Philippines–Australia Land Administration and Management Project

PHILIPPINE VALUATION STANDARDS

26 NOVEMBER 2004

REPORT B4

LAND equity

PHILIPPINE VALUATION STANDARDS

INTRODUCTION

The Philippine Valuation Standards is an initial step towards the development of a uniform set of standards of professional appraisal practice in the country. This is in recognition of the need to promote and maintain a high level of public trust in professional appraisal practice by establishing requirements for the valuation of land and other types of property.

While the Standards have been prepared initially for taxation purposes, it is addressed to both private and government appraisers and valuers. Assessors and appraisers of Local Government Units (LGU) and the National Government should adhere to the Standards for more reliable and consistent valuations. The Assessors' primary role is to ensure that the property appraisal, particularly for tax purposes is accurate so that the tax burden will be distributed fairly.

In developing the Philippine Valuation Standards, various existing international valuation standards were reviewed and used as models. These include the Uniform Standards of Professional Appraisal Practice (USPAP), International Valuation Standards (IVS), Australian Property Institute (API), New Zealand Property Institute (NZPI), Asean Valuers Association (AVA) Standards, and the standards prepared by the International Association of Assessing Offices (IAOO). Proper acknowledgement is therefore made to these organizations.

Three (3) Standards have been initially developed:

Code of Ethics and Professional Conduct

Market Value Basis of Valuation

Mass Appraisal Development and Appraisal

The above standards should be read in the context of the background materials and implementation guidance contained in the General Valuation Concepts and Principle which was prepared for this purpose.

The importance of adhering to a uniform valuation standard patterned after generally accepted appraisal principles and internationally accepted standards cannot be overemphasized. It is therefore highly recommended that all government agencies and private appraisal organizations support and follow the Proposed Valuation Standards.

PHILIPPINE VALUATION STANDARDS

I. GENERAL VALUATION CONCEPTS AND PRINCIPLES

1.0 INTRODUCTION

1.1 The underlying fundamentals of property valuation provide the basis in the development of the valuation standard for the Philippines. The Philippine Valuation Standards are developed based on the generally accepted valuation concepts, principles and procedures which are similar throughout the world. The draft of the Philippine Valuation Standards is based on these fundamentals.

1.2 Property Appraisers and Assessors are those who deal with the special discipline of economics associated with preparing and reporting valuations. As professionals, Appraisers must meet rigorous tests of competence and training, and demonstrate appraisal skills. They must also exhibit and maintain a Code of Ethics and Conduct and follow the Standards of professional practice based on a set of General Valuation Concepts and Principles (GVCP).

1.3 The Philippine Valuation Standards developed is patterned after valuation standards of a number of international organizations and acknowledgement is made to these various international organizations[1].

2.0 LAND AND PROPERTY CONCEPT

2.1 ***Land*** is one of the major factors of production which is supplied by nature without the aid of man. Land may include not only the earth surface, both land and water, but also anything that is attached to earth's surface, including all natural resources in their original state, such as mineral deposits, wildlife, timber[2].

2.2 Property rights in land are established on the theory that the rights in fee simple ownership in land normally include the wedge shaped area downward from the earth's surface to the center of the earth (sub-surface rights) and the area upward from the earth's surface out into space (supra-surface or air rights). The latter is limited by Act of Congress concerning public use of navigable air space which is considered in the public domain[3].

---

[1] - International Valuation Standards Committee (IVCS) Valuation Standards
- US Appraisal Foundation, Uniform Standards of Professional Appraisal Practice (USPAP)
- Asean Valuers Association (AVA) Valuation Standards
- Australian Property Institute & New Zealand Property Institute Standards
- International Association of Assessing Officers (IAOO) Standards

[2] -American Institute of Real Estate Appraisers (AIREA), & Society of Real Estate Appraisers (SREA), Real Estate Appraisal Terminology, Revised Edition (1982) p. 45

[3] - Ibid

2.3 Valuation of land as if vacant or of land and improvements on the land or for the benefit of the land is an economic concept. Whether vacant or improved, land is also referred to as real estate. Value is created by the real estate's utility, or capacity to satisfy the needs and wants of human societies. Contributing to value are the real estate's general uniqueness, durability, potential features of location, relatively limited supply, and the specific usefulness of a given site.

2.4 All appraisals are concerned with property. Property is the inherent rights of ownership and future benefits of tangible and intangible assets and is taken to mean any right or interest reflecting a source or attribute of wealth. The word property, used without further qualifications may refer to real property, personal property, or other types of property such as businesses and financial interests, or a combination thereof. Personal property pertains to movable physical assets. Anything that is not part of real estate is personal property. Realty consists of land and all improvements on and to the land. This term is synonymous with real estate. Real property consists of rights in realty.

2.5 The distinction between real property (rights in realty) and realty (the physical thing) is significant, in that it is the real property rights that are transferred and valued in the market and not the real estate.

2.6 The basic rights of private ownership of property include possession, control, enjoyment, disposition or use, exclusion, plus the right not to exercise any of the above rights. The term used to describe the full set of private ownership rights is "bundle". The "bundle of rights theory" states that these rights are both divisible and separable, i.e. they may be exchanged in whole or in part. In every appraisal, it is necessary to identify what rights, or what part of the total bundle, are appraised, i.e., which property rights is to be appraised.

