



# 24TH BALTIC VALUATION CONFERENCE

*SEPTEMBER 4th to 6th 2014, ESPOO, FINLAND*

## **THE OBJECTIVE UNCERTAINTY OF THE MARKET VALUES OF REAL ESTATE (IN THE EXAMPLE OF A DEVELOPED AND AN EMERGING MARKET)**

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# VALUATION STANDARDS

- 1) U.S. appraisal standards USPAP (Uniform Standards of Professional Appraisal Practice),
- 2) Standards of the American Society of Appraisers BVS (Business Valuation Standard),
- 3) International Valuation Standards (IVS) developed by the International Valuation Standards Council (IVSC),
- 4) Professional Valuation Standards of RICS (Royal Institution of Chartered Surveyors),
- 5) European Valuation Standards (EVS) of TEGoVA,
- 6) National Standards.

# VALUATION UNCERTAINTY

One of the possible ways to synchronize the diversity of valuation standards is by solving the problem of Valuation uncertainty . This problem is raised in a number of documents and is subject to ongoing debate. Its importance has been heightened by **the global financial crisis of 2007-2008**.

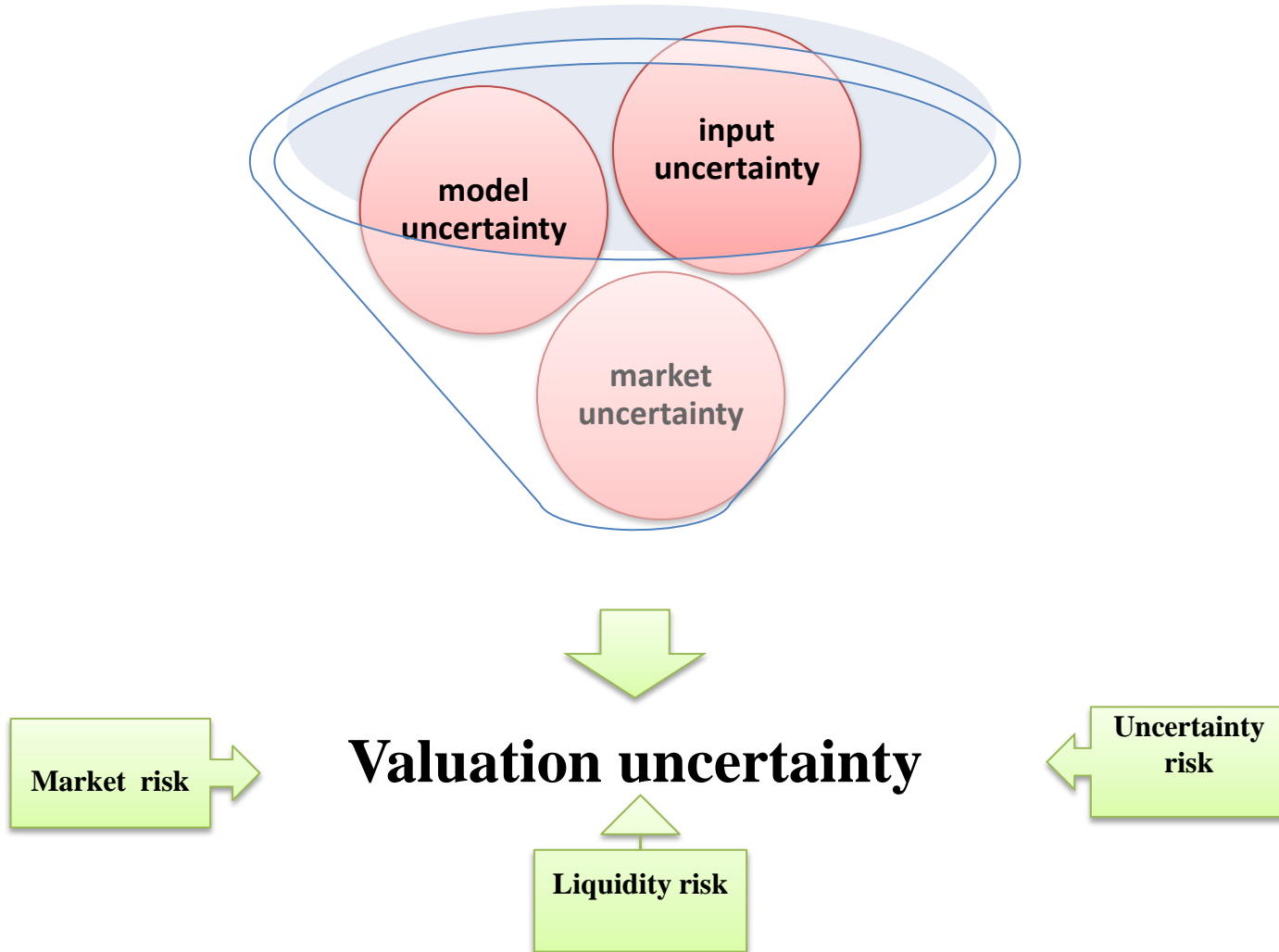
Uncertainty, in this case, is not related to the appraiser's qualification or opinion, but it is determined by the intrinsic characteristics of the property, **the specificity of the market or the availability of information**.

