

ASAVAL Conference – Portugal

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Property Valuation; pricing the uncertain future - opportunities and threats

Are we certain that we are uncertain?

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Agenda

- **TEGoVA - Valuation During the Pandemic**
- **Market Value is an estimate of price based on the professional judgement of the valuer – (art?)**
- **Valuation Uncertainty – determining Market Value in a “paused” or “stagnant” market**
- **Understanding Valuation Uncertainty**
 - **the likelihood that Market Value equates to price**
 - **uncertainty in inputs feed into uncertainty in value**
 - **A Quantitative Analysis of Valuation Uncertainty**
 - **it is NOT directly the uncertainty of cash flows**
- **Valuation and Worth are NOT the same**
- **What is Comparable Evidence?**

Property Valuation: Uncertainty & Challenges

*Normal uncertainty' is a universal and an
unsurprising fact of property valuation*

Michael Mallinson 1994

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Addressing Uncertainty 1

- **How do various Clients interpret valuation provided with an indication of uncertainty?**
 - **It really depends upon the client. Indicative evidence has suggested that, in the UK, the majority of clients are fully conversant with the concept of “material uncertainty”. Fund managers and property company clients are generally qualified or property trained and thus they understand the issue of valuation uncertainty in the valuation report**
 - **The problem is with the “uneducated” clients who don’t understand “Market Value” let alone uncertainty in valuation. For example, many bank clients see the valuation as a fixed figure that will never decrease from that (snapshot) figure. With such misunderstanding of what a valuation figure represents, discussing uncertainty with them is very difficult**

Addressing Uncertainty

□ How did valuers value in the UK?

- It is important when considering this issue that one recognises that not all markets have been hit by covid as badly as others. In fact, many markets are now thriving
- The out of London residential markets are experiencing a boom as people realise that they can work from home easily and that they can live outside London with more space
- The RICS has been very good at ensuring that valuers reflect this in their valuations and advised that the use of Material Uncertainty should be reviewed on a weekly basis
- But, that said, there are markets where activity has stopped and not recovered. Here the valuer has to look at market sentiment much more than comparable evidence. Such valuations are naturally still within the ambit of material uncertainty

Material Uncertainty

- Any valuation, at any snapshot in time, is affected by uncertainty. It is the degree of uncertainty that changes as market dynamics change
- In valuation parlance, there is **normal uncertainty** and **material (abnormal) uncertainty**
- Uncertainty impacts in two ways:
 - the **cash flows** and **ARY** from investment are uncertain
 - the resultant **Market Value** figure is uncertain
- These uncertainties are **NOT** the same
 - Yes, one drives the other but when discussing valuation uncertainty, you are discussing the likelihood of your **Market Value** figure matching the sale price of a hypothetical sale today

A Range of Uncertainty

- Valuation Uncertainty is about a range of possible “values” and the valuers choice of Market Value within that range
- If the market is strong, the valuer will be more certain that the Market Value estimate will match the hypothetical sale price
- If the market is weak or “paused”, the valuer will be less certain that the Market Value estimate is correct
- Valuation uncertainty is NOT about the likelihood of the property matching investment expectation

Modelling Uncertainty

- Using a simple implicit capitalisation model, the valuation is **Market Rent/ARY**
 - We need to address the probability and range relating to the inputs not the output
 - The analysis of property is a heuristic process; valuers will assess the market by a benchmarking of comparables sales and other market data
 - Within that process, the valuer must ascribe one single figure to each of the inputs (**Market Rent/ARY**) in the analysis
 - Yet, the valuer will have a view on the confidence that he/she believes applies to the individual inputs
 - The thought process of the valuer can be expressed as a triangular probability distribution (**most likely, maximum and minimum**)
-

