Those countries which have public registers where sales and leases can be

inspected have an advantage but the register may lag the bargain by some months or more.

- The uniqueness of each lot in terms of both physical and legal attributes means that few comparisons are straightforward. It is common to value similar types of premises in relation to size, by devaluing to prices paid per square metre, and specialist premises by other criteria such as throughput for petrol stations or seats for cinemas. Other differences, such as location, can usually be estimated if the valuer has enough information, including historic information, which will give a guide to the premium or discount applying to a particular situation. However, it must be acknowledged that there is subjectivity in these kinds of adjustment. The RICS definition of value allows for this in saying 'the best price reasonably obtainable' within the definition.

## 2.2 Application of the comparative principle



The principle is applied as follows:

- The valuation for rent of common types of premises.
- The valuation for sale or purchase of common types of premises.
- The comparison of investment yields from sales of investments as described below.
- Sometimes in the comparison of undeveloped land prices (this should normally be checked against a residual valuation, described later).
- Turnover estimates for specialist premises valued on the basis of profits. The relationship between expected profits and capital values is examined later.

What has been indicated here is that all methods of valuation employ elements of comparison, but it is usual to distinguish the comparative method in those cases where the comparison is direct to the lot or unit of land or buildings involved.

## 3 The investment principle



The principle rests on the thesis that the capital (as opposed to rental) value of real estate will relate directly to the income that it generates or can be expected to generate. Values in the market will vary with:

- the quantum of income;
- the quality of security of the income;
- the duration of the income;
- expectation about the future trends in the income.

These variables will be in part a function of the wider economy (market risk), in part a function of the local economy (expressed through demand and supply for the premises), and in part a function of the particular building under consideration.

The quantum of income can be readily established from a let property or can be estimated from comparable premises. Landlord's expenses are similarly available, and because there is in established market economies fairly regular trading in investment property, the relationship between net income and price can be analysed.

There are at the moment two alternative models for the analysis and synthesis of sales data on investments in real estate, described as the all risks yield or traditional model and the discounted cash flow model. We shall introduce these here in outline.

### 3.1 All risks yield and Years' Purchase



This may be illustrated at its simplest where there is a fee simple or perpetual interest in land and the rent is fixed for a very long period of time, which means the income can be described as a perpetuity for practical purposes. This fixed rent situation often arises when there has been a grant of a ground lease without provisions for reviewing the rent.

Let us assume a rent of \$100 fixed for 100 years. The question of market value becomes:

- What price would purchasers pay for the right to receive \$100 per annum?

The answer to this question becomes less concerned with the quality of the land and more concerned with the amount of the income and the reliability of the tenant, although the land quality will have some bearing since the tenant is more likely to continue paying for a good property than a poor one.

The investment value then becomes a matter of the right to receive rent. Someone offering \$500 for the estate would receive \$100 per annum or 20 percent return, which is very attractive in relation to competing investments like bonds which similarly produce fixed incomes. At a price of \$800, the return would be 12.5 percent, and at \$1250, 8 percent.

In fact the market is likely to settle at an interest rate somewhat above the bond rate because of the relatively illiquid and management-intensive nature of real estate (this is not an invariable rule, because in real estate there may be prospects of a deal between investor and tenant at some time during the lease, which the owner can use to extract extra value).

We can now derive some simple relationships which can be used for valuing fixed incomes.

$$\begin{array}{l} \text{a} \quad \text{Rent} \div \text{interest rate} \quad = \text{capital} \\ \quad \text{Thus: } 100 \div 0.08 \quad = \$1250 \\ \quad \quad 100 \div 0.10 \quad = \$1000 \end{array}$$

$$\begin{array}{l} \text{b} \quad \text{Rent} \times 100 \div R \quad = \text{capital (where R is interest as a percent)} \\ \quad \text{Thus: } 100 \div 8 \quad = 12.5 \\ \quad \quad 12.5 \times \text{rent} \quad = \$1250 \end{array}$$

For historic reasons the latter format is usually adopted in valuation literature and reporting, and the multiplier of  $100/R$  is known as Years' Purchase for a perpetuity.