If the price obtained in a real transaction performed on the date of valuation is lower than the estimated value, then a risk is generated (Uncertainty risk) in making management decisions based on the valuation.

# VALUATION UNCERTAINTY

- The nature of the market (**developed or emerging**) has a direct impact on the magnitude of Valuation uncertainty and on the consequent risk posed.
- The fact that **Valuation uncertainty** stems from the very nature of appraisal, sets high requirements for the training and competence of the appraiser who must prepare a reasoned and honest opinion on the value of the object being evaluated and to explain the reasons for uncertainty and the reliability of the results obtained.

# VALUATION UNCERTAINTY – FACTORS AND RISKS



# BASIC CONCEPTS WITH REFERENCE TO VALUATION UNCERTAINTY

## RISKS

<b>Market risk</b>	Risk that the value of an asset might fluctuate in the future depending on the changes in market conditions.
<b>Liquidity risk</b>	Risk that the economic entity might be unable to obtain cash or its equivalent on a specific date.
<b>Uncertainty risk</b>	Risk of loss from the difference between the price of the asset in a real transaction performed on the valuation date, and the estimated value

## FACTORS

<b>Market uncertainty</b>	Occurs due to the probabilistic nature of the market and in low market activity and/or liquidity
<b>Model uncertainty</b>	Occurs due to the use of several approaches and methods of valuation, the results of which must be coordinated and weighed to obtain the final estimated value, or in the absence of adequate valuation methods and models.
<b>Input uncertainty</b>	Occurs due to insufficient experience or incompetence of the appraiser; lack of information; use of various alternative scenarios and input databases that are not credible and realistic

# VALUATION UNCERTAINTY

In accordance with IVS 2011, in the valuation report it should be communicated, verbally, about the presence of substantial Valuation uncertainty. RICS standards generally do not permit the representation of the final assessment as a range. However, the question arises about the limits of materiality i.e. the quantitative parameters of Valuation uncertainty which, at this stage, are not determined and which should be defined according to the subject being evaluated and the purpose of the valuation.

