

ADVANTAGE OR DISADVANTAGE ASSESSMENT BASED ON ALTERNATIVE VALUES

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Abstract: International Valuation Standards Committee (IVSC) wants to avoid the emergence of international disputes and/or the formation of misconceptions in some countries, regarding the use and application of market valuation bases unsubstantiated. Evaluators responsible for applying these standards must ensure that there have been selected the appropriate measurement bases using all means to increase the understanding of evaluation beneficiaries, avoiding circumstances that might mislead the public and objectively reporting estimates made. The International Valuation Standard 2 (IVS 2) comes to saturate an alternative situation, having two goals, namely: identify and explain the other evaluation bases than the *market value* and, at the same time, to establish the standards for their implementation; to show the difference between these bases and the market value. This are the main goals of this paper.

Key words: evaluation standards, alternative value, evaluation bases, market value.

JEL Classification : M40, M41

1. Introduction

Rapid pace of change has contributed to increased recognition data from market participants on the importance of assessing property professionally. The rapid pace of globalization of investment markets emphasized the need to assess property based on internationally recognized standards. Thus, one can say that it was obvious that without the existence of valuation standards internationally recognized, the likelihood of confusion was high.

Trying a comparative approach between the views of national professional organizations in the field of evaluation, we can see that differences can lead to disagreements involuntary. In response to this situation, members of the technical committee of the Royal Institution of Chartered Surveyors (RICS) and representatives of the assessment bodies in the United States have started a dialogue that allowed the establishment, in 1981, the International Valuation Standards Committee of assets (TIAVSC). In 1994, the Committee changed its name and is now known as the International Valuation Standards Committee (IVSC). Since 2003, IVSC becomes a nonprofit association that consists of professional organizations in assessing, worldwide, united by a single act of incorporation.

IVSC recognize the diversity of purposes for which property assessments are required, namely:

- use assessments to financial statements,
- decisions on loans guaranteed by property (guarantees, pledges, mortgages)
- the transactions involving transfer of ownership, dispute settlement and establishing fees.

International Valuation Standards Committee (IVSC) wants to avoid the emergence of international disputes and/or the formation of misconceptions in some countries, regarding the use and application of market valuation bases unsubstantiated. Evaluators responsible for applying these standards must ensure that there have been selected the appropriate measurement bases using all means to increase the understanding of evaluation beneficiaries, avoiding circumstances that might mislead the public and objectively reporting estimates made.

According to Evaluation Standards (SEV 4.02) and in line with the European Valuation Standards, **the rating base is represented by the market value.**

The market value is the estimated amount for which an asset could be exchanged, at the valuation date, between a purchaser decided to buy and a seller decided to sell in a free transaction (unbiased), after a proper marketing, in which each party acted knowingly, prudently and without compulsion¹.

The concept of market value reflects the perceptions and collective action on the market and is the basis for the assessment of most of the resources in market economies.

The market value is an estimate of the property rights value on the goods at a given time. The market value may be defined as a representation of the usefulness of the asset recognized by the market and not by the person or

¹ Champness P. – European professional standards approved for assessment of real estate properties., page 16.

facility that owns it, for which good has another utility.

If this is the case for the market value, then the **International Valuation Standard 2 (IVS 2)** comes to saturate an alternative situation, **having two goals, namely:**

- ✚ identify and explain the other evaluation bases than the *market value* and, at the same time, to establish the standards for their implementation;

- ✚ to show the difference between these bases and the *market value*.

Although most assessments by experts, especially for assets, which are referred to in the International Valuation Standard for Application 1 (IVA 1), the Valuation for Financial Reporting involves the market value, there are circumstances where there are required different measurement bases of the *market value*. It is essential that both the evaluator and the evaluation recipients clearly understand the difference between the market value assessment and the measurement bases besides the market value, as the effects that these differences (if any) between these two concepts can have on the applicability evaluation.

2. Specific of evaluation bases

This Standard presents and explains the evaluation bases different from the market value, of which we consider appropriate to recall the most relevant.

- **Usefulness value** is the value which a particular property has for a specific use and a specific user, and therefore is not in relation with the market. This value refers strictly to the amount by which a particular property contributes to the entity it is part of, without having regard to the best use of the property or the amount of money that can be obtained from its sale.

The definition given in accounting for the usefulness value is the updated value of future cash flows which are expected to be generated from the use of an asset and from its disposal at the end of its useful life, as it is noted in the International Standard for Financial Reporting 5, Annex A.