Valuations are set out as follows:

Rent		\$100
Landlord's expenses		nil
Net rent		\$100
YP in perp @ 8%	$\left( \frac{100}{8} \right)$	12.5
Capital value		\$1250

It may be noticed that the figure of Years' Purchase in perpetuity is in fact the number of years of rent that equates to the purchase price. It is the payback period, but the more important relation is the rate of interest since that is related to competing investments and indeed borrowing costs for the investor who is using borrowed money.

### 3.2 Discounting and income in perpetuity



Another way of looking at the purchase of an income of \$100 pa is to see the price as the value today or 'present value' of a future stream of income.

Each year's income is worth a certain amount, but not \$100 because of the waiting period involved until the income is received.

The first year's rent (assuming rents annually in arrears) is worth such sum (P) as will grow at 8 percent per annum in one year.

Thus:

a Present value of first year's rent (P):

$$\begin{aligned} P + (8\% \times P) &= 1.08P = \$100 \\ \text{Therefore } P &= 100 \div 1.08 \\ &= 92.5926 \end{aligned}$$

b Present value of second year's rent (P2):

$$\begin{aligned} P2 + \text{interest @ 8\% for 2 years} &= \$100 \\ \text{Therefore } P2 \times (1.08) \times (1.08) &= \$100 \\ P2 &= \$100 \div (1.08)^2 \\ &= \$85.7339 \end{aligned}$$

What is happening here is this: the present value of each year's rent is reducing by 8 percent for every year from now, and a discounted value is being found.

Using the general formula, present value of \$1 =  $1 \div (1 + i)_n$ , you can calculate the value of the rent due in any year. In Year 100 you will find it too small to be of significance.

The value of an investment is the sum of the present values of the stream of income. How this is set out as a formula varies between economics, accountancy and valuation texts, but the result is the same.

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The sum of the present values of \$1 is:

$1 \div (1 + i)^1 + 1 \div (1 + i)^2 + 1 \div (1 + i)^3$  and so on for the number of years.

This sum simplifies to:

$$\text{Present Value of \$1 per annum} = \frac{1-V}{i}$$

where V is the present value of the last instalment [ $1 \div (1 + i)_n$ ]

Present Value of \$ per annum more usually known as Years' Purchase, Single Rate for n years.

In the case of perpetuities, V tends to ZERO so the formula for the present value of \$1 per annum in perpetuity is:

$1 \div i$  or  $100 \div R$ .

Years' Purchase in perpetuity is therefore the same as **present value of \$1 per annum in perpetuity**.

Comment

You will notice we have ignored complexities like rents receivable quarterly and management costs in the model. These can of course be allowed for, but generally if they are ignored in analysis of deals they can be ignored in synthesis because like is being compared with like. This practice should be used with care since there may be an effect when dealing with short-term interests and cases where management costs are significant in relation to income.

## EXERCISE

- Calculate the value of an income of \$200 pa receivable in perpetuity. Use rates of (i) 6 percent and (ii) 9 percent.
- Calculate the present value of \$100 pa receivable for three years, using 10 percent.

*(Answers at end of Section 6.)*

### 3.3 Variable incomes



Variable incomes are of two main types:

1. Where the property is let at its full open market rental, and changes are expected in the rent levels in future, upwards or downwards.
2. Where the property is currently let at a rent which is below or above the current level of rents.