2.7 Estates are ownership rights and interest in property. The estate most commonly appraised is the fee simple estate, or the fee simple absolute estate which is the fullest type of private ownership possible. Fee simple is an estate without restrictions but subject to the limitation of eminent domain, escheat, police power, and taxation.

2.8 Many recognized principles are applied in valuing real estate. They include the principles of supply and demand; competition; substitution; anticipation; increasing and decreasing return, balance, conformity, change; contribution and others. Common in all these principles is their direct or indirect effect on the degree of utility and productivity of a property. Consequently, it may be stated that the utility of the real estate reflects the combined influence of all market forces that come to bear upon the value of property.

3.0 REAL ESTATE, PROPERTY, AND ASSET CONCEPTS

3.1 ***Real estate*** is defined as the physical land and all those items which are attached to the land. It is the physical, tangible entity which can be seen and touched, together with all the additions on, above, or below the ground.

Philippine law[4] prescribes the basis for distinguishing real estate from personal property. Although these legal concepts may not be recognized, they are adopted here to distinguish important terms and concepts.

3.2 ***Real property*** includes all the rights, interests, and benefits related to the ownership of real estate. Ownership of real estate is evidenced by a Certificate of Title, Free Patent or Tax Declaration in the absence of Certificate of Title.

3.3 ***Personal property*** includes interests in tangible and intangible items which are not real estate. Items of tangible personal property are not permanently affixed to real estate and are generally characterized by their own moveability.

3.4 Property such as plant, machinery and equipment are tangible or physical assets which are intended to be used on a continuing basis as part of an enterprise.

3.5 ***Depreciation*** is loss in value brought about by physical deterioration and/or obsolescence. Physical deterioration is loss in value due to wear and tear and exposure to the elements. Obsolescence can either be functional or economic (environmental). Functional obsolescence is loss in value within the property as a result of the development of new technology, changes in design or market preferences. Economic obsolescence is the loss in value resulting from influences external to the property itself.

4.0 COST, PRICE AND VALUE

4.1 In appraisal terminology, the terms cost, price and value are distinct and not synonymous to each other. The specific meanings of these terms have to be distinguished as they are used in the valuation discipline.

4.2 Cost is the amount of money necessary to produce, create or manufacture an item of property. It includes material, labor, equipment, contractor's overhead and profits, and fees.

4.3 Price is the amount of money necessary to purchase the finished goods or item of property manufactured when offered for sale in the open market.

4.4 Value exists when an item of property has utility, is relatively scarce, arouses the desire of potential buyer to buy and backed by purchasing power. Value is an economic concept referring to the amount most likely to be agreed upon by buyers and sellers in an open market transaction. The economic concept of value reflects the market's view of the benefits that accrue to one who owns the good or receives the services as of the effective date of valuation.

4.5 There are many types of value. In valuing property, it is of utmost importance that the appraisers and the assessors use the type of value appropriate in the particular appraisal engagement. Any change in the type and definition of the

[4] Republic Act No. 386 as amended (Civil Code of the Philippines)

value can have material effect on the conclusion of value assigned to property for the specific purpose. For real estate appraisal the most common type of value is market value.

4.6 Market value estimate for replaceable property may be based on cost of reproduction new or replacement cost. Cost of Reproduction is the cost to construct or manufacture a replica property using the same design, materials and workmanship. A replacement cost estimate envisions constructing or manufacturing a similar structure having the same or comparable utility and using materials and design concept currently used in the market.

5.0 MARKET VALUE

5.1 The concept of market value reflects the collective actions and reactions of buyers and sellers in a typical open market. It is usually the basis for valuing real estate property particularly for taxation purpose.

5.2 Market value is defined as 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 (a transaction between independent, unrelated parties involving no irregularity) after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

5.3 Market value may also be expressed as the amount at which ownership of the appraised property might be justified by a prudent investor or alternatively as the present worth of future benefits of ownership.

5.4 It is important to emphasize that market value is an objective estimate of the identified rights of ownership under the Bundle of Rights Theory and as of the specific date of appraisal. It is a market supported estimate developed in accordance with the Philippine Valuation Standards.

6.0 HIGHEST AND BEST USE

6.1 Real Estate is valued on the basis of the rights inherent in the ownership (Bundle of Rights) rather than the physical land. Consequently, in the appraisal of land whether vacant or improved, the maximum benefits of ownership must be analyzed.

6.2 When improved land is valued separately from the improvement, economic principles require that the improvements be analyzed and valued based on whether they contribute to the total value of the property or detract from it (Principles of Contribution). Therefore, market value of land is analyzed as if the land is vacant and available for use and development in accordance with the "Highest and Best Use" concept.

6.3 When improved land is valued as a property unit (combination of land and improvements), market value is estimated by considering the highest and best use of the property as improved.

6.4 **Highest and Best Use** is defined as:

The most probable use of property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued.

6.5 A use that is not legally permissible or physically possible cannot be considered a highest and best use. A use that is both legally permissible and physically possible may nevertheless require an explanation by the Appraiser/Assessor justifying why that use is reasonably probable. Once analysis establishes that one or more uses are reasonably probable uses, they are then tested for financial feasibility. The use that results in the highest value, in keeping with the other tests, is the highest and best use.

