

# **IPAV European Valuation Conference - October 28<sup>th</sup> 2020**

***Are we certain that we are uncertain?***

**Nick French, 2020**

**What is Material Uncertainty?**

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# Agenda

- **TEGoVA - Valuation During the Pandemic**
- **Market Value is an estimate of price based on the professional judgement of the valuer – (art?)**
- **Valuation Uncertainty – determining Market Value in a “paused” or “stagnant” market**
- **Understanding Valuation Uncertainty**
  - **the likelihood that Market Value equates to price**
  - **uncertainty in inputs feed into uncertainty in value**
  - **A Quantitative Analysis of Valuation Uncertainty**
  - **it is NOT directly the uncertainty of cash flows**
- **What is Comparable Evidence?**
- **The new normal for Comparable Evidence**

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***Normal 'uncertainty' is a universal and an  
unsurprising fact of property valuation***

**Michael Mallinson 1994**

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# Material Uncertainty

- Any valuation, at any snapshot in time, is affected by uncertainty. It is the degree of uncertainty that changes as market dynamics change
- In valuation parlance, there is **normal uncertainty** and **material (abnormal) uncertainty**
- Uncertainty impacts in two ways:
  - the **cash flows** and **ARY** from investment are uncertain
  - the resultant **Market Value** figure is uncertain
- These uncertainties are **NOT** the same
  - Yes, one drives the other but when discussing valuation uncertainty, you are discussing the likelihood of your **Market Value** figure matching the sale price of a hypothetical sale today

# A Range of Uncertainty

- Valuation Uncertainty is about a range of possible “values” and the valuers choice of Market Value within that range
- If the market is strong, the valuer will be more certain that the Market Value estimate will match the hypothetical sale price
- If the market is weak or “paused”, the valuer will be less certain that the Market Value estimate is correct
- Valuation uncertainty is NOT about the likelihood of the property matching investment expectation

# Modelling Uncertainty

- Using a simple implicit capitalisation model, the valuation is **Market Rent/ARY**
  - We need to address the probability and range relating to the inputs not the output
  - The analysis of property is a heuristic process; valuers will assess the market by a benchmarking of comparables sales and other market data
    - Within that process, the valuer must ascribe one single figure to each of the inputs (**Market Rent/ARY**) in the analysis
    - Yet, the valuer will have a view on the confidence that he/she believes applies to the individual inputs
    - The thought process of the valuer can be expressed as a triangular probability distribution (**most likely, maximum and minimum**)
-

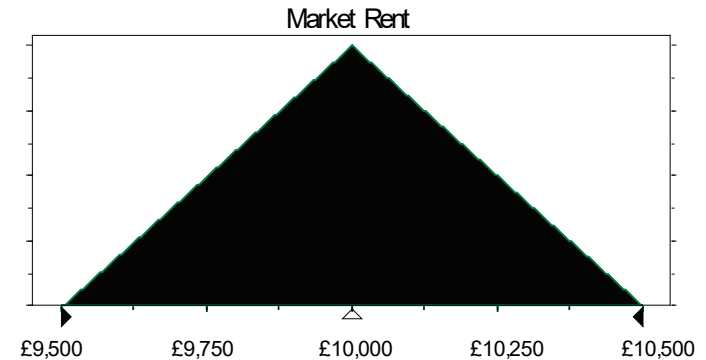
# Input Range – Normal Uncertainty

## Assumption: Market Rent

Triangular distribution with parameters:

Minimum	£9,500
Likeliest	£10,000
Maximum	£10,500

Selected range is from £9,500 to £10,500

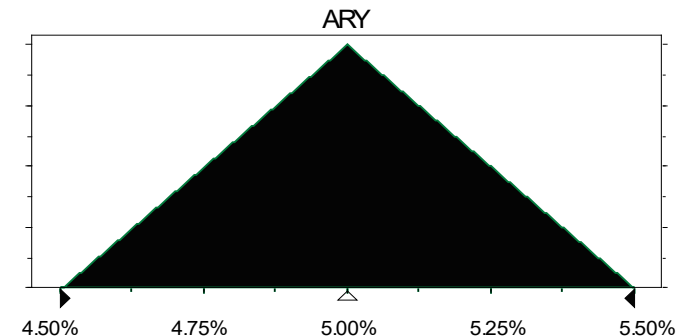


## Assumption: ARY

Triangular distribution with parameters:

