IVS 1 – Market Value Basis of Valuation

International Valuation Standards Committee

Standard 1
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Market Value Basis of Valuation

This Standard should be read in the context of the background material and implementation guidance contained in General Valuation Concepts and Principles.

1.0 Introduction

1.1 The objective of this Standard is to provide a common definition of *Market Value*. This Standard also explains the general criteria relating to this definition and to its application in the valuation of property when the purpose and intended use of the valuation calls for estimation of *Market Value*.

1.2 *Market Value* is a representation of value in exchange, or the amount a property would bring if offered for sale in the (open) market at the date of valuation under circumstances that meet the requirements of the *Market Value* definition. To estimate *Market Value,* a Valuer must first determine *highest and best use,* or most probable use. (See International Valuation Standards [IVS], General Valuation Concepts and Principles, para. 6.3, 6.4, 6.5.) That use may be for continuation of a property's existing use or for some alternative use. These determinations are made from market evidence.

1.3 *Market Value* is estimated through application of valuation methods and procedures that reflect the nature of property and the circumstances under which given property would most likely trade in the (open) market. The most common methods used to estimate *Market Value include the cost approach, sales comparison approach, and the income capitalisation approach,* including *discounted cash flow analysis*.

1.4 All *Market Value* measurement methods, techniques, and procedures will, if applicable and if appropriately and correctly applied, lead to a common expression of *Market Value* when based on market-derived criteria. Construction costs and depreciation should be determined by reference to an analysis of market-based estimates of costs and accumulated depreciation. Sales comparisons or other market comparisons should evolve from market observations. The *income capitalisation approach,* including *discounted cash flow analysis,* should be based on market-determined cash flows and market-derived rates of return. Although data availability and circumstances relating to the market or the property itself will determine which valuation methods are most relevant and appropriate, the outcome of using any of the foregoing procedures must be *Market Value* if each method is based on market-derived data.

1.5 The manner in which property would ordinarily trade in the (open) market distinguishes the applicability of the various methods or procedures of estimating *Market Value*. When based on market information, each method is a comparative method. In each valuation situation one or more methods are generally most representative of (open) market activities. The Valuer will consider each method in every Market Value engagement and will determine which methods are most appropriate.

2.0 Scope

2.1 IVS 1 applies to the *Market Value* of property, normally real estate and related elements. It requires that the property under consideration be viewed as if for sale on the (open) market, in contrast to being evaluated as a part of a going concern or for some other purpose.

3.0 Definitions

3.1 *Market Value* is defined for the purpose of these Standards as follows:

Market Value is the estimated amount for which a property should exchange on the date of valuation 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.

3.2 The term *property* is used because the focus of these Standards is the valuation of property. Because these Standards encompass financial reporting, the term *asset* may be substituted for general application of the definition. Each element of the definition has its own conceptual framework:

3.2.1 *"The estimated amount..."* refers to a price expressed in terms of money (normally in the local currency), payable for the property in an arm's-length market transaction. *Market Value* is measured as the most probable price reasonably obtainable in the market on the date of valuation in keeping with the *Market Value* definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of *Special Value* (defined in IVSC Standard 2, para. 3.11).

3.2.2 *"...a property should exchange..."* refers to the fact that the value of a property is an estimated amount rather than a predetermined amount or actual sale price. It is the price at which the market expects a transaction that meets all other elements of the *Market Value* definition should be completed on the date of valuation.

3.2.3 *"...on the date of valuation..."* requires that the estimated *Market Value* is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances as of the effective valuation date, not as of either a past or future date. The definition also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might otherwise be made.

3.2.4 *"...between a willing buyer..."* refers to one who is motivated, but not compelled to buy. This buyer is neither over-eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present property owner is included among those who constitute "the market." A Valuer must not make unrealistic assumptions about market conditions nor assume a level of market value above that which is reasonably obtainable.

3.2.5 *"...a willing seller..."* is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the property at market terms for the best price attainable in the (open) market after proper marketing, whatever that price may be. The factual circumstances of the actual property owner are not a part of this consideration because the 'willing seller' is a hypothetical owner.

3.2.6 *"...in an arm's-length transaction..."* is one between parties who do not have a particular or special relationship (for example, parent and subsidiary companies or landlord and tenant) that may make the price level uncharacteristic of the market or inflated because of an element of *Special Value*. (See IVS 2, para. 3.11.) The *Market Value* transaction is presumed to be between unrelated parties, each acting independently.

3.2.7 *"...after proper marketing..."* means that the property would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the *Market Value* definition. The length of exposure time may vary with market conditions, but must be sufficient to allow the property to be brought to the attention of an adequate number of potential purchasers. The exposure period occurs prior to the valuation date.