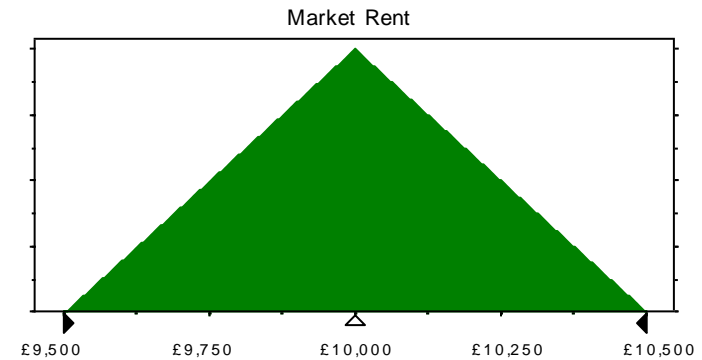
Input Range – Normal Uncertainty

Assumption: Market Rent

Triangular distribution with parameters:

Minimum	£9,500
Likeliest	£10,000
Maximum	£10,500

Selected range is from £9,500 to £10,500

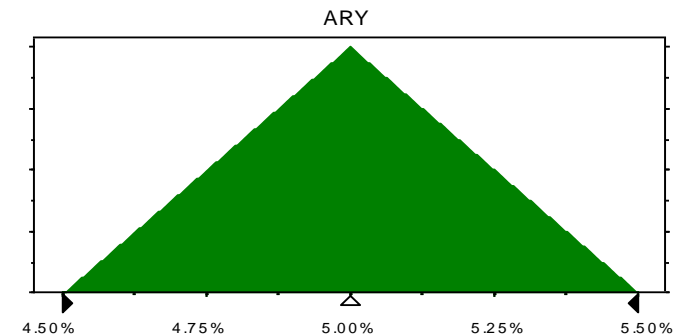


Assumption: ARY

Triangular distribution with parameters:

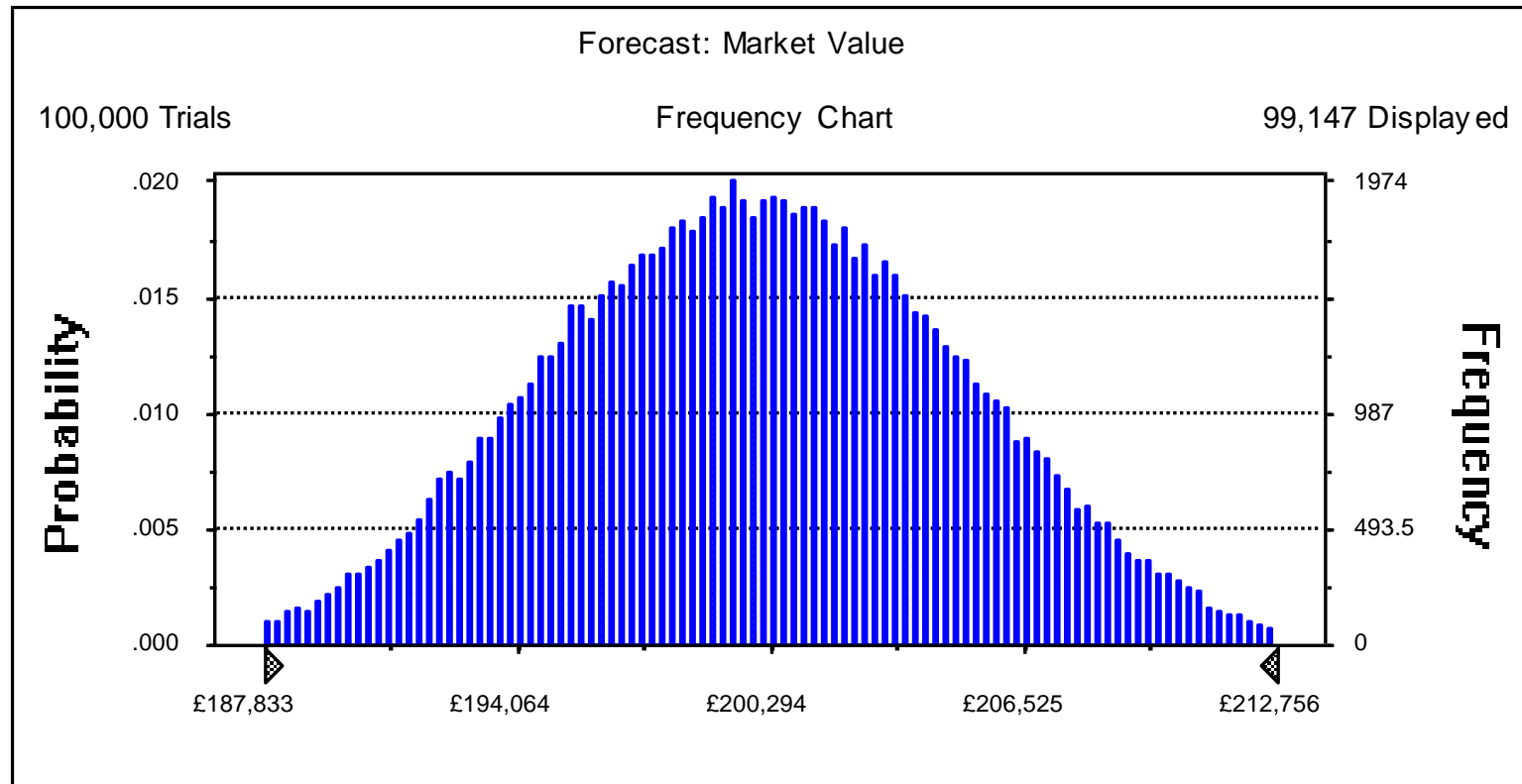
Minimum	4.50%
Likeliest	5.00%
Maximum	5.50%