- **Investment or subjective value**, is the value of the property for a particular investor or category of investors or for identified investment objectives (goals). This subjective concept makes the bond between a specific property and a specific investor, group of investors or entity that has investment objectives and / or criteria identified for the investment. The investment value or subjective value of a property asset may be higher or lower than the market value of that asset. The concept of the investment value or subjective value is not to be confused with the *market value* of a real estate investment. However, the market value may reflect a range of individual estimates of the value of investment or subjective value of a particular asset. The investment value or subjective value is associated with the special value.

- **Continuous operation value** means the value of an entity as a whole. The concept involves assessing an entity that will continue to operate and the *continuous operating value* of which can be assigned to its parts, reflecting their contribution to the total. But the value of a component thus determined does not reflect its fair market value. Therefore, the concept of continuous operation value may be applied only to property that is part of an entity or entities.

- **Insurance value** is based on the value of the property given by some definitions contained in a policy or contract of insurance.

- **Tax, imposing or taxable value** is a value that is based on the definitions contained in the laws relating to the evaluation, assessment and/or taxation of property.

What we consider appropriate to be expressly highlighted is that, although some jurisdictions may cite the market value as the basis of assessment, the methods by which there is estimated the value can produce different results from the *market value*, as it is defined in IVS 1.

As a result, the *tax, imposing or taxable value* cannot be considered as being the same as the *market value*, as it is defined in IVS 1, unless explicitly indicated otherwise.

- **Recovery value** refers to the value of a property, except land, especially given the values of the materials it contains than the continued use, without requiring special repairs or adjustments. It can be depicted as gross or net, in the second case by subtracting cost of sales from the gross salvage value. In the latter case, it may be equal to the *net realizable value*. In any case, the items included or excluded, we believe it would be appropriate to identify them.

- **Liquidation or forced sale value** reflects the amount that could be received reasonably, from the sale of a property in a time too short to be consistent with the necessary marketing period specified in the definition of the *market value*. In some countries, the *forced sale value* in particular may involve also a seller obligated to sell and a buyer or buyers who purchase, being aware of the disadvantage of the seller.

- **Special value** envisages a term relating to an item of great value over the *market value*. The special value can be derived, for example, as a result of physical association, functional or economic ownership of any property, e.g. neighboring one. It is an additional value that may be applicable to a particular owner or user, or potential buyer or user of the property, mainly to the general market. Trying a different formulation, we can say that the special value is applicable only to a buyer with special interests.

➤ **Merger value**, i.e. the additional value resulting from the merger of two or more property holdings, represents a particular form of *special value*.

In our opinion, the special value may be associated with ongoing operational elements of value and investment or subjective value. The evaluator must ensure that the criteria used for assessing such properties are different from those used to estimate the *market value* by presenting clearly any special assumptions used.

➤ **Mortgage guarantee value** highlights the value of the property determined by the evaluator with a conservative estimate of future selling of the property by considering the long term maintainable issues of property, the normal and local market conditions, the current use and alternative appropriate uses of the property. In estimating the mortgage guarantee value there will be considered speculative elements. The mortgage guarantee value must be grounded in a clear and transparent way.

The mortgage guarantee value is defined in EU Directive 89/647/ECC and approved by Directive 98/32/EC. These directives are correlated with banking regulations and set minimum solvency ratio for lenders involved in loans secured by properties.

The mortgage guarantee value is a component of the risk analysis technique, which can help in calculating the size of risk associated with a security held by a bank in accordance with these directives. This is a technique to estimate the long-term risk and not a basis for determining the value at some point. Therefore, it is essentially different from other similar valuation bases.

➤ Other expressions of value, particularly for specific installations, machinery and equipment, and/or for special situations, are defined in GN 3, Evaluation of installations, machinery and equipment.

For more purposes, evaluations in accordance with IFRS require the reporting of the fair value. IVA 1 shows this requirement as satisfied by the evaluator who reports the market value of the asset.

However, there are times when there are required by IFRS, different bases from the market value. They relate to the use of a particular asset in accordance with IAS 36 or salvage value for depreciation, according to IAS 16, both kinds of value being specific to the entity. IVA 1 shows in detail these aspects.

Although, the concept, the use and application of different market assessments may be appropriate in certain situations, we consider that it is necessary that the evaluator gives assurances that such value, which is not based on the market, found and reported, will not be considered as a representation of the value of the market.

The usefulness value is a basis for evaluating different from the market value, where the value is measured in terms of a particular user. The usefulness value is sometimes referred to as "the amount for a particular user or owner".

