

THIRD EDITION

PROPERTY VALUATION

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WILEY Blackwell

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Property Valuation

Third Edition

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WILEY Blackwell

This edition first published 2023
© 2023 John Wiley & Sons Ltd.

Edition History

Blackwell Publishing Ltd (1e, 2007); John Wiley & Sons Ltd (2e, 2013)

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PO19 8SQ, UK

Editorial Office

111 River Street, Hoboken, NJ 07030, USA

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Library of Congress Cataloging-in-Publication Data

Names: Wyatt, Peter, 1968- author.

Title: Property valuation / Peter Wyatt.

Description: Third Edition. | Hoboken, NJ : Wiley, 2023. | Revised edition of the author's Property valuation, 2013. | Includes bibliographical references and index.

Identifiers: LCCN 2022030096 (print) | LCCN 2022030097 (ebook) | ISBN 9781119767411 (paperback) | ISBN 9781119767428 (adobe pdf) | ISBN 9781119767435 (epub)

Subjects: LCSH: Commercial real estate-Valuation-Great Britain. | Real estate investment-Great Britain.

Classification: LCC HD1393.58.G7 W93 2023 (print) | LCC HD1393.58.G7 (ebook) | DDC 333.33/8720941-dc23/eng/20220804

LC record available at <https://lcn.loc.gov/2022030096>

LC ebook record available at <https://lcn.loc.gov/2022030097>

Cover Design: Wiley

Cover Image: © VideoFlow/Shutterstock

Preface

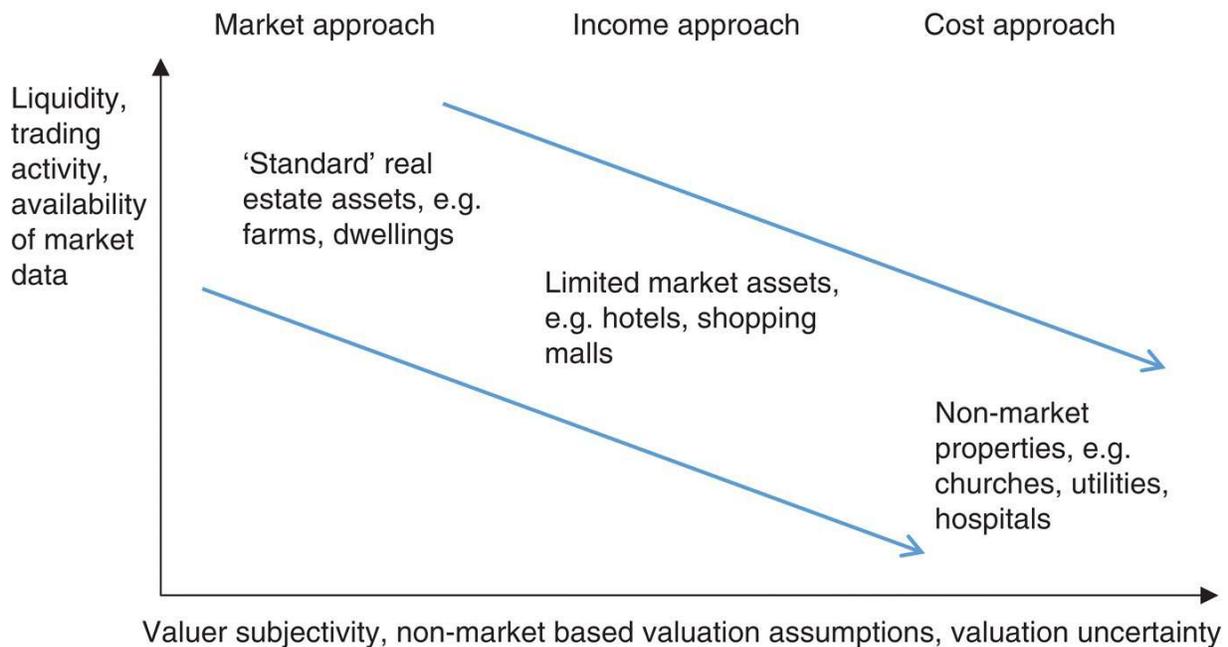
The legal ownership of land and buildings, also known as 'real property' and collectively referred to as *property* throughout this book, confers rights that enable it to be developed, occupied or leased. The physical occupation of property is essential for social and economic activities including shelter, manufacture, commerce, recreation and movement. Typically, physical property ownership is not desired as an end in itself, although a prestigious site or landmark building can confer non-financial value. Rather, demand for property is a derived demand; occupiers require property to help deliver social and economic activities, and investors require property as an investment asset. This concept of derived demand has a direct bearing on its valuation. The interaction between the supply of and demand for property generates exchange prices and valuations are estimates of those market prices. Valuers interpret the way in which market participants measure and quantify value. Increasingly, there is recognition of value beyond 'market' value; referred to as non-market value. The valuer's skill set has conventionally focused on the estimation of market value but in some cases social and environmental assessments can complement market valuations to ensure that owners, occupiers and other affected parties are aware of and, if appropriate, fairly compensated for any interference with their property rights.

