FACE VALUE

Valuation achieves the best estimate of the value of a property, but is a complex issue involving many macro and micro factors

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IN TODAY'S world where people have easy access to all sorts of information and data on the Internet, one may question the need for professional valuation and if it is truly necessary. Indeed, the availability of property and transaction information online has impacted valuation as a profession. Businesses need to realise that online data is only a general guide and do not challenge or replace professional opinion.

Very often, business operators have to make timely decisions relating to real estate – such as if the price or rent of a property is reasonable, if it is timely to buy or rent based on the business' capabilities and requirements, and if there are any downside risks or upside potential to be mindful of. And this is where professional valuation comes into play.

Professional valuation is the cornerstone that underpins all real estate ownership and transactions. It determines the market value or price of a real estate asset such that it can be transacted in an open market.

When used timely and effectively, having up to date information on the market value of one's property can prove handy to businesses; particularly, for small and medium-sized enterprises (SMEs) whose real estate contributes to a major portion of the business cost.

THE NEED FOR COMMERCIAL VALUATION

More often than not, the most common requests by SMEs is to obtain a valuation report for financing purposes from the banks or lending institutions for the purchase or sale of a real estate asset. In this instance, the basis of property valuation for sale and purchase is the market value.

In general, and in accordance with the standards and practice of the Singapore Institute of Valuers and Surveyors, market value is defined as "the estimated amount for which a property should exchange on the valuation date 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".

When purchasing a real estate asset for business operations prove to be too costly for small businesses, SMEs owners may also consider renting premises for their business operations. They may then need to consider whether the rents are in line with the market, before a commitment is made. In many lease renewal cases, rental valuation can be commissioned when both landlord and tenant are unable to arrive at a mutually agreed rental rate.

Similar to multi-national corporations, SMEs also require valuation to be conducted for financial reporting. According to the Financial Reporting Standard, businesses are required to measure and disclose the fair value of assets and liabilities. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The standard also requires the valuation to consider the highest and best use of an asset, taking into account the use of the asset that is physically possible, legally permissible and financially feasible.

In conducting valuation for company audit purposes, valuers work closely with the external auditors, sharing with them how the fair asset market value was derived, as well as ensuring that the accounting standards are met. Often, this requires a qualified valuation professional who has sound knowledge of the real estate market in Singapore to provide justifications of certain market practices, among other things.

Tax matters can also be another purpose of commercial valuation, especially stamp duty, when ownership of a share of the property or the entire property is transferred. In such cases, the basis of valuation will be in accordance with the provisions of the appropriate tax statutes that are prevailing at that point in time.

VALUING DIFFERENT TYPES OF PROPERTY

Providing a current market value tagged to a property takes more than just an opinion. While there are methodical ways to arrive at a reasonable value range for the property, valuers need to be also fully aware of the local real estate market conditions, economic and social trends, as well as government regulations, environmental conditions and outlook for the near future, among other things. There are three commonly applied valuation methods in the determination of real estate value: the sales comparison, cost and income approaches. Where possible, these methods are employed and used as a check against one another to provide a value that is reasonable and supportable, given the uniqueness of the property and the prevailing market conditions.

The sales comparison method can be used in all valuations, where there are adequate transactions and property information to indicate the level of value for the property. The approach is to identify current transactions of properties that closely resemble the subject property and make appropriate adjustments to reflect their differences – such as size, location, siting and tenure.

The cost method assumes that the cost of constructing the property is equivalent to its value. It is based on the broad assumption that a potential real estate purchaser will not pay more for an asset than the cost to build an equivalent. This method entails the estimation of the value of the site. The amount of depreciation and obsolescence are also estimated and deducted from the cost of improvements to arrive at the depreciated replacement cost. Land value is then added to the depreciated replacement cost to arrive at the capital value of the property. The simplistic approach, hence, renders some limitation in its use and is, therefore, more heavily relied upon only for properties that are seldom traded – such as places of worship, schools, shipyards or bus depots.

The third approach is the income method, in which the net current or market rent is capitalised at an appropriate rate to derive the capital value of the property. The property's tenure and asset class are some of the factors that have to be taken into consideration. The ambit of the income method includes the discounted cash flow analysis, which is the projection of future cash flows over a time horizon, whereby the property is held and discounted to the present value.

Variations in income are accounted for based on the property's leasing pattern, anticipated capital expenditure, maintenance and management, as well as the costs associated with the initial purchase and sale of the property at the end of the holding period. It will also take into consideration an investor's desired rate of return. The mechanics of the income method can be complex but essential in any commercial real estate transaction. Based on the relationship between the rate of return that an investor requires and the next income that a real estate asset produces, this method is generally employed for income-producing properties such as office buildings and shopping malls, and is mandatory for the valuation of properties held by real estate investment trusts.

All in all, valuation is all about achieving the best estimate of the value of a property and it is a complex issue, where many macro and micro factors come into play. It is both an art and science, and the accuracy and timeliness of the real estate valuation reports are important to buyers and sellers, as well as mortgage lenders and investors, among others. For SME owners, it is highly recommended to engage professional valuers to assess whether the property that you are interested in is under- or over-valued, and if the investment is a worthwhile one for your business. ■

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