Selected range is from 4.50% to 5.50%



Rent correlated with ARY at -0.32:

Market Valuation: Normal Uncertainty



Trials	100000	Standard Deviation	£5,035
Mean	£200,019	Range Minimum	£183,878
Median	£199,985	Range Maximum	£215,977

Input Range – Material Uncertainty

Assumption: Market Rent

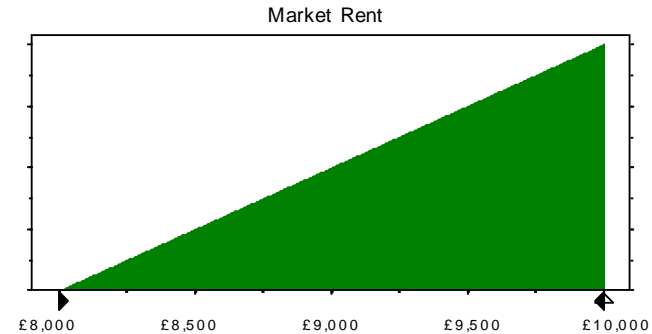
Triangular distribution with parameters:

Minimum £8,000

Likeliest £10,000

Maximum £10,000

Selected range is from £8,000 to £10,000



Assumption: ARY

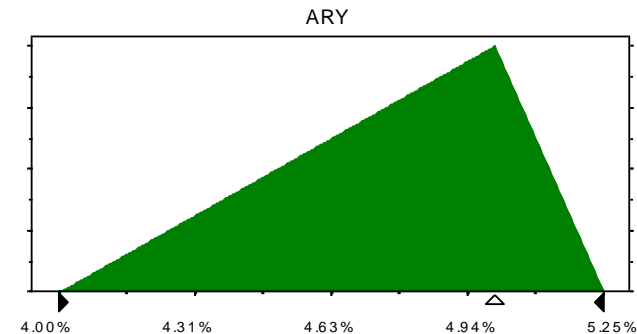
Triangular distribution with parameters:

Minimum 4.00%

Likeliest 5.00%

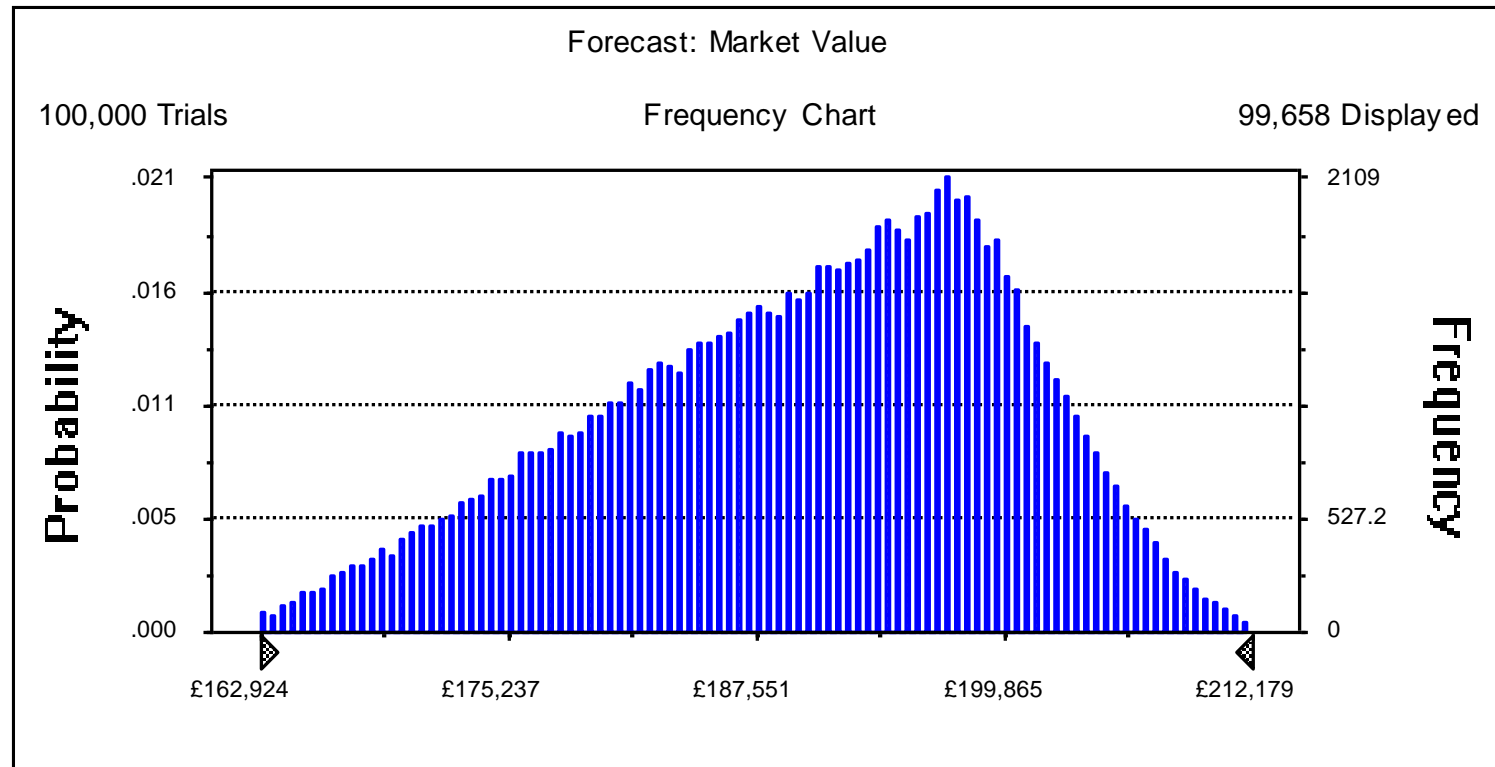
Maximum 5.25%

Selected range is from 4.00% to 5.25%



Rent correlated with ARY at -0.32:

Market Valuation: Material Uncertainty



Trials	100000	Standard Deviation	£10,285
Mean	£190,030	Range Minimum	£157,994
Median	£191,348	Range Maximum	£214,477

Modelling Uncertainty

- The Crystal Ball example is just for illustration – you do NOT have to use probability modelling but it, I think, helps to show the nature of valuation uncertainty
- When a valuer talks about valuation uncertainty they are looking at uncertainty in inputs...
 - Lack of comparable evidence
 - Uncertainty in the future cash flow (reflected in income or yield NOT both)
 - Lack of inspection/access to property information
- BUT THE **VALUATION UNCERTAINTY** ITSELF IS THE POSSIBLE DIVERGENCE OF THE MARKET VALUE FIGURE TO PRICE AT THAT DATE

Property Valuation: Uncertainty - Statement

TEGoVA Guidance on Uncertainty

Valuation During the Pandemic – March 2020

In short, the impact of the pandemic is that there is less certainty – and a higher degree of caution – attached to valuations than would normally be the case