3.2.8 *"...wherein the parties had each acted knowledgeably and prudently..."* presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the property, its actual and potential uses, and the state of the market as of the date of valuation. Each is further presumed to act for self-interest with that knowledge, and prudently to seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell property in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other purchase and sale situations in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.

3.2.9 *"...and without compulsion..."* establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.

3.3 *Market Value* is understood as the value of an asset estimated without regard to costs of sale or purchase and without offset for any associated taxes.

3.4 *Highest and Best Use* (HABU). The most probable use of a property, which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

4.0 Relationship to Accounting Standards

4.1 Valuation for financial reporting, which is the focus of International Valuation Application 1 (IVA 1), should be read in conjunction with this standard.

4.1.1 IVA 1, Valuation for Financial Reporting, provides guidance to Valuers, Accountants, and the Public regarding valuation standards affecting accountancy. The *Fair Value* of fixed assets is usually their *Market Value*. (See General Valuation Concepts and Principles, para. 8.1.)

4.1.2 When there is no evidence of *Market Value* because of the specialised nature of the fixed assets and because they are rarely sold except as part of a continuing business, they are valued at their *Depreciated Replacement Cost* (International Accounting Standards 16 [IAS 16]).

4.2 There are numerous examples of terms used interchangeably by Valuers and Accountants. Some lead to misunderstandings and possible Standards abuses. IVS 1 defines *Market Value* and discusses criteria for establishing *Market Value*. Other important terms are defined in IVS 1 and 2 and contribute to the more specific requirements discussed in IVA 1, Valuation for Financial Reporting.

5.0 Statement of Standard

To perform valuations that comply with these Standards and Generally Accepted Valuation Principles (GAVP), it is mandatory that Valuers adhere to all sections of the Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting (sections 4, 5, 6, and 7).

5.1 **In performing and reporting a *Market Value* estimate, the Valuer shall**

5.1.1 **completely and understandably set forth the valuation in a manner that will not be misleading;**

5.1.2 **ensure that the estimate of *Market Value* is based on market-derived data;**

5.1.3 **ensure that the estimate of *Market Value* is undertaken using appropriate methods and techniques;**

5.1.4 **provide sufficient information to permit those who read and rely on the report to fully understand its data, reasoning, analyses, and conclusions; and**

5.1.5 **comply with the requirements of IVS 3 in reporting the valuation. Accordingly, the Valuer shall**

5.1.5.1 **define the value being estimated and state the purpose and intended use of the valuation, the effective date of valuation, and the date of the report;**

5.1.5.2 **clearly identify and describe the property and property rights or interests being valued;**

5.1.5.3 **describe the scope/extent of the work undertaken and the extent to which the property was inspected;**

5.1.5.4 **state any assumptions and limiting conditions upon which the valuation is based;**

5.1.5.5 **fully and completely explain the valuation bases/approaches applied and the reasons for their applications and conclusions; and**

5.1.5.6 **include a signed Compliance Statement (Certification of Value) attesting to the Valuer's objectivity, professional contributions, non-bias, non-contingency of professional fees or other compensation, as well as Standards' applicability, and other disclosures.**

6.0 Discussion

6.1 The *Market Value* concept and definition are fundamental to all valuation practice. A brief summary of essential economic and procedural foundations is presented in General Valuation Concepts and Principles and Code of Conduct, the documents upon which these Standards are predicated.

6.2 The concept of *Market Value* is not dependent on an actual transaction taking place on the date of valuation. Rather, *Market Value* is an estimate of the price that should be realised in a sale at the valuation date under conditions of the *Market Value* definition. *Market Value* is a representation of the price to which a buyer and seller would agree at that time under the *Market Value* definition, each previously having had time for investigation of other market opportunities and alternatives, and notwithstanding the fact that it may take some time to prepare formal contracts and related closing documentation.

6.3 The concept of *Market Value* presumes a price negotiated in an open and competitive market, a circumstance that occasionally gives rise to the use of the adjective *open* before the words *Market Value*. The words *open* and *competitive* have no absolute meaning. The market for one property could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of participants. The market in which the property is exposed for sale is not a definitionally restrictive or constricted market. Stated conversely, the omission of the word *open* does not indicate that a transaction would be private or closed.

6.4 Market valuations are generally based on information regarding comparable properties. The Valuation Process requires a Valuer to conduct adequate and relevant research, to perform competent analyses, and to draw informed and supportable judgements. In this process, Valuers do not accept data without question but should consider all pertinent market evidence, trends, comparable transactions, and other information. Where market data are limited, or essentially non-existent (as for example with certain specialised properties), the Valuer must make proper disclosure of the situation and must state whether the estimate is in any way limited by the inadequacy of data. All valuations require exercise of a Valuer's judgment, but reports should disclose whether the Valuer bases the *Market Value* estimate on market evidence, or whether the estimate is more heavily based upon the Valuer's judgement because of the nature of the property and lack of comparable market data.