7.0 UTILITY

7.1 The key criterion in the valuation of any real or personal property is its utility. Procedures employed in the valuation process have the common objective of defining and quantifying the degree of utility or usefulness of the property valued. This process calls for interpretation of the utility concept.

7.2 Utility is a relative or comparative term, rather than an absolute condition. For example, the utility of agricultural land is ordinarily measured by its productive capacity. Its value is a function of the quantity and quality of produce, which the land will yield in an agricultural sense, or of the quantity and quality of buildings essential to the agricultural operation. If the land has development potential, however, its productivity is measured by how productively it will support a residential, commercial, industrial, or mixed use. Consequently, land value is established by evaluating its utility in terms of the legal, physical, functional, economic, and environmental factors that govern its productive capacity.

7.3 Fundamentally, property valuation is governed by the way specific property is used and/or how it would ordinarily be traded in the market. For some property, optimum utility is achieved if the property in question is operated on an individual basis. Other property has greater utility if operated as part of a group of properties, e.g., properties owned and managed by a business enterprise such as a chain of multiple retail outlets, fast food restaurants, or hotels. Therefore, a distinction must be made between a property's utility viewed individually and when considered as a part of a group. The Appraiser/Assessor will regard the property as the market views it, whether as a discrete entity or as part of an aggregate or portfolio. Typically, the Appraiser/Assessor determines the value of the property as an individual entity. If the value of the property, taken as part of an aggregate or portfolio is other than its individual value, such value should be considered.

7.4 A common effect of political or economic uncertainty is a change in utility, whether in terms of capacity or efficiency. The Appraiser's/Assessor's responsibility in such situations is to assess the market expectancy of the time span for such events. Temporary shut-downs or closures may have little or no impact on property values, whereas prospects for long-term cessation of activities may result in a permanent diminution in value. The property valued must be viewed in the light of all internal and external factors bearing on its operating performance.

8.0 SPECIAL PURPOSE PROPERTY

8.1 Special purpose properties are properties which are designed, constructed and developed for a specific use or purpose. By its very nature this type of property is rarely offered for sale in the open market except as part of a going concern. Because of the special design and function, conversion of special purpose properties to other types of development or application is generally not economically feasible.

8.2 In valuing special purpose properties, it is the Appraiser's/Assessor's responsibility to gather pertinent data and information and develop sound reasoning from the market to support conclusions of value. While all the appraisal methods should be considered, the Cost Approach to value is commonly applied in the appraisal of special purpose properties.

9.0 APPROACHES TO VALUE

9.1 Valuation of any type of property for any application including taxation purposes requires that the Appraiser/Assessor apply one or more valuation approaches. The term valuation approach or methodology refers to generally accepted analytical methodologies that are in common use internationally.

9.2 There are three generally accepted methods of estimating fair market value- cost, market and income.

9.2.1 The *Cost Approach* to value considers the cost to reproduce the property appraised. From this amount is deducted an allowance for depreciation or obsolescence present, whether arising from physical, functional or economic causes. This approach in appraisal analysis is based on the proposition that an informed purchaser would pay no more for a property than the cost of producing a substitute property with same utility as the subject property.

Cost approach is particularly applicable to relatively new property and to unique or special purpose property.

9.2.2 The *Market Approach* considers prices recently paid for comparable assets. Appropriate adjustments are made in the indicated market prices of similar property to reflect the condition and utility of the appraised property relative to the actual or normal market comparative. This approach in appraisal analysis is based on the proposition that an informed purchaser would pay no more for a property than the cost in acquiring an existing property with the same utility.

Market approach is particularly applicable when there is an active market with sufficient quantities of reliable data which are verifiable from authoritative sources. It is relatively unreliable when market is limited.

9.2.3 In the *Income Approach*, an estimate is made on the prospective economic benefits of ownership. This approach is predicated on the proposition that an informed purchaser would pay no more for a property than the cost of obtaining an income stream of the same size and embodying the same risk as that involved in the subject property.

Income approach is particularly applicable when the future benefits of ownership may reasonably be estimated in the light of related risk to be incurred.

9.3 The Appraiser/Assessor must consider application of each of the three approaches in every appraisal. The approaches selected must be supported by the facts and circumstances of the case on hand. The applicability of any approach in a given valuation problem depends on the character of the problem, the type of property involved, the nature of the market, and of course the availability of required data appropriate quality and in sufficient quantity.

10. SUMMARY

10.1 The Philippine Valuation Standards (for taxation purposes) are intended to facilitate the use and adaptation of internationally recognized appraisal standards. The adoption of international best practice valuation standards will contribute to the acceptance and transparency particularly of the taxation system.

10.2 The taxation authorities, property owners and the general public need to have confidence in the work of Appraiser/Assessors. The Valuation Standards when supported by legislation and the regulation of Appraisers/Assessors will provide the confidence that public can rely upon.

II. STANDARD 1
CODE OF ETHICS AND PROFESSIONAL CONDUCT

INTRODUCTION

To promote and preserve the public trust inherent in professional appraisal practice, an assessor/ appraiser must observe the highest standards of professional ethics.