Section A covers valuation principles. [Chapter 1](#) begins with a discussion on property rights and the way in which those rights can confer value to their holders. The chapter ends by explaining how and why valuation has evolved as a discipline to help estimate the value of those property

rights. [Chapter 2](#) outlines the economics of property value relevant to property markets and estimates of exchange price. It introduces economic terms and concepts associated with the supply of and demand for property, the concept of rent as a payment for their use and some land-use theory. It explains how property values arise using economic principles and theories that have been developed and expounded over the past century and a half. Building on the theories relating to the agricultural land market, the causes and spatial distribution of urban land and property uses and rents are described. The chapter examines the economics of supply and demand and the establishment of equilibrium exchange price in the property market and its constituent sectors. The chapter explains the causes of price differentials between land uses. [Chapter 3](#) describes the main property market sectors – occupation, investment and development – and the way that they interact with one another. [Chapter 4](#) explains the mathematics that underpin the valuation methods described in Section B.

Section B covers valuation approaches. It begins with [Chapter 5](#), which describes the valuation process, from confirmation of the instruction to value a property through to the publication of a valuation report. [Chapters 6, 7 and 8](#) explain the valuation methods and techniques that fall under the three internationally recognised approaches to property valuation – market, income and cost. Whichever method is employed, it should reflect the behaviour of market participants. The figure below shows that in active markets, where there is a large quantity of transactions involving properties with similar characteristics, the role of the valuer is essentially to interpret market signals and apply them to the subject property – a comparison approach. With limited availability of market information, market-valuation methods are increasingly cost-based.

Valuers are required to make more assumptions, and this increases valuation uncertainty.



Using the market approach ([Chapter 6](#)), the valuer examines recent market transactions involving comparable properties and uses this market intelligence to help estimate value. The income approach ([Chapter 7](#)) considers the net income that a property might generate, typically in the form of rent, and this income can be capitalised to estimate a capital value. Both the rent and the capitalisation rate will be estimated using comparable evidence. For properties where comparable evidence is lacking, the cost approach ([Chapter 8](#)) estimates the cost of replacement, perhaps incorporating a depreciation rate for older or less-functional properties. Building costs, depreciation rates and land values are all estimated by referring to comparable evidence. The cost approach also covers the valuation of development land. The choice of valuation approach depends on the type of property that is to be valued and the purpose of the valuation.

Section C considers the application of these valuation approaches in practice. [Chapter 9](#) examines the valuation

of investment properties, where the ownership and use of a property is split so that the occupier pays a rent to the owner, representing the return on the owner's investment. Valuations are required to determine the level of rent that might be charged and the price that an investor might pay when buying or selling a property investment. [Chapter 10](#) covers the valuation of development property, an important and challenging area of valuation work. The valuer is required to estimate the cost of construction and the market value of a development that is hypothetical, since it has not been built yet. This is done so that either the value of development land or development profit can be calculated. [Chapter 11](#) explains how valuations are used in financial statements of companies and public bodies to report the market value of their property assets. The chapter also explains how valuations are relied upon by lenders to assess the value of property that is used as loan security. Most countries have some form of tax that is based on property values so [Chapter 12](#) considers how valuations are undertaken for tax purposes. Similarly, most countries have legislation that allows them to compulsorily acquire property for government purposes. [Chapter 13](#) explains how valuations are central to the assessment of compensation to owners, occupiers and other affected parties. Finally, [Chapter 14](#) reviews the issues of risk, flexibility and uncertainty and the way that they affect valuations.

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The website includes:

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Section A

Valuation Principles

Chapter 1

Property Rights and Property Value

1.1 Property rights

Real Property refers to the physical land (including minerals and other natural resources, soil, trees, plants and growing fruits) and improvements to land (including infrastructure, buildings and other facilities). *Tenure* refers to the relationship, either formal or informal, between members of a society and real property (UN FAO [2002](#)). Tenure determines who can hold and use resources, for how long and under what conditions. These 'holding and using' arrangements are referred to as *property rights*, and the way in which they are formed, recognised and transferred between members of society depends on whether tenure systems are based on written policies and laws or unwritten customs and practices (UN FAO [2012](#)).

For example, an individual may hold or 'own' a piece of land in perpetuity, providing the holder with an extensive set of property rights, free of disturbance. This *freeholder* may decide to lease or rent the land to another person for a period of time. The *leaseholder* would benefit from use rights (rather than ownership rights), which would end when the lease expires. There can be any number of arrangements, depending on the tenure systems in place. For example, *shared equity* refers to a combination of leasehold for a term of years but with the ability (usually subject to conditions) to acquire the freehold. This kind of arrangement has been used to enable occupiers of residential dwellings to rent initially but then buy their homes later.