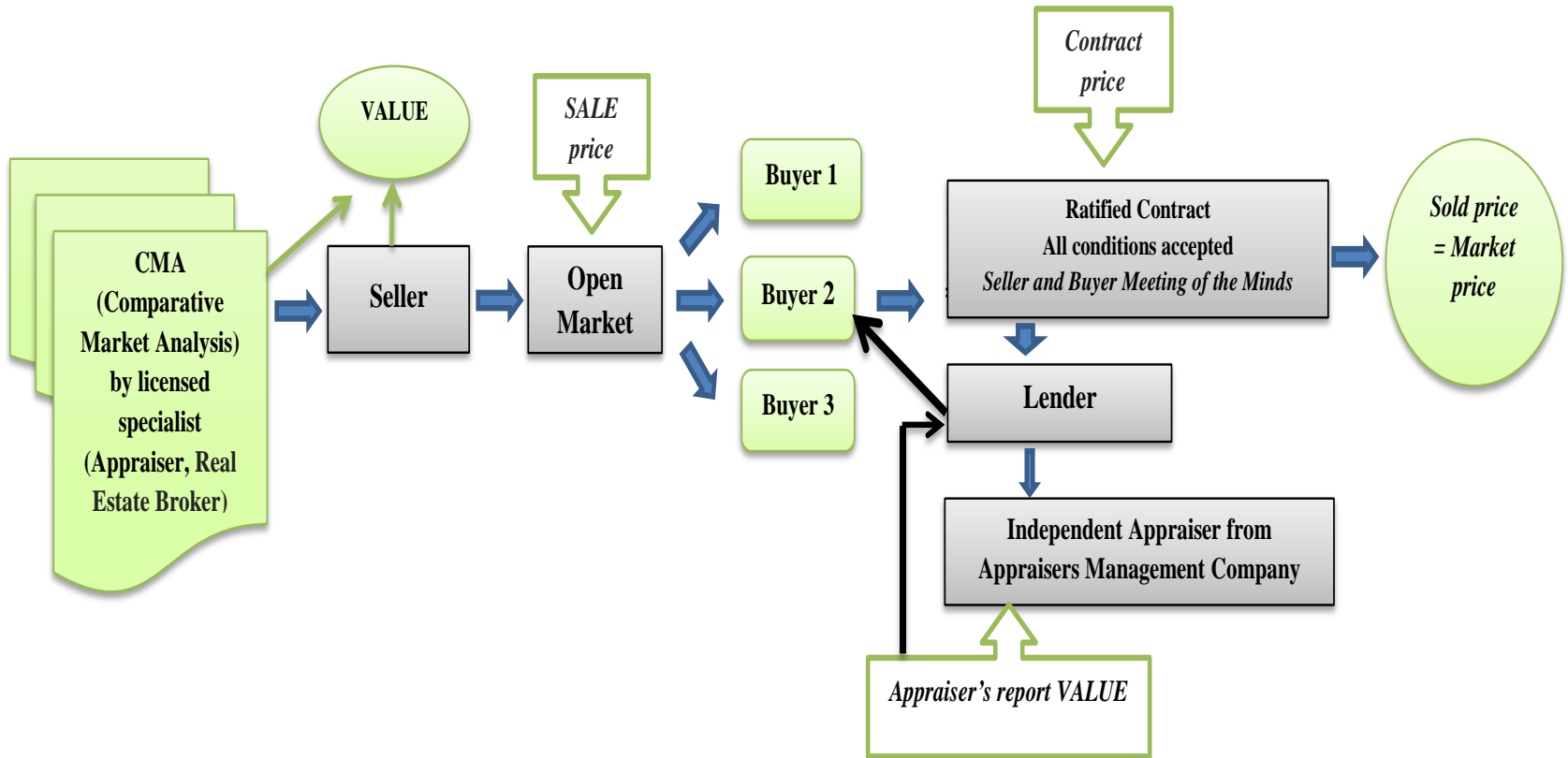
**NOTE for  
Emerging Market**



In a survey of RICS, most consumers believe that there is no need of quantitative parameters characterizing the degree of uncertainty of the concrete valuation results.

However many clients believe, that it would be useful and necessary to be noted in the valuation report the extent to which the appraiser is confident in the conclusion reached, especially if the valuation is marked by a high degree of uncertainty.