It is fundamental to the operation of this standard that valuations performed in compliance therewith should be provided by honest and competent Professional Assessors/ Appraisers, free of bias or self-interest, whose reports are clear, will not mislead, and will disclose all matters essential to the proper understanding of the valuation. Assessors/Appraisers should always promote and preserve public trust in the valuation profession.

SCOPE

Assessors/Appraisers must comply with these Standards. A valuation claiming to be prepared under this Standard binds the Assessor/Appraiser to follow this Code of Conduct.

The functions of Assessors/Appraisers are strictly professional in character. They are charged with solemn business, civil and social responsibilities.

This Code is intended complementary to the rules, by-laws, and regulations of national societies or organizations controlling or monitoring the activities of Assessors/Appraisers.

Ethics

Assessors/Appraisers should at all times maintain a high standard of honesty and integrity and conduct their activities in a manner not detrimental to government, the public, their profession, or their respective national professional valuation body.

INTEGRITY

1. An Assessor/Appraiser must not act in a manner that is misleading or fraudulent.
2. An Assessor/Appraiser must not knowingly develop and communicate a report that contains false, inaccurate, or biased opinions and analysis.
3. An Assessor/Appraiser must not contribute to, or participate in, a valuation service that other Assessors/Appraisers would consider to be unreasonable or not justified.
4. An Assessor/Appraiser must act legally and comply with the laws and regulations of the Philippines
5. An Assessor/Appraiser must not claim, or knowingly let pass, erroneous interpretation of professional qualification that he or she does not possess.

6. An Assessor/Appraiser must acknowledge the contribution of others who participate professionally with him in any appraisal.
7. An Assessor/Appraiser shall ensure that any staff person or subordinate assisting in any valuation service adhere to this Code of Conduct.
8. An Assessor/Appraiser must render properly and adequately develop valuations without advocacy for accommodation of any particular interest, being factual, objective, unbiased and honest, in presenting his oral or written analysis, conclusions and opinions.

RECORD KEEPING

An Assessor/Appraiser must prepare a complete file and working paper for each appraisal, appraisal review, or appraisal consulting assignment. The file must include:

1. the name of the owner and the identity, by name or type, of any other intended users;
2. true copies of any written reports, documented on any type of media;
3. summaries of any oral report or testimony, or a transcript of testimony, including the appraiser's signed and dated certification; and
4. all other data, information, and documentation necessary to support the appraiser's opinions and conclusions and to show compliance with this Rule and all other applicable Standards, or references to the location(s) of such other documentation.

An Assessor/Appraiser must retain the file and working papers for a period of at least six (6) years after preparation or at least two (2) years after final disposition of any judicial proceeding in which the appraiser provided testimony related to the assignment, whichever period expires last.

An Assessor/Appraiser must have custody of his or her file, or make appropriate retention, access, and retrieval arrangements with the party having custody of the file working papers.

III. STANDARD 2 MARKET VALUE BASIS OF VALUATION

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

INTRODUCTION

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.

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

3. Market Value resides in estimate and determination of what is fair, economic, just and equitable value under normal conditions and all elements of value that are inherent in property should be considered.

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

5. 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 capitalization 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.

SCOPE

This Standard refers to the estimation of Market Value of real estate and other types of property. It requires that the property under consideration be viewed as if for sale in the (open) market, in contrast to being evaluated as part of a going concern or for some other purpose.

The standard covers both government assessors/appraisers and private practitioners and is applicable for all purposes using Market Value as basis, including taxation and other government purposes.

DEFINITION

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 (a transaction between independent, unrelated parties involving no irregularity) after proper marketing wherein the parties had each acted knowledgeable, prudently, and without compulsion.*

This definition assumes that titles to the property are good and marketable, free from liens and encumbrances and that fee simple ownership is transferable.

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated.
2. both parties are well informed or well advised, and each acting in what they consider their own best interest.
3. a reasonable time is allowed for exposure in the open market.
4. payment is made in cash or its equivalent.
5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.
6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/ or terms, services, fees, costs, or credits incurred in the transaction.

STATEMENT OF STANDARD

To perform valuations that comply with these Standards and General Valuation Concepts and Principles (GVCP), it is mandatory that Appraisers/Assessors adhere to the Code of Conduct pertaining to Ethics, Competence, Disclosure, and Reporting.

In performing and reporting a Market Value estimate, the Appraiser/Assessor shall:

1. completely and understandably set forth the valuation in a manner that will not be misleading;
2. ensure that the estimate of Market Value is based on market-derived data;

3. ensure that the estimate of Market Value is undertaken using appropriate methods (Cost Approach, Market Data / Sales Comparison Approach and Income Capitalization Approach) and techniques; and
4. provide sufficient information to permit those who read and rely on the report to fully understand its data, reasoning, analyses, and conclusions. In this connection, the Appraiser/Assessor should:

   (a) define the value being estimated and state the purpose and intended use of the appraisal, and the date of the report;
   (b) clearly identify and describe the property and property rights or interests being appraised;
   (c) describe the scope/ extent of the work undertaken and the extent to which the property was inspected;
   (d) state any assumptions and limiting conditions upon which the valuation is based;
   (e) fully and completely explain the methods applied and the reasons for their applications and conclusions; and
   (f) include a signed Compliance Statement (Certification of Value) attesting to the Assessor/Appraiser's objectivity, professional contributions, non-bias, as well as Standards' applicability, and other disclosures.