The ways in which real property can be held have been the focus of a great deal of philosophical thought. A key debate is whether property rights should be held communally (or in common) or whether they can be legitimately held individually (or privately). Private property rights are advocated on libertarian and utilitarian grounds. From a libertarian perspective, there are those who advance a natural right to property. Aristotle argued that, although privately owned, individuals will learn to exercise generosity and moderation and share their property. In the thirteenth century, Thomas Aquinas argued that while property should be private, the *use* of things should remain common. 500 years later in the eighteenth century, Edmund Burke believed that private property provided the foundation for a just social order and a spur to personal industry and national prosperity. He argued in favour of widespread access to acquiring property, which he regarded as a check on encroachments by the state. Similarly, Georg Hegel and his followers probed relations between the existence of private property and things such as self-assertion, mutual recognition, stability of will, and the establishment of a sense of prudence and responsibility. They argued that not only is private property morally legitimate, but it also contributes to the ethical development of the individual.

Advancing a natural right to property, in the seventeenth century, John Locke maintained that an individual has a right to property on account of what he has done to it, so long as his appropriation does not violate the property rights of others. Thus, improving land in some way, perhaps by draining it or constructing buildings on it, imparts a degree of private control that others should refrain from interfering with. Utilitarian arguments for private property purport to show that the happiness or welfare of a society will be improved if resources (and, in particular, the means

of production) are owned and controlled privately rather than by the state or a community. Developing a utilitarian theory of real property, Jeremy Bentham argued that the state should protect and promote private property ownership because landowners are more likely to invest in their land and to manage it better than public owners. Similarly, Demsetz ([1967](#)) argues that, by excluding others, private ownership internalises ‘many of the external costs associated with communal ownership’. This concentration of benefits and costs on owners incentivises more effective use of resources.

Perhaps unsurprisingly, as Linklater ([2015](#), p. 12) observed, living in a private property society encourages self-interest, in contrast to clan values, family values and communal structures found in other societies. Locke observed that with markets and prosperity come inequality and insecurity. To overcome these insecurities, people form governments to protect their private property, in return for which landowners should pay tax. Not every individual will or must establish such a relationship, so natural rights are not universal like a natural right to life and liberty (Waldron, [1990](#)). This contrasts with the more contemporary view set out in Article 17 of the Universal Declaration on Human Rights, which states that ‘everyone has the right to own property alone as well as in the association of others’. And of course, it contrasts with the case for communal property rights and the abolition of private property, advanced by Marx and Engels in the nineteenth century. To summarise, the way that property rights are held shapes the way society is organised.

1.1.1 Tenure

This ‘holding’ of property rights or *tenure* can be communal or individual. An example of communal tenure would be an apartment block that is jointly owned by all of

the occupants, while each apartment is leased to individual occupants. Also, tenure can be customary, perhaps vested in a village community and administered by elders. Customs and traditions may allocate rights of private residence, communal grazing and so on.

Tenure is a social construct that regulates how property rights are allocated among members of society. Property rights are myriad, but the main ones are: *use, take* (fishing rights for example), *extract* (minerals or water for instance), *enjoy* (or usufruct), *access* (such as a right of way), *transfer* (buy, sell, lease, inherit, assign), impose *charges* (seize, foreclose, and so on, perhaps in cases of default), and *options* (such as a right to buy). There may also be rights granted to the state on behalf of the people, which can take precedence over other property rights. Examples of these *overriding interests* include land and property taxes; occupiers' rights such as *adverse possession, easements* and *wayleaves*; land recovery in cases of fraud and forgery; and acquisition by the state. Also, so that they can plan the physical environment of their jurisdictions, many states require landowners to ask permission before they develop or change the use of their land.

Property rights may be held by the state, by a community or privately. The definition of real property interests in the latest edition of the International Valuation Standards now includes communal, community and collective rights held in an informal, traditional, undocumented and unregistered manner (IVSC [2021](#)). This includes informal tenure rights over tribal land and in informal settlements, which can take the form of possession, occupation and use rights. In the case of state and communal property, *use rights* are important, in terms of who is entitled to them and what they entitle holders to do. Many African countries have customary tenure systems based around communal

ownership where the rights are held jointly *in common*. Decisions about allocation of rights among members of the community, how land might be used and so on are made by agreement. It is important to ensure that rights are allocated in a way that minimises external costs on neighbours and on future generations.

Under private ownership, it is argued that the economic use of land can be optimised and costs that are incurred by the owner (internal costs) will be minimised. But each owner has no direct incentive to minimise costs that affect other landowners (external costs). Each owner may negotiate with other landowners to minimise these external costs, and this is likely to be cheaper than negotiations between communal landowners since there are fewer stakeholders involved. To conduct these kinds of negotiations, societies often establish centralised bodies such as planning authorities to represent affected parties, which will include affected landowners as well as other members of society.