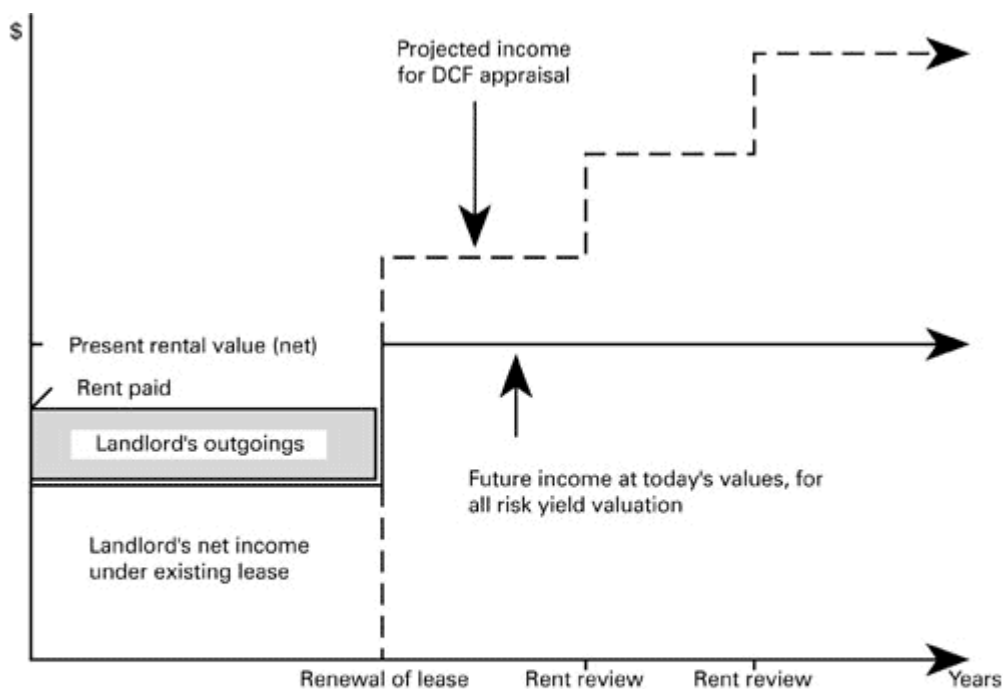
The all risks yield method deals with the first of these situations by selecting a discount rate that takes account of the prospects of changes in income. If the expectation is that rents will increase, and other risks attaching to the property are low, the discount rate will fall below that of fixed interest securities and move towards that of shares in good quality companies.

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If, on the other hand, the expectations for rent are not good, the discount rate will rise to reflect potential falls in rent or vacancies. The appropriate yield (discount rate) will be signalled by the market by actual deals done, and the valuer will follow the market evidence.

The situation described in (2) above, where the rent is not currently at the market level, can be dealt with fairly simply by using the present value principle to value the current rent up to the point where it ends, and separately valuing the rent thereafter. The all risks yield from market transactions may be adjusted for the different levels of rent, in a process which we will look at later.

FIGURE 1 Prime retail investment



1. All risk yield for the estate, when let at full rent: 5% (from market deals)
2. Assumed target yield for major investor: bond yield + 4% = 9.5%
3. Conventional valuation: discount rent at today's rental values at 5%
4. DCF valuation: discount projected rent at 9.5%

### 3.4 Discounted cash flow



Discounted cash flow employs the same concept of present value as has been described in the context of Years' Purchase.

The technique is used in very many business contexts, which is one reason for its increasing use in the property context.

When evaluating real estate by discounted cash flow, the following changes are made to the traditional model:

- In place of an income stream based simply on today's rent, incomes are forecast for the expected holding period of the investment (including the final sale price, if any, of the investment at the end of the holding period).
- In place of the all risks yield, the investor's target rate of return is employed.

### 3.5 Short-term investments



Short-term investments in real estate arise from lease contracts with a number of years to run. Sometimes they have a positive value, sometimes a negative value. An alternative concept to present value is used in some markets, which is the sinking fund method. Capital value is a function then of:

- The interest rate on capital of the purchaser.
- The amount of the income received which the investor has to set aside to replace what is effectively a wasting asset. This depends not only on the capital to be replaced but also on the reinvestment rate on capital set aside.

(The set-aside amount is known as a sinking fund.)

You may like to note that investment valuations are used not only for let properties but also for owner-occupied properties where there are relatively few sales to users but rents and yields are well established.

#### 4 The residual principle



The residual principle has been referred to in the context of rental values of shops and agricultural land, where the analysis of land price appears fairly consistent with the economic theory of rent as a surplus. This concept is employed in valuing building land, where a logical approach to land value is to estimate the 'output' value in terms of the price which can be expected for completed buildings, and to deduct 'input' costs, such as site preparation, building costs, fees and finance charges. If there is then a surplus, it can be expected that the entrepreneur (developer) will make a bid for the land, subject first to an allowance for profit and risk. A valuation on this basis usually takes the following form:

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#### Land valuation

Gross Development Value (on completion)		100
<i>Less</i>		
Site preparation costs	5	
Building costs	50	
Consultants & statutory fees	7	
Finance during construction and selling	9	
Selling/letting costs	4	75
Balance for profit and land		25
Profit @ 15% of value		15
Budget for land (purchase, fees and interest)		10

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A similar though not identical result can be obtained by a summation of the present values of the various costs (excluding interest) and the selling-out price, using for the discount rate the cost of borrowing money. This alternative will be essential where the sale of completed buildings is phased with a more complex timetable for construction. Under these circumstances the more simple residual tabulation will be inaccurate.