EXPLANATION

Market Value is an estimate of the price that is expected to be realized in the sale of the property 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.

The concept of Market Value presumes a price negotiated in an open and competitive market. 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 characterized 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.

Market valuations are generally based on information regarding comparable properties. The valuation process requires an Assessor/Appraiser to conduct adequate and relevant research, to perform competent analyses, and to draw informed and supportable judgments. In this process, Assessors/Appraisers do not accept data without question but should consider all pertinent market evidences, trends, comparable questions and other information. Where market data are limited, or essentially non-existent (as for example with certain specialized properties), the Assessor/Appraiser 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 an Assessor/Appraiser's judgment, but reports should disclose whether the Assessor/Appraiser bases the Market Value estimate on market evidence, or whether the estimate is more heavily based upon the Assessor/Appraiser's judgment because of the nature of the property and lack of comparable market data.

Because changing conditions are characteristics of markets, Assessors/Appraisers must consider whether available data reflect and meet the criteria for Market Value.

(a) Changes in market condition occur constantly and this may continue over a period of years. Economic change may give rise to erratic market data. If some sales are out of line with the market, the Assessor/Appraiser will generally give them less weight. It may still be possible for the Assessor/Appraiser 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.

(b) 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. Assessors/Appraisers 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 Assessor/Appraiser 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.

(c) During periods of market transition characterized 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 warranted assumptions are made regarding future markets. In these circumstances, Assessors/Appraisers must carefully analyze and reflect actions and attitudes of the market and take care that they fully disclose the results of their investigations and findings in their reports.

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 to 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.

IV. STANDARD 3 MASS APPRAISAL DEVELOPMENT AND REPORTING

In developing a mass appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques necessary to produce and communicate credible mass appraisal.

A mass appraisal includes:

1. Identifying the property to be appraised.
2. Classifying the properties by logical groups and constant market behaviour, physical characteristics and general location.
3. Identifying factors and forces that affect and influence value in the respective market area.
4. Selecting a model property within each group that will represent the average characteristics of the property comprising the group.
5. Adjusting the differences between the model and market comparable.
6. Applying the conclusions reflected in the model to the properties within the group.
7. Calibrating and adjusting the values to compensate for such factors as corner influence, size and shape and other physical characteristics.
8. Reviewing the mass appraisal results.

STANDARD RULE 3-1

In developing a mass appraisal, an appraiser must:

(a) be aware of, understand, and correctly employ those recognized methods and techniques necessary to produce a credible mass appraisal;

Mass appraisal provides for a systematic approach and uniform application of appraisal methods and techniques to obtain estimates of value that allow for statistical review and analysis of results.

This requirement recognizes that the principle of change continues to affect the manner in which appraiser perform mass appraisals. Changes and developments in the real property and personal property fields have a substantial impact on the appraisal profession.

(b) Be sure that there are no substantial error of omission or commission committed that significantly affects a mass appraisal; and

(c) Render a mass appraisal in a careful and not negligent manner.

<u>STANDARD RULE 3-2</u>

In developing a mass appraisal, an appraiser must observe the following specific appraisal requirements:

(a) identify intended users;

(b) identify the purpose and intended use of the appraisal;

(c) identify the scope of work necessary to complete the assignment, including any special limiting conditions;

The scope of work is acceptable when it is consistent with:

- the expectations of participants in the market for the same or similar appraisal services; and
- what other appraiser's peers' actions would be in performing the same or a similar assignment.

(d) identify any extraordinary assumptions and any hypothetical conditions necessary in the assignment;

An extraordinary assumption may be used in an assignment only if:

- it is required to properly develop credible opinions and conclusions;
- the appraiser has a reasonable basis for the extraordinary assumption; and
- use of the extraordinary assumption results in a credible analysis.

(e) identify the effective date of the appraisal;

(f) define the value being developed;

(g) identify the characteristics of the properties that are relevant to the purpose and intended use of the mass appraisal, including:

i. the group with which a property is identified according to similar market influence;

ii. the appropriate market area and time frame relative to the property being valued; and

iii. their location and physical, legal, and economic characteristics.

(h) identify the characteristics of the market that are relevant to the purpose and intended use of the mass appraisal, including:

i. location of the market area;

ii. physical, legal, and economic attributes;

iii. time frame of market activity; and

iv. property interests reflected in the market.

(i) in appraising real property, identify and analyze the effect on use and value of the following factors: existing land use regulations, reasonably probable modifications of such regulations, economic supply and demand, the physical adaptability of the real estate, neighborhood trends, and highest and best use of the real estate; and

(j) recognize that land is appraised as though vacant and available for development to its highest and best use and that the appraisal of improvements is based on their actual contribution to the site;

(k) analyze the relevant economic conditions at the time of the valuation, including market acceptability of the property and supply, demand, scarcity, or rarity.

STANDARD RULE 3-3

In developing a mass appraisal, an appraiser must:

(a) identify the appropriate procedures and market information required to perform the appraisal, including all physical, functional, and external market factors as they may affect the appraisal;

(b) employ recognized techniques for specifying property valuation models; and

Mass appraisers must develop mathematical models that, with reasonable accuracy, represent the relationship between property value and supply and demand factors, as represented by quantitative and qualitative property characteristics. The models may be specified using the cost, sales comparison, or income approaches to value.