Barry ([2015](#)) notes that this economic perspective on property rights and their ownership ignores social, cultural, and political dimensions of land tenure, particularly in the case of private ownership. Land may form part of a person's identity, and communal property rights may foster connections between people and between people and their physical environment.

In westernised economies, private property rights prevail but the consequence of this approach to land tenure has come under scrutiny (see Picketty [2014](#) for example). It appears insensitive to the distribution of property rights and associated welfare or wealth in society. A situation can arise where net wealth is maximised but enjoyed by a few land-owning elites is superior to a situation in which there is slightly less wealth but enjoyed by everyone equally. As

globalisation continues, market integration, technological advances, population growth and mass migration lead to rapid urbanisation and growing pressure on land and growing pressure on institutions¹ to protect property rights. This pressure is acutely observed in developing countries where private property rights tend to lack legal formality and are under threat from those who fail to recognise the rights of others and seek to deprive citizens of their customary, ancestral and religious rights in terms of both peaceful enjoyment and economic benefit. The threat is not new; state colonisation is replaced by corporate land grabbing, but the impact remains the same.

It is important to recognise all legitimate tenure right holders, whether formal or informal. This is the goal of the Voluntary Guidelines on the Responsible Governance of Tenure Rights (UN FAO [2012](#)), which aim to:

- Safeguard tenure rights against threats, infringements and arbitrary loss, including forced evictions,
- Provide justice to deal with infringements, including compensation where rights are taken for public purposes, and
- Promote and facilitate enjoyment of legitimate tenure rights, and prevent disputes, violent conflicts and corruption.

In much of the world, tenure, and thus property rights, is not recorded in documentary form. Instead, tenure, such as it might be known, may take the form of verbal agreements, social relationships, customs and traditions. There is much debate among land professionals as to whether these unregistered property rights should be registered in a way that is recognisable to western-led developed nations, or whether they should be recognised for what they are and societies' institutions that deal with

them (such as lenders, businesses, developers, and investors) adapt their practices to handle this diversity of property rights. There are arguments for and against both approaches. Some argue that registration of property rights releases hidden wealth or capital that is latent within land (see, for example, de Soto [2001](#)). Others see registration as an aid to big business in exploiting the more minor interests of smallholders and communal landowners. In this respect, land is no different from other resources; consolidation of ownership can reduce competition and increase returns. It is a matter for each society and nation to decide how it wants to organise its land resource and the ownership of property rights.

A single parcel of real property may have many rights relating to it, and these rights may be held by many different members of society. For example, the state may hold an overriding right to expropriation, a freeholder may hold transfer rights, a lender may hold repossession rights, a leaseholder may hold use rights and society as a whole may have a right of access. Relationships between rights and those who hold those rights can be complex and difficult to identify, particularly if they are unregistered.

1.1.2 Property rights in England

English common law, as it relates to property, is derived from the system of feudal land tenure by which the monarch and his or her lords ruled the land. In the United Kingdom, only the Crown can own land and historically lords merely 'held' their land under a system of tenure. The lords, in turn, granted lesser rights to hold property to others in return for loyalty, services or *rent*. The monarch or superior *landlords* could withdraw their patronage and reclaim their land at any time. This holding of land was categorised according to its duration and, because of its derivation in the doctrine of legal estates, it is more

accurate to speak of someone holding an *estate* rather than owning physical land (Card et al. [2003](#)). The two most important estates are freehold and leasehold. A freeholder holds land in perpetuity from the Crown and is at liberty to use it for any purpose subject to statutory regulation and the legal protection afforded to third parties. The freeholder (landlord or *lessor*) may be an occupier or may be an investor deriving a rental income from a lease granted to an occupier. A leaseholder (tenant or *lessee*) holds a property for a term of years, the duration of which is usually specified in or implied by the terms of the *lease* granted by the landlord. Under certain conditions tenants can obtain legal rights that protect their occupational interest and investment that they may have made to improve the premises.

In England, there are four principal types of lease set out here in order of decreasing length:

- Long *ground leases* are typically for a term of more than 100 years where the landlord grants a lease of, say, a vacant site to a tenant who in turn may construct a building on it and enjoy the economic benefits of doing so during the term of the lease. Historically these ground leases required a rent to be paid that typically remained the same during the entire term and, as time passed, the real value of this rent diminished. Nowadays, it is common to find rent review mechanisms inserted into ground leases that enable the landlord to participate in rental value growth.
- Long leases of say 99- or 125-years' duration are granted in respect of residential apartments and dwellings. At the end of these residential leases, tenants may have a right to renew for a further term.