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TEGoVA - Uncertainty

TEGoVA advice concerning valuation

- Real estate valuation work in most countries is difficult to undertake in the absence of market activity (sales, asking prices, market sentiment)
- TEGoVA advised that where valuers were instructed to arrive at a market value of a property
 - They should set a benchmark value (pre-crisis MV) that the client can usefully gauge the market value reported at the relevant current date of valuation
 - In reporting a value at a current date of valuation, valuers should make clear reference to the comparable evidence relied upon and state the extent to which adjustments if any have been made to that evidence on account of the crisis

TEGoVA – Country specific

TEGoVA advice concerning indigenous markets

- Valuers should ensure that the Terms of Engagement agreed with the client reflect this change to normal procedure
- Valuers should also recommend that the value of the subject property be kept under frequent review
- Different country specific Valuation Organisations have issued separate, but complementary, advice to their members
- In Portugal, ASAVAL issued specific recommendations as did the national regulator

Value and Worth

- One of the outcomes of clients questioning “uncertain” valuations is that they retort that it can be market value because they wouldn’t sell at that figure
- This is the frequent misunderstanding of the difference between the **Market Value** of a property and the **worth** of it to a particular owner or occupier
- a client’s unwillingness to transact at a certain level should not influence the assessment of **Market Value**
- The assessment of worth does not require a hypothetical transaction but an assessment of the worth of an asset to an individual/company based on subjective criteria

Value and Worth – in Football !

- Even Football pundits understand **Price, Value and Worth**
- Data analysts Carteret Analytic say Manchester City take the view that Garcia's 'value in use' (essentially his Intrinsic Value – **Worth**) over the remaining year of his contract is more valuable to them than a derogatory 'value in exchange' (**Market Value**) £5m offer from Barcelona
- According to Carteret Analytic, Garcia's Intrinsic Value for Manchester City is £32m. The data analysts go on to say that even if you halved this because he is in the last year of his contract, his 'value in use' to Manchester City will still be least £16m. **BBC Sport Website – Deadline Day 2020 – 5th Oct**

Property Valuation: Uncertainty & Challenges

The complexity of simple comparison

*Comparison plays a part in all valuations by all approaches (Market, Income and Cost) and is the lynchpin for determining market value. **TEGoVA 2020***

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Comparable Evidence Guide

- Comparable evidence in real estate valuation – RICS Guidance Note**
Oct 2019 - Downloadable from www.rics.org
- Pricing to Market - An Investigation into the use of Comparable Evidence in Property Valuation – TEGoVA Report**
June 2020 - Downloadable from www.tegova.org
- Both documents the potential sources of comparable evidence in the valuation process, particularly where there are issues of availability and use – very topical**

Hierarchy of Evidence

Direct transactional evidence - Hard information

1. Recent Sale/let - valuer was party to the transaction
2. Recent Sale/let - a colleague was party to the transaction
3. Recent Sale/let - a colleague in a different company was party to transaction

Public Information – Soft information

4. Publically available list of recent transactions in a professional magazine
5. Publically available list of recent transactions listed for free on the internet

Database - Soft information

6. Private Subscription Service – List of recent transactions on the internet
7. Government Listing or Cadastre - transactions listed for free on the internet
8. Government Listing or Cadastre - transactions listed for a fee on the internet

Sale Price - Soft information

9. Market information on the reported sale/letting of the property being valued

Continued

Hierarchy of Evidence

Asking Price - Soft information

10. Details of sales particulars with asking prices of similar properties
11. Purchase enquiries to the valuer/company colleagues for similar properties
12. Purchase enquiries to colleagues at other companies for similar properties

Historic Evidence - Soft information

13. Evidence of historic transactions that may be used to extrapolate today's MV

Market Sentiment - Soft information

14. General market discussions/commentaries with colleagues
15. Published market commentaries in magazines or on the internet

Indices - Soft information

16. Free Property market indices, derived from aggregated information
17. Private Subscription Service – Property market indices