### Reasons for using the residual method

There are various reasons why direct comparison is inappropriate to development property, apart from the case of residual building land.

1. **Physical factors.** Site and subsoil conditions, existing buildings requiring adaptation or demolition, the need to support adjoining property, alteration to underground services, are all variables between sites and tend to make direct comparison inappropriate.
2. **Use and intensity.** Proposed development varies between sites. For example, use may be for offices or shops. On some sites there will be a potentially high density, eg 3:1, permitting 3m<sup>3</sup> of building to every 1m<sup>3</sup> of land, usually with the land area including half the widths of the adjoining streets; on other sites density may be more restricted. Height and daylighting angle restrictions may constrain the size of a building, and these too will vary between sites.
3. **Rack rental and capital values**, and therefore **site values**, vary substantially (in central areas particularly) within a small distance. A cursory study of almost any high street will demonstrate the point. All this makes for difficulty in direct comparison.
4. **Legal constraints** deriving from the title to the land, or the existence of rights of way etc, or existing tenancies, vary between sites.
5. **Conditions** attached to planning consent vary from site to site, eg conditions may require the developer to provide open space, a residential element in a new commercial building complex etc.

For all these reasons, comparison is impracticable in many instances. The method of valuation therefore is to look at the property from the point of view of the entrepreneur developer, whose reasoning may be hypothesised as: 'My bid for the land in its present state would be the market value after development, less the total of all costs, with a profit margin for own risk and reward.'

Essentially this is a value-to-the-owner approach, but since the market is made up of many such persons it can be applied to market value.

#### 4.1 Strengths and weaknesses of the residual principle



##### Strengths

- The residual models the behaviour of builders and developers who must necessarily adopt a method that takes account of costs, sales prices and other expenses.
- There may be no alternative in the absence of the sale of truly comparable sites, particularly in the city-centre context where location and other factors such as density controls and particular site conditions are unique.
- The model can be adapted and refined, to take account of different possible outcomes and costs or to include cost inflation or value increase.

##### Weaknesses

- Calculations are notoriously sensitive to changes in the various estimates included.

You can see this in our example if you increase value on completion by 5 percent and express the resulting change in land value as a percentage of the original figure.

- The estimates may be according to current prices and costs or predicted prices and costs when the scheme is carried out. This will lead to different conclusions of value.
- At the time of the carrying out of the valuation, there may be insufficient design detail to make accurate assessments of costs.
- Different developers will accept different margins for profit and risk, again resulting in different bids.

#### 4.2 Comment

△ We accept that there is room for considerable variation in using the residual method but, working in co-operation with developers who know their costs and margins, the method can be employed in negotiation for sites and bids in tenders and auctions.

Sensitivity analysis can be used to test the result of variations in estimates. The profit and risk margin should cover a reasonable range of outcomes.

#### 5 The profit principle

△ Rent as a function of profit will now be a familiar idea. In the profits method of valuation, this concept is exploited to the full by basing valuations for rent on actual or estimated profit of an operator. Where possible, the actual accounts of the business for previous years will be used, but where these are unavailable or unreliable, the valuer will make estimates based on analogous businesses. In the UK, valuations based on profits are usually made by specialist firms who study the relevant trade journals and get to know the business sector very well.

A valuation based on business profits is called in the RICS Valuation Standards 'value fully equipped as an operational entity'. The land and building element is not separately valued because the premises are rarely sold except with the business continuing.

It is likely that if the business was not continuing, the value of the premises would be lower to take account of the need to re-establish the customer base.

'Value fully equipped' means that the premises are fully fitted out and furnished and stocked, and the business will be sold with the benefit of any goodwill it has accrued.

The potential bidder in the market is assumed to have the following purchasing criteria:

- What is the likely level of sales I can expect having regard to past records, trends and possible improvements in operation?
- What will be the cost of purchases, and all the various operating costs?
- What money will I have to employ in the business by way of working capital?
- How will I finance the purchase, and what return on capital do I need to cover capital costs and provide for a reasonable reward and risk in bad as well as good years?

