REAL ESTATE VALUATION IN TRANSITION ECONOMIES

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An appearance in the end of last century the countries with developing, emerging market forces the creation of valuation communities in these countries, elaboration and use of new valuation methodology and practice. The practices and methods, which were developed for and reflect the conditions of well-developed market economies, have had to be adapted to economies in transition. In the paper an attempt to aggregate these processes on the base of experience of countries of central and eastern Europe is set forth. The main of the same concerns about valuation in the transitioning economies of Asia and Pacific Rim.

It is necessarily to create national professional bodies of valuers, as well as regional associations of valuers' organizations. One of the main aims of these organizations must be an elaboration of valuation standards. Such standards have, as a rule, be harmonized with International Valuation Standards and have to reflect national and regional peculiarities of valuation well-known in all transition economies: weak and non-transparent real estate market with unreliable data, existence of different exchange rates for the same currency acting on the market, variable rates in the discounting procedure because of big inflation and significant risks, and others.

Keywords: Appraisal, Emerging markets, Real estate, Transition economies, Valuation.

Methodology of real estate valuation and practice of valuation communities in stable economies are well-known. An appearance in the end of last century the countries with developing, emerging market forces the creation of valuation communities in these countries, elaboration and use of new valuation methodology and practice. The practices and methods, which were developed for and reflect the conditions of well-developed market economies, have had to be adapted to economies in transition. In the paper (Trifonov N., 2002) an attempt to aggregate such peculiarities on the base of countries of central and eastern Europe is set forth. The main of the same concerns about valuation in the transitioning economies of Asia and Pacific Rim.

The Beginning of Independent Valuation: Professional Societies

Countries moved into a new market economy, introducing a wide range of reforms to ensure such transition. With no institutions providing independent valuation, it became necessary, as the property market evolved, to have professionals who understood the market and could perform appraisals according to market principles.

To meet this demand, the financial sectors of these transitioning economies made the creation of a valuation profession a high priority. The need was especially acute in the field of real estate field, where the banking market was already well developed and used appraisals for loan security since they can use only value estimates that correspond to market values. Another large sector needing valuation services is accounting. Because the rate of inflation is high, fixed assets need to be valued each year. Assigning value to deposits going into statutory reserves is also a need.

The goals of real estate valuation in transitional economies are essentially the same as in the developed ones: for the purposes of sale/purchase, occupation, investment, development, or redevelopment. It is rare to use valuation for the stock market or a flotation/merger. Some countries attempt to establish valuation for taxation purposes—so-called mass appraisals.

All countries with transition economies are headed in much the same direction and face the same problems in trying to establish a valuation profession. To facilitate this transition, they are forming their own professional societies and working to gain entry into the worldwide community of valuers. Usually created professional societies share these common goals:

- Support the activity of the specialists who perform valuation of all property types
- Work in cooperation with the state to establish an institute of independent valuation
- Represent of the society and its members to state, international, and other structures
- Control the practice of valuation by developing and maintaining ethical rules for the members of its valuation societies
- Consult and provide information to the participants of the valuation market
- Create juridical and normative documents to regulate valuation activity, including national valuation standards and, possible, valuation standards of the professional society
- Organize training for valuers

Interactions between valuers and governments are of great importance. In some countries the state tends to oversee the practice of valuation, requiring special permission or a license to offer expert opinions as a valuer. In many countries, professional valuation societies regulate valuation activity, so valuation field is self-regulated.

Valuation Standards

Attention is focused now on finalizing professional standards of valuation of all kinds: standards of professional body, national standards and regional standards. These standards, in large part, are modeled on the International Valuation Standards (IVS, 2003) of the International Valuation Standards Committee (IVSC) and, in Europe, on the European Valuation Standards developed by the European Group of Valuers' Association (TEGoVA). Note that even IVS 2000 was harmonized with International Accounting Standards.

Other international valuation standards such as those established by the Appraisal Institute, The Appraisal Foundation (Uniform Standards of Professional Appraisal Practice [USPAP]), and the Royal Institute of Chartered Surveyors are less influential. In many countries professional societies practice in accordance with international and have not developed standards of their own.

Community of valuers in countries in transition need to gain a wide range of appraisal experience and to refine their methodology based on their international experience. Supporting these efforts is membership in international societies such as International Real Estate Society (IRES) with its umbrella system, Federation internationale des geometres (FIG), and IVSC, which gives appraisers an opportunity to participate in international professional activities and to receive training and information from the worldwide community of valuers. Nevertheless the existing international valuers' organizations are not enough. For example, in the territory of former USSR the Council of Valuers' Associations of Commonwealth of Independent States (CVA CIS) has founded in 2002 with the objective of setting up Valuation Standards of CIS in Russian which must reflect peculiarities of transitional economics of the region (Trifonov N., 2003). There is no such international association in Pacific Rim now. Maybe that role could be played by World Association of Valuation Organizations (WAVO) founded some years ago with an objective to join of all valuation and property professional associations world wide.

Valuation Techniques

Appraisal practices in transitioning economies are usually based on modified versions of three well-known approaches—cost, income, and comparative. In urban areas the residual method is used to provide the best estimate of the market value of the land.

Establishing the unit of currency to be used in an appraisal is of great importance. Typically in countries under investigation there are effectively different exchange rates for same currency. It is critical, therefore, for a valuer to choose a currency unit that is appropriate to the market of the subject being appraised.

Economies in transition present some unusual subjects for valuation such as unfinished construction, tenant contributions for improvements due to reconstruction, obligations such as debts, damages, and services. These subjects require special valuation methods. Data for these unusual types of appraisals typically is unreliable because of a weak market. This makes it necessary to perform multiple independent appraisals of the same subject using the various valuation approaches listed above.

Notes on the three primary approaches to value in countries with economies in transition:

Cost approach. Data on local construction costs lags behind that of western European and North American countries by 10—15 years. In many cases, construction operations are paid for in cash. In countries of the former USSR, construction indices were not published in the first half of the century so the base costs of construction now used are from 1984 or 1991. In Germany base costs from 1913 are still used.

Income approach has undergone two modifications (static and dynamic). The first modification is direct capitalization and the second is DCF techniques. Valuers usually use both techniques for the initial iteration and for verification of the results. In the direct capitalization of businesses, optimization methods can be used. Inflation and other significant risks make it necessary to use variable rates in the discounting procedure, especially over a long period. Generally, though, the return time for many investments is short—about three to four years.

Comparative approach. The absence of a real market usually gives rise to the use of sophisticated probability procedures and numerous adjustments. High inflation makes it necessary to be extremely diligent in monitoring the market. In many countries offered prices (purchase or selling prices as well as rent rates) could be more reliable that transaction prices because of specific taxation of real estate transactions.

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