# Usual Practice in USA



- 1) **APPRAISED VALUE  $\geq$  MARKET PRICE**
- 2) **APPRAISED VALUE  $\leq$  MARKET PRICE**
- 3) **VALUE  $\geq$  MARKET PRICE**
- 4) **VALUE  $\leq$  MARKET PRICE**

**LENDER IS FUNDING UP TO APPRAISED VALUE**





## Usual Practice in USA



We analyzed properties in two zip codes in Bethesda and Rockville, Maryland: 20817, 20852 sold between 2012 and 2014. All houses were built after year 2002 and had 2+ car garages, 5+ bedrooms and 4+ bathrooms and (<http://www.mris.com/>). Total of 196 properties matched our criteria.

In 59% of the transactions the Original Listing price, reflecting Property Value was only 1 to 3% apart from Contract Price / Market Price. The Appraised Value was equal or very similar to the Contract price, thus confirming the Market price.

The rest of the properties (41%) could be divided in three distinguished groups. We selected 10 properties from each group:

- Market Value > (Market Price = Appraised Value) - 13%
- Market Value < (Market Price = Appraised Value) - 6%
- Market Value = Market Price = Appraised Value - 22%

# Market Value > (Market Price = Appraised Value) - 13%



Address	List Price	Orig Price	Close Price	DOM	Adv Subdiv	Tax Living Area
8432 Burning Tree Rd	\$1,699,000	\$1,899,000	\$1,510,000	78	BURNING TREE VALLEY	6,291
6017 Cairn Ter	\$1,995,000	\$2,450,000	\$1,860,000	232	MASS AVE FOREST	5,840
808 Royal Cres	\$699,000	\$831,900	\$645,000	190	KING FARM	2,560
6203 Halbert Rd E	\$1,799,900	\$2,149,000	\$1,750,000	113	BANNOCKBURN COOP	4,516
7224 Arrowood Rd	\$5,995,000	\$7,250,000	\$5,600,000	744	BETHESDA OUT RES 1	9,322
7519 Oldchester Rd	\$1,995,000	\$2,195,000	\$1,875,000	120	ENGLISH VILLAGE	4,060
5907 Kirby Rd	\$2,199,000	\$2,349,000	\$2,000,000	157	PINEVIEW	5,144
6609 Lybrook Ct	\$1,990,000	\$2,195,000	\$1,830,000	161	LYBROOK	5,160
215 Long Trail Ln	\$1,100,000	\$1,250,000	\$1,050,000	119	FALLSGROVE	4,621
7301 Broxburn Ct	\$2,400,000	\$2,650,000	\$2,000,000	71	BANNOCKBUR	6,630