(c) employ recognized techniques for calibrating mass appraisal models. Calibration refers to the process of analyzing sets of property and market data to determine the specific parameters of a model.

STANDARD RULE 3-4

In developing a mass appraisal, an appraiser must observe the following specific requirements, when applicable:

(a) collect, verify, and analyze such data as are necessary and appropriate to develop, when applicable:

i. the cost new of the improvements;

ii. accrued depreciation;

iii. value of the land by sales of comparable properties

iv. value of the property by sales of comparable properties;

v. value by capitalization of income—i.e., rentals, expenses, interest rates, capitalization rates, and vacancy data;

This Rule requires appraisers engaged in mass appraisal to take reasonable steps to ensure that the quantity and quality of the factual data that are collected are sufficient to produce credible appraisals.

Geographic data must be contained in as complete a set of cadastral maps and tax maps as possible, compiled according to current standards of detail and accuracy. Sales data must be collected, confirmed, screened, adjusted, and filed according to current standards of practice. The sales file must contain, for each sale, property characteristics data that are contemporaneous with the date of sale.

(b) identify the need for and extent of any physical inspection.

STANDARD RULE 3-5

In applying a calibrated mass appraisal model an appraiser must:

(a) value land with improvements by recognized methods or techniques based on the cost approach, the sales comparison approach, and income approach, as applicable;

(b) value sites by recognized methods or techniques; such techniques include but are not limited to the sales comparison approach, allocation method, abstraction method, capitalization of ground rent, and land residual technique;

STANDARD RULE 3-6

In reconciling a mass appraisal an appraiser must:

(a) reconcile the quality and quantity of data available and analyzed within the approaches used and the applicability or suitability of the approaches used; and

(b) employ recognized mass appraisal testing procedures and techniques to ensure that standards of accuracy are maintained.

It is implicit in mass appraisal that, even when properly specified and calibrated mass appraisal models are used, some individual value estimates will not meet standards of reasonableness, consistency, and accuracy. However, appraisers engaged in mass appraisal have a professional responsibility to ensure that, on an overall basis, models produce value estimates that meet attainable standards of accuracy.

STANDARD RULE 3-7

A written report of a mass appraisal must clearly communicate the elements, results, opinions, and value conclusions of the appraisal.

Each written report of a mass appraisal must:

(a) clearly and accurately set forth the appraisal in a manner that will not be misleading;

(b) contain sufficient information to enable the intended users of the appraisal to understand the report properly;

When any portion of the work involves significant mass appraisal assistance, the appraiser must describe the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant mass appraisal assistance in the certification.

(c) clearly and accurately disclose all extraordinary assumptions, hypothetical conditions, or limiting conditions that directly affect the appraisal and indicate its impact on value;

Examples of extraordinary assumptions or hypothetical conditions might include items such as the execution of a pending lease agreement, atypical financing, a known but not yet quantified environmental issue, or completion of onsite or offsite improvements. In a written report the disclosure is required in conjunction with statements of each opinion or conclusion that is affected.

(d) state the purpose and intended use of the appraisal;

(e) disclose any assumptions or limiting conditions that result in deviation from recognized methods and techniques or that affect analyses, opinions, and conclusions;

One limiting condition that must be disclosed is whether or not any physical inspection was made.

(f) set forth the effective date of the appraisal and the date of the report;

In taxation the effective date of the appraisal may be prescribed by law. If no effective date is prescribed by law, the effective date of the appraisal, if not stated, is presumed to be contemporaneous with the data and appraisal conclusions.

The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market or property use conditions as of the effective date of the appraisal was prospective, current, or retrospective.

(g) define the value, including the type and definition and its source;

(h) identify the properties appraised including the property rights;

The report documents the sources for location, describing and listing the property. When applicable, include references to legal descriptions, addresses, parcel identifiers, photos, and building sketches. In mass appraisal this information is often included in property records.

(i) describe the procedure for collecting, validating, and reporting data;

The summary report must describe the sources of data and the data collection and validation processes. Reference to detailed data collection manuals must be made, as appropriate, including where they may be found for inspection.

V. GLOSSARY OF TERMS

For purposes of these standards, the following definitions apply:

Abstraction Method - method of land valuation in the absence of vacant land sales, whereby improvement values obtained from the cost model are subtracted from sales prices of improved parcels to yield residual land value estimates.

Allocation - the distribution of the appraised value of the property between land and building. This is accomplished on a ratio basis utilizing percentage breakdowns from comparable locations by subtracting a figure representing the percentage contribution of buildings to total value from total value of the improved property (100%). Although a distribution of a price value between land and improvements by statistical ratio can be useful at times, the procedure has limitations.

Anticipation, Principle of – affirms that value is created by the anticipation of future benefits.

Appraisal - is the act of estimating the value of property. It is an estimate or opinion of value, usually market value or value as defined by the appraiser. It is made as of a specific date and is a conclusion which results from a logical and orderly analysis of facts.

Appraisal date - the date as of which the conclusion or opinion rendered in an appraisal is applicable and valid. The date of appraisal identifies the market conditions that existed when the appraisal was made.

Appraiser/Assessor - one who conducts appraisals; specifically, one who possesses the necessary qualifications, ability, and experience to execute or direct the appraisal of real or personal property.