6.5 Because changing conditions are characteristic of markets, Valuers must consider whether available data reflect and meet the criteria for *Market Value*.

6.5.1 Periods of rapid changes in market condition are typified by rapidly changing prices, a condition commonly referred to as *disequilibrium*. A period of disequilibrium may continue over a period of years and can constitute the current and expected future market condition. In other circumstances, rapid economic change may give rise to erratic market data. If some sales are out of line with the market, the Valuer will generally give them less weight. It may still be possible for the Valuer to judge from available data where the realistic level of the market is. Individual transaction prices may not be evidence of *Market Value,* but analysis of such market data should be taken into consideration in the Valuation Process.

6.5.2 In poor or falling markets there may or may not be a large number of "willing sellers." Some, but not necessarily all, transactions may involve elements of financial (or other) duress or conditions that reduce or eliminate the practical willingness of certain owners to sell. Valuers must take into account all pertinent factors in such market conditions and attach such weight to individual transactions that they believe proper to reflect the market. Liquidators and receivers are normally under a duty to obtain the best price in asset disposals. Sales, however, may take place without proper marketing or a reasonable marketing period. The Valuer must judge such transactions to determine the degree to which they meet the requirements of the *Market Value* definition and the weight that such data should be given.

6.5.3 During periods of market transition characterised by rapidly rising or falling prices, there is a risk of over- or under-valuation if undue weight is given to historic information or if unwarranted assumptions are made regarding future markets. In these circumstances Valuers must carefully analyse and reflect the actions and attitudes of the market and take care that they fully disclose the results of their investigations and findings in their reports.

6.6 The concept of *Market Value* also presumes that in a market value transaction a property will be freely and adequately exposed on the (open) market for a reasonable period of time and with reasonable publicity. This exposure is presumed to occur prior to the effective date of value. Markets for fixed assets typically differ from those available for stocks/shares, bonds, and other current assets. Fixed assets tend to be unique. They are usually sold less frequently and in markets which are less formal and more inefficient than, for example, markets for listed securities. Further, fixed assets are less liquid. For these reasons, and because fixed assets do not commonly trade on a public exchange, the application of the concept of *Market Value* requires the use of assumptions such as adequate market exposure over a reasonable time period to allow for proper marketing, and completion of negotiations.

6.7 Revenue producing properties held as long-term investments by a property company, pension (or superannuation fund), property trust, or similar type of owner are typically valued on the basis of individual asset disposal pursuant to an orderly plan. The aggregate value of such assets viewed or treated as a portfolio or as an assembled group of properties could exceed or could be less than the sum of the *Market Value* of each asset individually.

6.8 All valuations should refer to the purpose and intended use of the valuation. In addition to other reporting requirements, the Valuer should make it abundantly clear into which class each asset has been placed if the function of the valuation is related to the preparation of financial statements.

6.9 In exceptional circumstances *Market Value* may be expressed as a negative amount. Situations include certain leasehold properties, some specialised properties, obsolete properties with demolition costs exceeding land value, some properties affected by environmental contamination, and others.

7.0 Disclosure Requirements

7.1 Valuation Reports must not be misleading. Valuations conducted for the purpose of estimating and reporting *Market Value* shall meet the requirements of section 5 above. Reports shall contain a specific reference to the definition of *Market Value* as set forth in this Standard, together with specific reference as to how the property has been viewed in terms of its utility or its *highest and best use* (or most probable use) and a statement of all substantive assumptions.

7.2 In making *Market Value* estimates the Valuer shall clearly identify the effective date of valuation (the date at which the value estimate applies), the purpose and intended use of the valuation, and such other criteria as are relevant and appropriate to ensure adequate and reasonable interpretation of the Valuer's findings, opinions, and conclusions.

7.3 Although the concept, use, and application of alternative expressions of value may be appropriate in certain circumstances, the Valuer shall ensure that if such alternative values are estimated and reported, they should not be construed as representing *Market Value*.

7.4 When valuations are made by an Internal Valuer, i.e., one who is in the employ of either the entity that owns the assets or the accounting firm responsible for preparing the entity's financial records and/or reports, there shall be a specific disclosure in the Valuation Report or Certificate of the existence and nature of any such relationships.

8.0 Departure Provisions

8.1 In following this Standard any departures must be in accordance with directions provided in IVS 3, Valuation Reporting.

9.0 Effective Date

9.1 This International Valuation Standard became effective 1 July 2000.