# Market Value<(Market Price=Appraised Value) - 6%



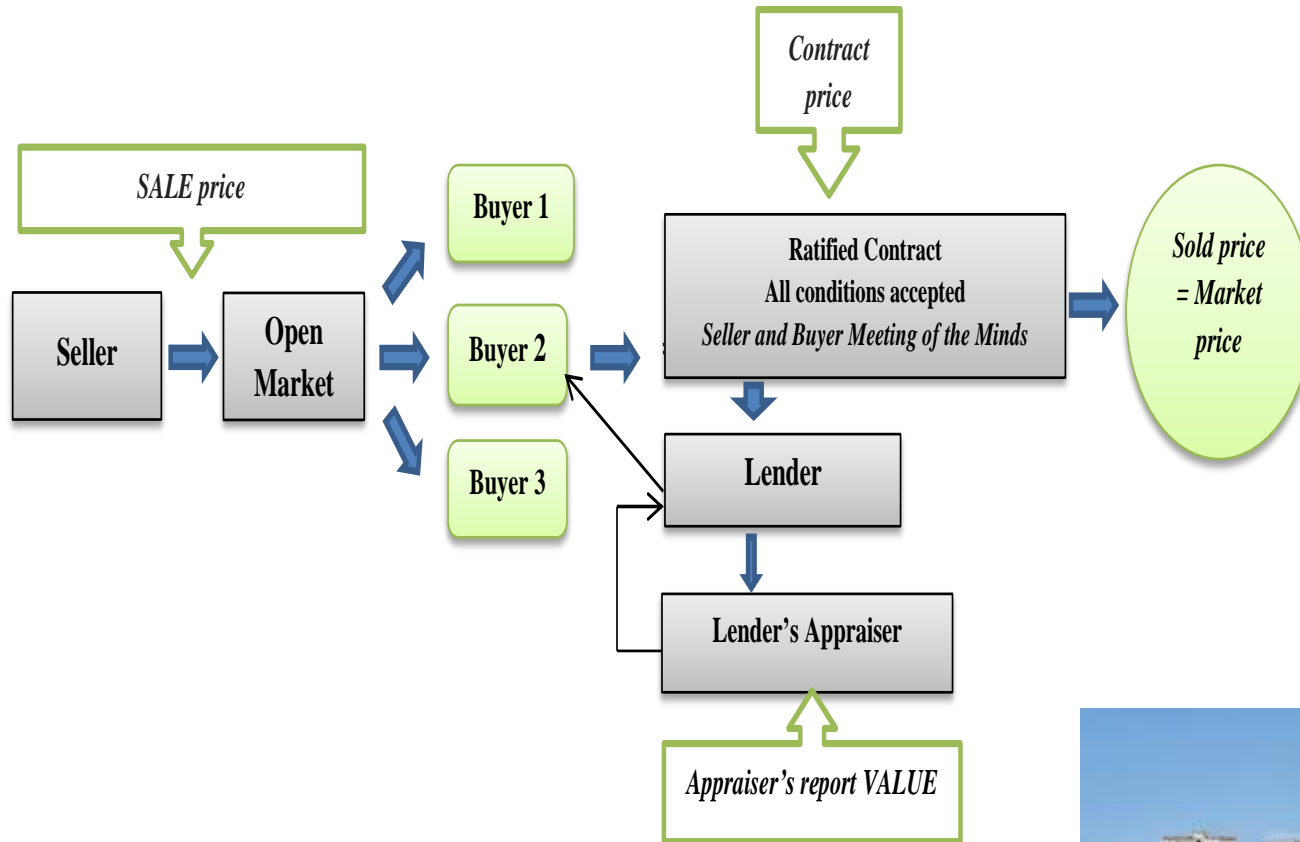
Address	List Price	Orig Price	Close Price	DOM	Adv Subdiv	Tax Living Area
118 Crabb Ave	\$429,900	\$429,900	\$519,991	0	ENGLANDS	2,160
8624 Beech Tree Rd	\$1,695,000	\$1,695,000	\$1,707,000	5	BURNING TREE VALLEY	4,590
112 Prettyman Dr	\$960,000	\$960,000	\$975,000	4	FALLSGROVE	4,022
116 Crabb Ave W	\$519,990	\$519,990	\$597,988	108	ENGLAND	2,160
311 Grand Champion Dr	\$789,000	\$789,000	\$809,000	4	KING FARM	2,858
8219 River Quarry Pl	\$1,499,000	\$1,399,000	\$1,513,470	143	RIVER QUARRY	
5520 Johnson Ave	\$1,375,000	\$1,375,000	\$1,383,409	48	ALTA VISTA	3,328
8202 River Quarry Pl	\$1,490,000	\$1,490,000	\$1,635,166	72	RIVER QUARRY	
209 Virginia Ave	\$599,990	\$599,990	\$667,000	53	CROYDEN PARK	897
6008 Henning St	\$1,099,000	\$1,099,000	\$1,189,000	51	AYRLAWN	3,449