Answers to the first three questions will determine the expected profit margin, and the answer to the last will determine capital value.

Market value will reflect the different perceptions of buyers in the market. In a rising market, bidders will tend to pay more and to sacrifice some of their own surplus to win a bidding competition.

### 5.1 Comment



- It is generally agreed that this method is suitable only for (a) those kinds of premises with a degree of monopoly because of licensing or (b) those which are not of a kind normally let or sold separately from the business in which they are employed.
- The need for accounts for the business restricts the scope for using this method.
- The underlying theory is well founded, but availability of data or trade information may be a problem in practice.
- Different buyers will have different overheads and profit requirements.
- Where there are sales of similar businesses, such as in districts dominated by small hotels, it is possible to use comparison based on rooms.
- The method is important for land and buildings in the leisure sector, including hotels, marinas, golf courses and other sport and recreational facilities. However, motives other than profit may be present in some cases.

### 6 The cost principle



The methods of valuation considered so far provide for various classes of real estate, but there remain:

- Land and buildings of special industrial character for which profit figures cannot be obtained.
- Land and buildings for which there is no market because of their public service or heritage characteristics.

Valuations of such premises are required for **taxation** purposes in some countries or for accountancy purposes. In Britain, public sector premises are required to be valued for the asset registers of various authorities. Special industrial properties have to be valued for accounts and stock exchange when a listing is sought, as well as for local tax assessments.

By their very nature, these properties are not traded in the market in their existing use. If they are sold it will be for demolition or conversion to some other use. This may be higher or lower than the valuation by cost principle.

The problem of valuation arose first in the context of local taxation in Britain. Statute law, first enacted in 1601, imposed a tax on every person having property in any parish (then the smallest unit of administration). Industrialisation produced specialist buildings and there were also some schools and other non-market properties for which assessments were required.

The local tax, or rates, were and are based on the annual value of lands etc. A hypothesis was invented which said that the annual value would be the percentage return required by a contractor (we would now say developer) on the cost of providing the premises in question. In other words, value depends on cost, including land and improvements. An adjustment was recognised to allow for the fact that the actual premises might be less valuable to an occupier than a new equivalent.

In the tax context there was much room for argument over the costs and the percentage rates to arrive at rent. The latter were particularly contested in the courts, and are now fixed by regulation of central government, which saves court costs and uncertainty.

An example of the use of the method, which is known in rating law as the Contractor's Test, was the case of *Imperial College London v Ebdon (VO) & Westminster City Council*. The premises were college buildings of various ages.

- **Buildings.**

The case concerned 15 buildings situated in the City of Westminster in an area of high real estate values. The buildings were of various ages. The parties agreed that the current cost of replacement, either in existing state or with modern substitutes where the buildings were outdated, was approximately £20m. This figure would include consultants' fees as well as building costs.

- **Allowance for age and obsolescence.**

Opinion varied widely on this, from 0 to 54 percent. The Lands Tribunal in its role as arbitrator awarded 11 percent. It awarded a further 7.5 percent for 'disabilities' to cover design and layout deficiencies of the actual premises compared with a modern substitute.

- **Land value.**

The land value in the open market, with educational use competing with residential or commercial, would in reality have been very high. However, English rating law requires an assumption of existing use, not alternative use, and the land was valued at a figure of £400,000 per acre (approximately £1m per hectare), much less than its unrestricted value.

The second type of valuation which requires a cost basis is the valuation of land and buildings for **accounts** purposes. It is a matter for company policy as to whether it shows its assets at historic or current cost in the published accounts, but there are some strong reasons for using current cost.

You may recall the discussion of value definition, where it was stated that for properties not normally bought and sold in the open market, the concept of deprival value suggests that the value to the company is the cost of replacement, subject to some allowance for the age and utility of the actual premises compared to a modern replacement. Such cost would be assessed as follows:

- |  |     |
|--|-----|
| 1 Purchase price for site (including incidental costs) | A   |
| 2 Cost of site works at current costs                  | B   |
| 3 Cost of construction of equivalent facilities        | C   |
| 4 Deduction for age and obsolescence                   | (D) |

A number of questions are raised by this simple model, but they concern practice rather than principle and will be considered elsewhere.