The exchange value is the value recognized by a market where the exchange of assets takes place. The IVSC definition of the *market value*, appropriate for financial reporting, is based on the exchange value and not on the usefulness value.

We believe that **the expressions "exchange value" and "usefulness value" can lead to confusion** if not explained clearly. Therefore, they should be avoided when they could result in confusion.

Properties can be evaluated on bases other than the *market value* or they can change their owners at prices that do not reflect the *market value* as it is defined. Such alternative bases can reflect either the economic usefulness or the functions of the property other than marketability, either some "atypical" conditions and outside the market. We note here the usefulness value, the investment or subjective value, the continuous operating value, the insurance value, the tax, imposing or taxable value, the special value, the liquidation value and forced sale value or the recovery value.

The continuous operation value² expresses the value attributed to an entity under operation and not to any parts of it. The total amount allocated to the individual assets, which are parts of the entity, are based on their contribution to the whole entity, usually known by their usefulness value, when referring to a particular entity and its owner, **not to a market value**.

What we consider worth mentioning relates to the fact that **it would be a coincidence if the use of a property would be equal to its market value**.

The usefulness value of a property tends to be higher than its market value if the entity would be able to manage it in a more cost effective way than a producer typical (average) of the same product or service. On the other hand, **the usefulness value can be smaller than the market value** given that the entity does not use an asset at maximum capacity and efficiency. *The usefulness value* can be higher than the *market value* also if the entity holds special production rights, legal contracts very advantageous unique patents and licenses, some experience, a special goodwill and other intangible assets that are not transferable to another owner.

The special value can be assigned to a property because of its unique centrality, owing to a temporary exceptional situation of the market or the price of a premium payable by a purchaser who has a special interest. **The merger value**, as element of the *special value* will be reported differently than the *market value*, as it is defined in the standards.

² Stan V.S. – Evaluation of enterprises, Iroval Ed., Bucharest, 2003, page. 86.

3. Conclusions

Seeking a review of this situation, we note that **the special value should not be incorporated into a representation of the market value** because such a procedure will lead to confusion and, consequently, would mean that this surplus value does not have a special character.

Noteworthy in our opinion is the **forced sale** at a price that comes from selling unusual or extraordinary circumstances, reflecting, usually a poor trading period without reasonable publicity and other times reflects the presence a seller is not willing to sell and / or conduct the sale under compulsion or coercion. For these reasons, the price associated with such sale, or forced into bankruptcy, called forced sale value is a representation of market value. In general it is not easy to estimate the evaluator because the nature and extent subjective and conjectural hypothesis that the assessor must make in order to formulate such an opinion. Forced sale value is also known by the term of liquidation price.

The recovery value is, as usual, the reflection of the current price hoped for property other than land, which has reached the end of its useful life, in terms of purpose and performance of their duties laid down originally. The concept of the recovery value is based on the idea that the asset is valued rather in terms of the value of the sales recovery, than of the purpose for which it was originally designed.

In this context, keeping the accounting approach that we are trying to ascribe to our research related to evaluation, we consider ourselves entitled to note that **the recovery value is known in accounting terminology also as net realisable value for an asset that has no utility for an entity**. The *recovery value* should not automatically imply that a property does not have any useful life or utility. The property sold for recovery can be reconstructed, transformed to serve a purpose similar or different and can provide parts for other properties that can still be used. Ultimately the recovery value would be the expression value for disposal or recycling value.

For assessments that are *not based on the market value* it is necessary to specify clearly, in accordance with the Conduct Code, which is the purpose of using assessments and that showed total transparency on the bases of valuation used, applicability and limitations thereof.

Each evaluation report elaborated on other bases than the market value is necessary to contain, in our opinion, an exposure of the limiting conditions or a similar presentation. Although it has the means of provision, the evaluator will not be using it to justify deviations "unreasonable" in IVS standards. Also, on an assessment on a basis other than the *market value*, the evaluator will not make unreasonable assumptions in light of the facts and found the course to date. All assumptions will be mentioned in all reports. Each evaluation report conducted on a basis other than market value must contain a certification of value / statement of compliance signed or a certified evaluator confirming accession to the instructions contained in the IVS Conduct Code, Section 7.1 and IVA 1. In particular, there should be made the distinction between market value and any other valuable consideration.

If an assessment is carried out by an internal evaluator, for example by a person employed in the entity owning the assets or in an accounting firm engaged with registration and/or preparation of accounting reports, there will be made an explicit mention in the assessment report or certificate of assessment, about the existence and nature of such relationships.

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