# Market Value=Market Price=Appraised Value - 22%



Address	List Price	Orig Price	Close Price	DOM	Adv Subdiv	<u>Tax Living Area</u>
5917 Kirby Rd	\$2,379,900	\$2,379,900	\$2,379,900	77	PINEVIEW	4,520
901 Oak Knoll Ter	\$849,000	\$849,000	\$849,000	16	FALLSGROVE	3,658
7603 Westfield Dr	\$1,625,000	\$1,625,000	\$1,625,000	0	LANDON WOODS	3,690
5916 Johnson Ave	\$1,389,000	\$1,389,000	\$1,389,000	0	AYRLAWN	3,611
9515 Milstead Dr	\$1,400,000	\$1,400,000	\$1,400,000	0	WYNGATE	3,790
6004 Henning St	\$1,450,000	\$1,450,000	\$1,450,000	0	AYRLAWN	3,925
8940 Bradmoor Dr	\$1,249,900	\$1,249,900	\$1,249,900	26	DEVONSHIRE	3,130
334 Oak Knoll Dr	\$998,000	\$998,000	\$998,000	4	FALLSGROVE	3,658
6013 Kirby Rd	\$1,500,000	\$1,500,000	\$1,500,000	5	PINEVIEW	3,507
7503 Newmarket Dr	\$1,600,000	\$1,600,000	\$1,600,000	0	KNOLLS	3,729

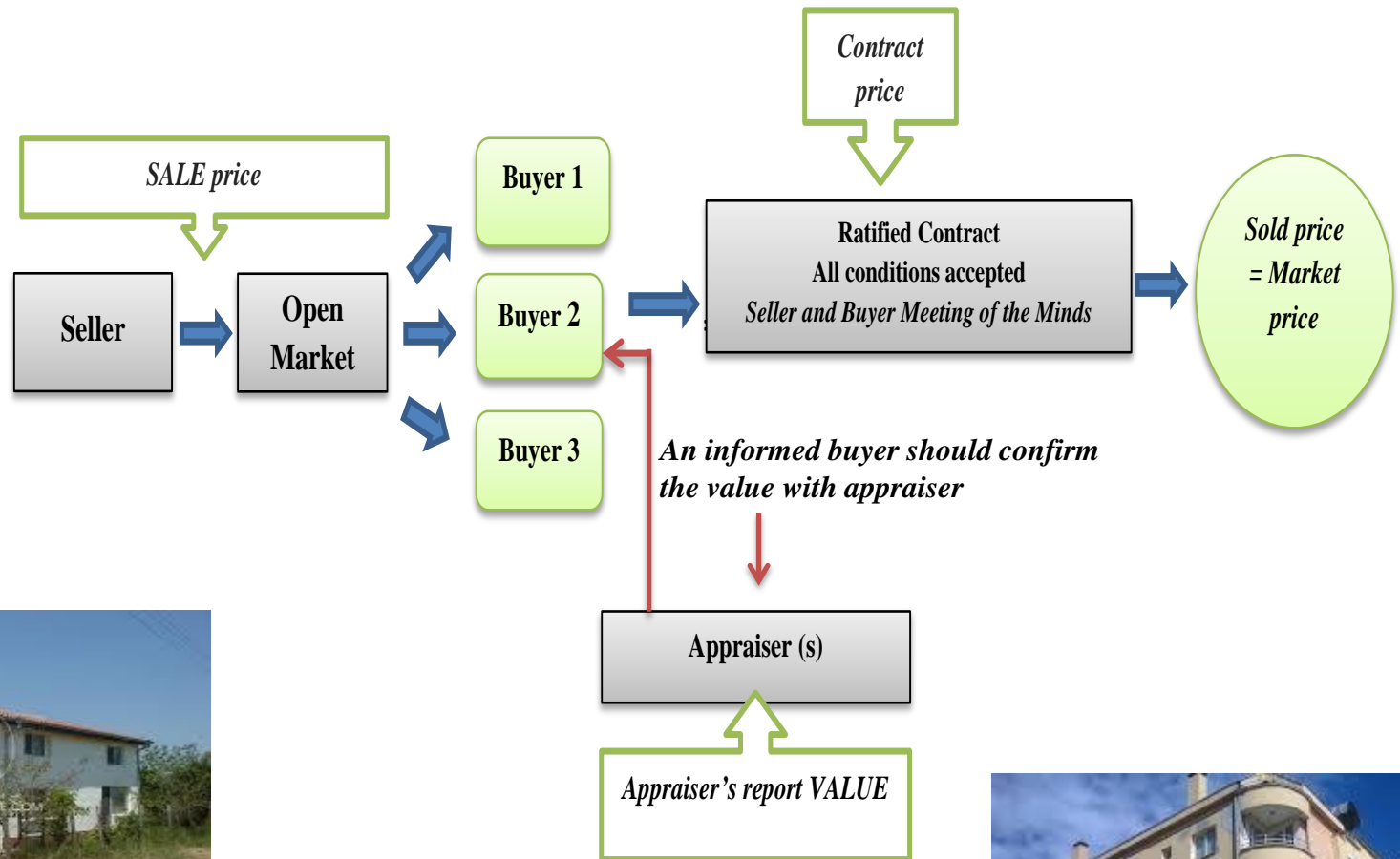
# Usual Practice in Bulgaria – Transaction funded by Lender