Arm's length transaction - a transaction freely arrived at in the open market, unaffected by abnormal pressure or by the absence of normal competitive negotiation as might be true in the case of a transaction between related parties.

Balance, Principle of – holds that the value is created and maintained in proportion to the equilibrium attained in the amount and location of the essential uses of real estate. The degree of value of a property is governed by the balance or appointment of the four factors in production.

Bundle of Rights - is the combination of rights associated with the ownership of real property, e.g., the right to use, to sell, to lease, to give away, or to exercise all or none of these rights.

Cadastral Maps – a scale map showing the dimensions of each parcel and related information such as parcel identifier, survey lines easements.

Capitalization – the process of converting into present value (or obtaining the present worth of) a series of anticipated future periodic installment of net income. In real estate appraising, it usually takes the form of discounting.

Certification of Value – a statement that appraisers, in their professional capacity, personally conducted the appraisal in an objective manner. Such a statement permits appraisers to state their precise position, thus protecting their integrity and the validity of their appraisals.

Change, Principle of – holds that economic, physical, governmental, and social forces are constantly at work and because changes brought about by these forces affect real property, the appraiser view real property and its environment as in transition, observing evidence of trends which may affect the property in the future.

Competition, Principle of – holds that profit tends to breed competition and excess profit tends to breed ruinous competition.

Conformity, Principle of – holds that the maximum of value is realized when a reasonable degree of homogeneity is present. Thus conformity in use is usually a highly desirable adjunct of real property, since it creates and/or maintains value.

Contribution, Principle of – states that the value of an agent of production or of a component part of a property depends upon how much it contributes to the value of the whole; or how much its absence detracts from the value of the whole. The Principle of Contribution is sometimes known as the Principle of Marginal Productivity.

Cost - is the amount of money necessary to produce, create or manufacture an item of property.

Cost Approach - also known as replacement or reproduction cost less depreciation. Under this approach to value, the land is appraised as vacant. The land value is then added to the depreciated cost of the improvements to arrive at an indication of value by the cost approach. It is based on the "Theory of Substitution" which states that no property is worth more than the replacement cost of a similar property having equal utility and equally desirable location which can be obtained without undue delay.

Depreciation - loss in value brought about by physical deterioration and/or obsolescence. Physical deterioration is loss in value due to wear and tear and exposure to the elements. Obsolescence can either be functional or economic (environmental). Functional obsolescence is loss in value within the property as a result of the development of new technology, changes in design or market preferences. Economic obsolescence is the loss in value resulting from influences external to the property itself.

Eminent Domain - the right of government or specified quasi-public bodies, such as public utilities, to acquire private property for public or quasi-public use upon payment of just compensation.

Encumbrance - an interest or right on real property which may diminish the value of the fee, but does not prevent conveyance of the fee by the owner. Mortgages, taxes, and judgments are encumbrances known as liens. Restrictions, easements and reservations are encumbrances, though not liens.

Estate –

1. A right or interest in property; it may be fee ownership interest or lease interest for a period of years. An estate in land is the degree, nature, or extent of interest which a person has in it.
2. The property of a deceased person.

Fee Simple – an absolute fee; a fee without any limitations to any particular class of heirs or restrictions, but subject to the limitation of eminent domain, escheat, police power, and taxation. An inheritable estate.

Fixed Assets – assets not readily convertible into cash. This term is synonymous with capital assets in undertaking in which capital is employed for the purpose of producing revenue; but it may also refer to tangible assets in undertakings where there is no proprietary accountability as hospital, religious and charitable organizations, and educational institutions. "Fixed assets" denotes a fixity of purpose or intent to continue use or possession. It does not refer to the immobility of an asset which is the distinctive characteristics of fixtures.

Going Concern Value –

1. The value existing in the proven property operation, considered as an entity with business established, as distinct from the value of real estate only, ready to operate but without a going business.
2. Includes consideration of the efficiency of plant, the know-how management, the sufficiency of capital.
3. It is an excess of value over cost which arises as a consequence of a complete and well-assembled operation production mechanism; it is the value of an efficient layout and operational control system resulting in the most desirable synchronization of the merchandising, production, or distribution activities of the enterprise, and includes goodwill. Synonym: value in use.

Highest and Best Use - 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.

Improvements – broadly buildings or other more or less permanent structures or developments located upon or attached to land. Not a significant or informative term without qualifications.

Increasing and Decreasing (Diminishing) Return, Principle of – states that when successive increments of one or more factors of production are added to fixed amounts of the other factors there is a resulting enhancement of income (in dollars, benefits, or amenities), initially at an increasing rate to a point of maximum return and then decreasing until eventually the increment to value becomes increasingly less than the value of the added factors (or factors). The Principle of Increasing and Decreasing Returns is sometimes known as the Principle of Diminishing Returns or the Principle of Variable Proportions.

Income Approach - an appraisal technique used to estimate the market value of a property on the basis of the income it produces or is capable of producing. The value is estimated by capitalizing the estimated future income, either gross or net. This approach is based on the theory that a property is worth what it will earn. Value is the present worth of future benefits arising from ownership.

Interest Rate – the rate of return on investment irrespective of, and independent of, any capital recovery received or demanded by the investor. Specifically, the rate on borrowed money.