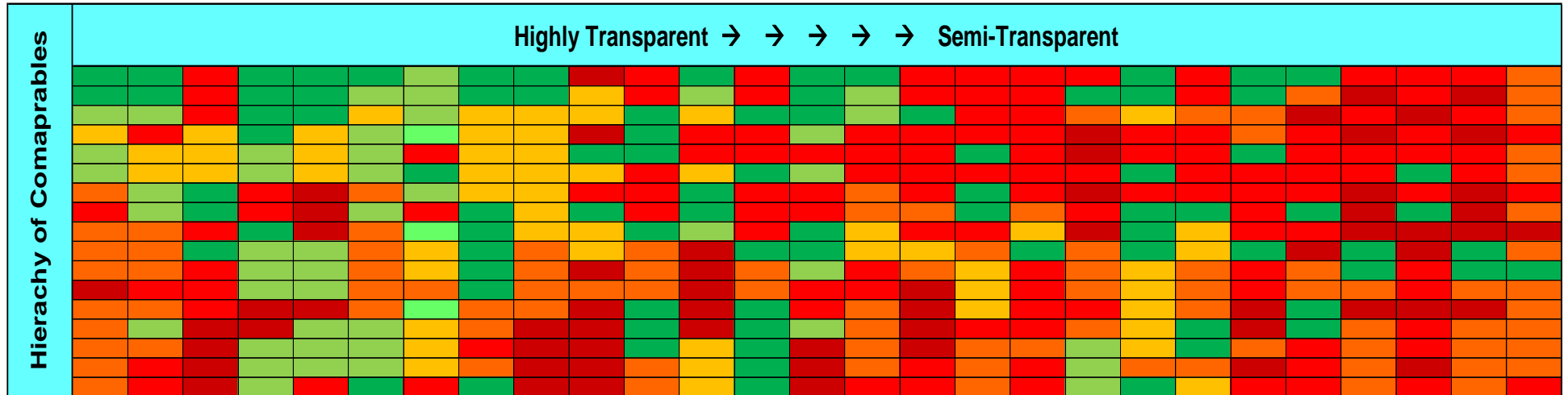
AVMs - Soft information

18. Private Subscription Service – Value by an Automated Valuation Model
19. Publically available property pricing provided online

TEGoVA Report – Comparable Evidence

- The report was commissioned as TEGoVA had debated what constituted “comparable evidence”.
Was it JUST transactional data or broader?
 - Not all countries are the same. There are different “degrees of transparency”. A highly transparent market will have access to all forms of comparable data and, thus, the valuer has the luxury of using **hard** transactional evidence. However, in more opaque markets, such data may not be available and the valuer has to rely upon **softer** sources of comparable evidence.
 - There is a correlation between the ranking of data sources and the transparency of the market in question
 - Each market has to deal with the data availability within their specific country.

Comparables - Veracity & Availability



Use of Comparable Data vs Transparency of Market

- This graphic illustrates that as markets become more opaque the not only does the lack of comparable data increase (more reds) but the data which is considered the most useful in the transparent markets (more greens and ambers) become less available and used

The Lack of Evidence

- ❑ **Coincidentally the TEGoVA report came out at a time when ALL markets were struggling with the lack of transactional evidence**
- ❑ **It was therefore universally well received as previously transparent markets found themselves having to provide valuations in opaque conditions**
- ❑ **Material Uncertainty is interlinked with market transparency**
- ❑ **It also reemphasises that valuation is not easy - the complexity of simple comparison**

Overall Conclusions

- COVID is just a catalyst; it has accelerated change in many markets and valuers need to adjust their practices to reflect these changes in the estimated price (Market Value)
- The only difference is the speed of change
- Material Uncertainty is not a catch-all caveat to abdicate the valuer from their professional responsibility to provide market value
- It is simply a signpost to be used, where appropriate, in markets where there is abnormal uncertainty

Property Valuation: Uncertainty & Challenges

Conclusions

The Property Valuation profession is facing unprecedented challenges as markets change rapidly due to the catalyst of covid and climate change legislation

I have written short articles in English on all the topics of this presentation. They are published in **The Property Chronicle and are available for free at www.propertychronicle.com/author/nickfrench/**