***Banks in Bulgaria may finance 50% to 100% of the appraised value, accepted by the lender.***



# Usual Practice in Bulgaria – Cash Transaction



## Usual Practice in Bulgaria

The object of study of the Valuation uncertainty in 39 immovable property assessment is based on immovable properties, realized in Bulgaria. They form part of the portfolio of Bulgarian banks that have provided loans to secure their sale.

- **Price premium** - a premium of the price above the *Appraised value*. Price premium occurs when **Market value > Appraised value**.
- **Price discount** – Discount, reduction that occurs when **Market value < Appraised value**.

1	Weighted average price premium (%)	<b>2,80%</b>
2	Minimum of the price premium (%)	<b>0,80%</b>
3	Maximum of the price premium (%)	<b>51,84%</b>
4	Weighted average price discount (%)	<b>-22,37%</b>
5	Minimum of the price discount (%)	<b>-56,16%</b>
6	Maximum of the price discount (%)	<b>-2,20%</b>

## Usual Practice in Bulgaria

No.	Description of property appraised (immovable property – land, buildings)	Market appraisal by independent appraiser - in Euro (excluding VAT)	Price of transaction made (selling price in Euro) - excluding VAT	Ratio "Market appraisal /Selling price"	Percentage by which the transaction price exceeds the market appraisal	Percentage by which the transaction price exceeds the market appraisal
1	Property: TC Monsieur Bricolage Sofia – land	4 327 018	4 431 294	0,98	2,41%	
2	A plot with an area of 400 sq.m., town of Popovo	7 038	10 455	0,67	48,55%	
3	Land plot - village of Emona, Nesebar municipality	334 996	287 354	1,17		-14,22%
4	Property – Regulated land plot (RLP) designated for investment construction, the land belonging to the village of Lozen (bypass city of Sofia – housing estate Gorublyane), an area of 11 000 sq.m.	1 628 000	1 760 000	0,93	8,11%	
5	Hotel – "Radisson" city of Sofia	33 730 000	34 000 000	0,99	0,80%	
6	House in the housing estate Boyana, "Rezniovete" Str., yard 1100 sq.m. House with developed built-up area (DBA) – 1000 sq.m.	1 100 000	1 274 000	0,86	15,82%	
7	House in the housing estate Boyana, "Dabova Gora" Str., yard – 800 sq.m. DBA – 770 sq.m.	685 300	704 550	0,97	2,81%	
8	An independent part of a business building located at "G.S. Rakovski" Str. (building of the European Council)	2 800 000	2 800 000	1,00		
9	RLP "Todor Aleksandrov" Blvd., area of 2 300 sq.m. designated for investment construction	4 140 000	4 600 000	0,90	11,11%	
10	Office, Pleven, Tsar Simeon Str.	89 200	81 000	1,10		-9,19%
11	Apartment, Sofia, housing estate Manastirski Livadi, Ralevitsa Str. No. 85	47 000	40 000	1,18		-14,89%
12	2 pcs. of gragaes, Sofia, housing estate Knyazhevo - Karpuzitsa	12 225	11 580	1,06		-5,28%
13	Apartment, Stara Zagora, Ruski Blvd.	51 100	36 813	1,39		-27,96%
14	Shop in Sofia, Rakovski Str. No. 201	90 900	94 500	0,96	3,96%	
15	Apartment, Sofia, Evl. and Hr. Georgievi Str.	101 900	84 600	1,20		-16,98%