## 6.1 Comment



- The principle is usually criticised on the basis that cost does not necessarily equal value, when using value in the sense of price in the market.

There are many examples of buildings and other constructions which have cost far more than they would fetch in the market. The recent sales of water undertakings in Britain and elsewhere are unlikely to have realised an amount equal to the current cost of the vast infrastructure of pipes, drains, reservoirs, treatment works etc which have been developed over more than a century.

- For a commercially motivated industry the cost of facilities would need to be economically justified, so it is rational that the cost of the facility was value for money when first constructed. Any change affecting profitability can be accommodated by the company's discretion to down-value the reported asset value.
- In some parts of the world where there is no sophisticated market or evidence of transactions, the cost principle has to be used, as there are no alternatives.
- Other criticisms relate to practical problems such as:
  - arriving at land values when plants are remote or on sites that would not be chosen in contemporary circumstances;
  - adjusting for age and obsolescence;
  - whether age allowance affects land value as well as constructions.
- All valuations which cannot be tested against some objective criterion such as prices realised in the market suffer from subjectivity. Accountants have wrestled with this problem as much as valuers, and conclude that the alternatives are:
  - some form of cost basis, historic or current;
  - some form of present value basis, which is the summation of the earning power of the asset;
  - market price.

Each method has advantages and disadvantages. For specialist plant, a present value basis would be attractive but industrialists are not willing or able to reveal earnings of particular plants.

### ANSWERS TO EXERCISE

a	Income	\$200
	× YP in perp @ 6% (100 ÷ 6)	<u>16.667</u>
		\$3333

@ 9% ( $\times 100 \div 9$ )

\$2222

b Value of first \$100	100	=	90.90
	1.10		
Value of second \$100	100	=	82.60
	(1.10) <sup>2</sup>		
Value of third \$100	100	=	<u>75.10</u>
	(1.10) <sup>3</sup>		
Total			\$248.69

### SELF-ASSESSMENT QUESTIONS

1. List the five main methods of valuation.

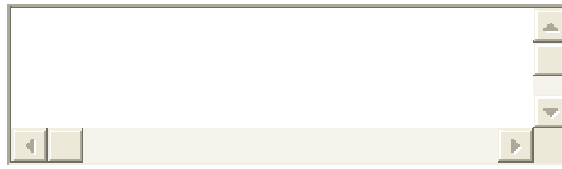
2. Examine the extent to which each method relies on comparable sales data.

3. Distinguish all risks yield and discounted cash flow methods of investment valuation.

4. Outline:

a. a profits-based valuation;

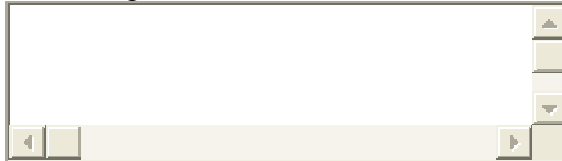
b. a residual valuation;



c. a cost-based valuation.



5. List strengths and weaknesses of each method.



## Summary



This paper considers the traditional valuation methods employed widely in practice in the UK.

- The comparative principle is applied on the assumptions that the valuation obtained is an estimate of market price and that what has been paid for very similar property interests will be paid for the property being valued.
- The investment method derives the capital valuation of a property interest from the income stream which the property generates or is expected to generate in perpetuity. The process involves the all risks yield as a capitalisation rate, from which a multiplier, or Years' Purchase, is derived. This is then applied to the property's rental value to obtain its capital value. Rental growth is implicitly assumed in the choice of yield.
- The use of DCF methods involves the use of the investor's cost of capital in place of the all risk yield and explicit rental growth. Since different investors may have different costs of capital, the method is, strictly speaking, a calculation of worth to that investor.
- The residual principle is employed in the valuation of development land or developer's profit where new projects are being appraised.
- The profit principle is applied to valuations of property interests where comparable recent sales data is non-existent or too meagre to offer a reliable guide. Leisure properties and licensed premises come into this category.
- Where profits cannot be assessed or where there is no identifiable market for a property, as with specialised industrial buildings, the cost principle (or contractor's method) is applied. Schools and other educational buildings would also come into this category.



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