Land Residual Technique – a valuation technique which presumes that income can be split between land and improvements and that the residual to land can be then capitalized into value. Typically, the building is valued independently of the land, and the annual return on the building value (return on investment and provision for capital recapture) is deducted from the anticipated Net Operating Income to the property (land and building). The residual amount is said to be attributable to the land and is capitalized at the appropriate Risk (Discount) Rate to indicate the land value. For new structures, the value assigned to the building is cost. If reasonably new and subject to minimal depreciation which can be satisfactorily estimated, the assigned value is the depreciated value as of the date of appraisal.

Limiting Conditions – conditions and assumptions under which appraisal is made.

Market - the environment or location in which goods and services trade between buyers and sellers through a price mechanism. It implies that goods and/or services may be traded among buyers and sellers without undue restriction on their activities. Each party will respond to supply-demand relationships and other price setting factors as well as to the party's own capacities and knowledge, understanding of the relative utility of the goods and/or services and individual needs and desires. A market can be local, national or international.

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 (a transaction between independent, unrelated parties involving no irregularity) after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

Market Data Approach - also known as the Comparative Approach. Traditionally, an appraisal procedure in which the market value estimate is predicated upon prices paid in actual market transactions and current listings, the former fixing the lower limit of value in a static or advancing market (price wise), and fixing the higher limit of value in a declining market; and the latter fixing the higher limit in any market. It is a process of analyzing sales of similar recently sold properties in order to derive an indication of the most probable sale price of the property being appraised. The reliability of this technique is dependent upon: a) the availability of comparable sales data; b) the verification of the sales data; c) the degree of comparability or extent of adjustment necessary for time differences; and d) the absence of non-typical conditions affecting the sales price.

In essence, all approaches to value (particularly when the purpose of the appraisal is to establish market value) are market data approaches since the data inputs are presumably market derived.

Mass Appraisal - the process of valuing a group of properties as of a given date using standard methodology, employing common data, and allowing for statistical testing.

Model Calibration – the process of analyzing sets of property and market data to determine the specific parameters of a valuation model.

Price - the amount of money necessary to purchase the finished goods or item of property when offered for sale in the open market.

Personal Property – all property other than real property; it is not permanently attached and is, therefore, movable.

Property – any object that may be lawfully acquired or owned which may normally, but not necessarily, have value.

A group of rights inherent in the party's relation to the physical thing, as the right to possess, use, and dispose of it.

The right to the future benefits of economic goods – material and nonmaterial – as determined by law. Although, technically the terms mean a right or interest in things rather than the things themselves, common usage makes it applicable to the things rather than to the right in interest.

Real Estate - the physical land and all those items which are attached to the land. It is the physical, tangible entity which can be seen and touched, together with all the additions on, above, or below the ground. Philippine law prescribes the basis for distinguishing real estate from personal property. Although these legal concepts may not be recognized, they are adopted here to distinguish important terms and concepts.

Real Property – includes all the rights, interests, and benefits related to the ownership of real estate. Ownership of real estate is evidenced by a Certificate of Title, Free Patent or Tax Declaration in the absence of Certificate of Title.

Replacement Cost - is the cost of constructing a similar property which is equally desirable and has the same utility as the one under appraisal.

Reproduction Cost - is the cost of constructing an exact replica of the building being appraised using current prices of labor and materials and contractor's practices.

Special Purpose Properties - are properties which are designed, constructed and developed for a specific use or purpose. By its very nature this type of property is rarely offered for sale in the open market except as part of a going concern. Because of the special design and function, conversion of special purpose properties to other types of development or application is generally not economically feasible.

Substitution, Principle of - states that prudent purchaser would pay no more for real property than the cost of acquiring an equally desirable substitute on the open market. The Principle of Substitution presumes that the purchaser will consider the alternatives available and will act rationally or prudently on the basis of the information about those alternatives, and that reasonable time is available for the decision. Substitution may assume the form of the purchase of an existing property, with the same utility, or of acquiring an investment which will produce an income stream of the same size with the same risk as that involved in the property in question.

Supply and Demand, Principle of - states that market value is determined by the interaction of the forces of supply and demand in the appropriate market as of the date of the appraisal.

Tangible Property - property that, by its nature, is perceptible by the senses. Generally the land, fixed improvements, furnishings, merchandise, cash and other items of working capital used in carrying on an enterprise.

Useful life - the period of time over which the structure may reasonably be expected to perform the function for which it was designed or intended.

Utility – In general economic theory, the capacity of an economic good to satisfy human desires or needs.

Valuation Model - is a representation in words or an equation of the relationship between value and variables representing factors of supply and demand.

Value – relationship between a thing desired and a potential purchaser. It is also refers to the present worth of future benefits arising out of ownership of property value exists when an item of property has utility, is relatively scarce, arouses the desire of potential buyer to buy and backed by the purchasing power.

NOTES

Sources of Information:

[1] Appraisal of Property (Revised Edition May 1987)
[2] International Valuation Standards Committee (IVSC) Standards
[3] Property Appraisal and Assessment Administration, IAOO, 1990
[4] Real Estate Appraisal Terminology (Revised Edition 1982)
[5] Uniform Standards of Professional Appraisal Practice (USPAP)