## Usual Practice in Bulgaria

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16	2 plots, restaurant, office, village of Opanets, Peven region	72 000	50 225	1,43		-30,24%
17	Apartment, Varna, housing estate Vl. Varnenchik	27 500	23 500	1,17		-14,55%
18	Apartment, Plovdiv, Nikola Karadzhev Str.	36 900	31 900	1,16		-13,55%
19	Apartment, Sofia, Manastirski Livadi	106 400	57 500	1,85		-45,96%
20	Apartment, Sofia, Manastirski Livadi	76 830	63 700	1,21		-17,09%
21	Industria area, Sofia, housing estate Benkovski	230 500	350 000	0,66	51,84%	
22	Apartment, Pleven	31 100	24 000	1,30		-22,83%
23	2 pcs. of apartments, garage, Varna	93 600	75 000	1,25		-19,87%
24	Apartment, Sofia, Hr. Botev Blvd.	41 900	32 000	1,31		-23,63%
25	Restaurant with a land plot, Sofia, Lyulin	760 610	615 000	1,24		-19,14%
26	House, Varna, Marko Balabanov Str.	300 000	263 000	1,14		-12,33%
27	Shop, Razgrad, Strandzha Str.	328 500	144 000	2,28		-56,16%
28	Apartment, Ruse	42 300	36 000	1,18		-14,89%
29	Studio, Sofia, Strelbishte	49 100	40 903	1,20		-16,69%
30	Apartment, Sofia, Mladost 1	55 900	40 039	1,40		-28,37%
31	Petrol station, Gabrovo, Industrial area	100 200	82 000	1,22		-18,16%
32	Agricultural land and structures, village of Topolite, Varna	161 200	132 000	1,22		-18,11%
33	Apartment, Pomorie	50 720	35 000	1,45		-30,99%
34	Land with land improvements/ car wash station, Sofia, Gorublyansko shose	42 800	40 600	1,05		-5,14%
35	Apartment, Varna, Vl. Varnenchik Blvd.	60 700	52 000	1,17		-14,33%
36	Apartment, Sofia, Mladost 2	51 700	33 557	1,54		-35,09%
37	House 1/2 yard, Pleven, Gen. Ganetski Str.	45 500	44 500	1,02		-2,20%
38	Apartment, Vidin, Tsar Asen I Str.	48 700	37 800	1,29		-22,38%
39	Apartment, Nesebar	26 900	25 565	1,05		-4,96%

# Usual Practice in Bulgaria

No	Analytical indicator	Real estate aggregation in Bulgaria
1	Number of analyzed objects, including:	39
2	Number of objects for which the market appraisal is greater than the transaction price	29
3	Number of objects for which the market appraisal is equal to the transaction price	1
4	Number of objects for which the market appraisal is less than the transaction price	9
5	Arithmetic average ratio "Appraisal Value/Market price" of the analyzed aggregation	1,18

The data shows that there is a discrepancy between value and price of the property. According to RICS / IPD the discrepancy is significant if greater than 15-20% .

Whether the appraiser has underestimated or overestimated the property or it is the existing market situation that led to this discrepancy - this issue needs further investigation and will be the subject of our future studies.

# In conclusion

In the Emerging market valuation in order to protect the consumer, it is very important that:

- ❑ Some rules are introduced and be followed by appraisers, banks and real estate professionals.
- ❑ Informing the public about the importance of appraising the property regardless of method of payment: cash or with borrowed money from the mortgage company.
- ❑ Increase appraiser's competency via standardized mandatory education followed by exams and required level of practice in the specific fields of valuation.