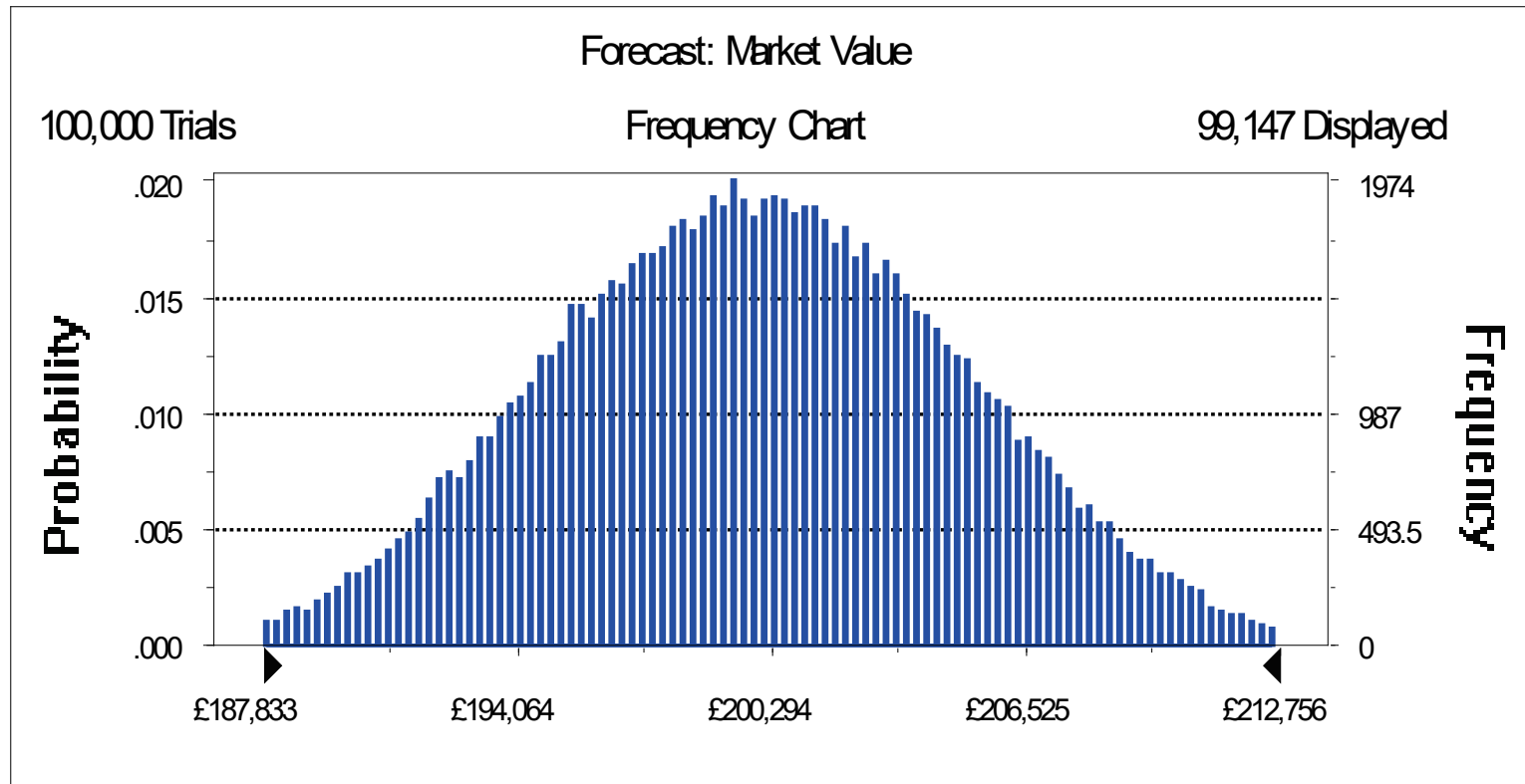
Minimum	4.50%
Likeliest	5.00%
Maximum	5.50%

Selected range is from 4.50% to 5.50%



Rent correlated with ARY at -0.32:

# Market Valuation: Normal Uncertainty



Trials	100000	Standard Deviation	£5,035
Mean	£200,019	Range Minimum	£183,878
Median	£199,985	Range Maximum	£215,977



# Input Range – Material Uncertainty

## Assumption: Market Rent

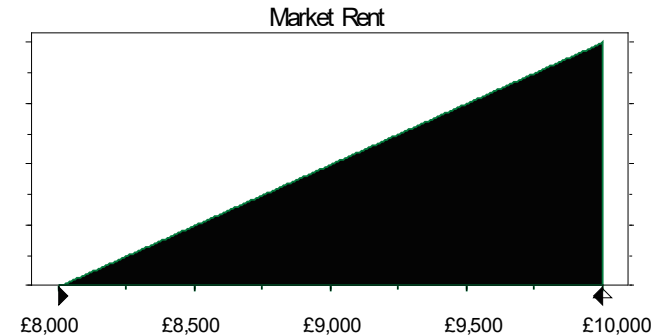
Triangular distribution with parameters:

Minimum £8,000

Likeliest £10,000

Maximum £10,000

Selected range is from £8,000 to £10,000



## Assumption: ARY

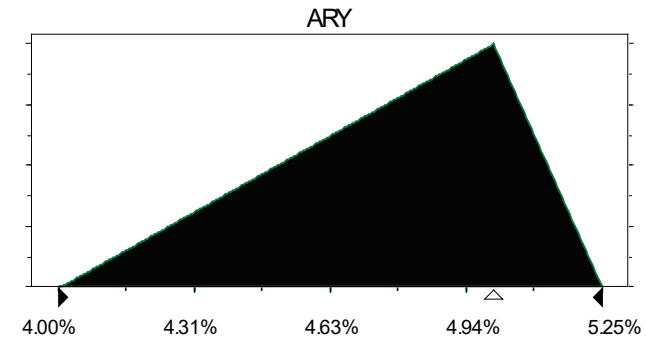
Triangular distribution with parameters:

Minimum 4.00%

Likeliest 5.00%

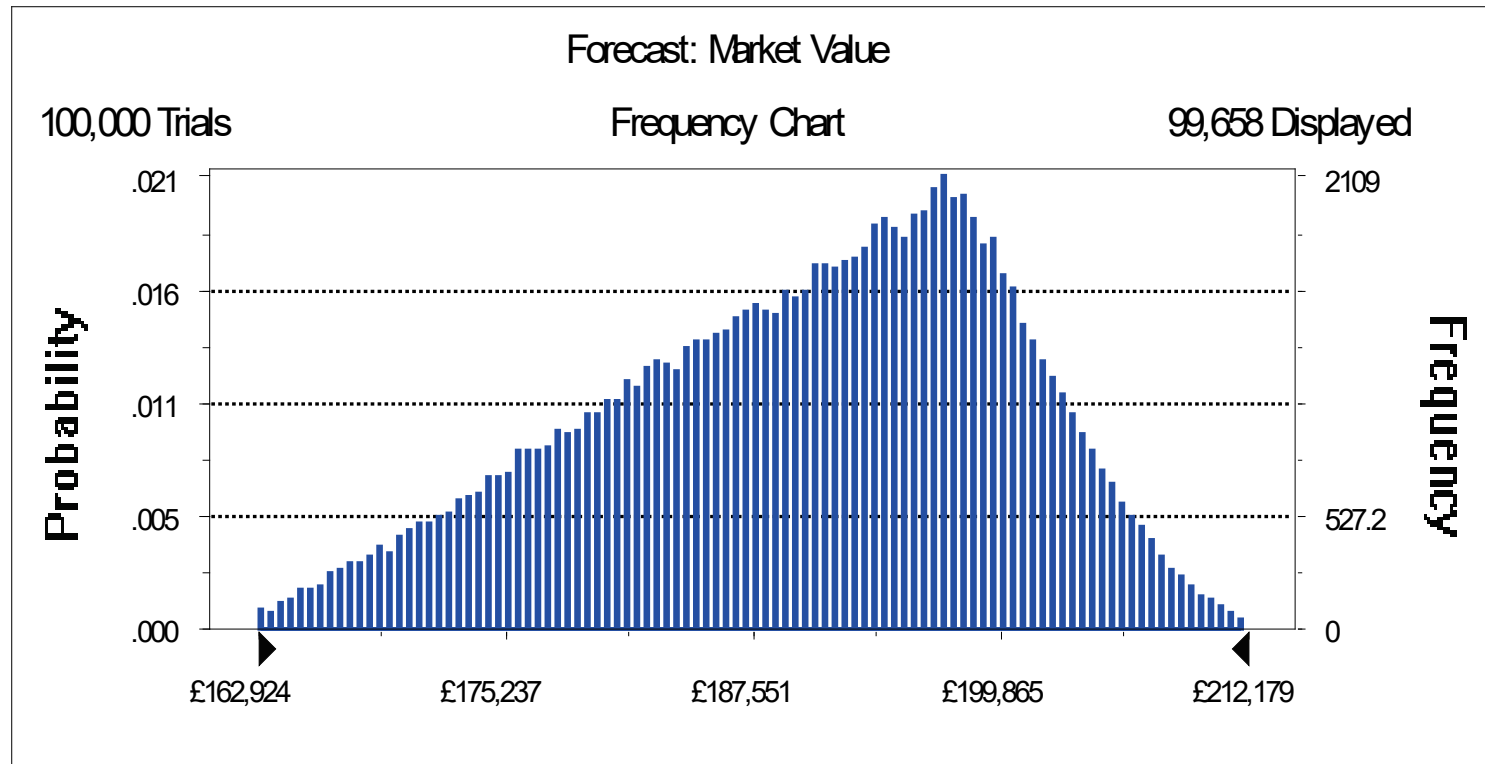
Maximum 5.25%

Selected range is from 4.00% to 5.25%



Rent correlated with ARY at -0.32:

# Market Valuation: Material Uncertainty



Trials	100000	Standard Deviation	£10,285
Mean	£190,030	Range Minimum	£157,994
Median	£191,348	Range Maximum	£214,477

# Modelling Uncertainty

- The Crystal Ball example is just for illustration – you do **NOT** have to use probability modelling but it, I think, helps to show the nature of valuation uncertainty
- When a valuer talks about valuation uncertainty they are looking at uncertainty in inputs...
  - Lack of comparable evidence
  - Uncertainty in the future cash flow (reflected in income or yield **NOT** both)
  - Lack of inspection/access to property information
- **BUT THE VALUATION UNCERTAINTY ITSELF IS THE POSSIBLE DIVERGENCE OF THE MARKET VALUE FIGURE TO PRICE AT THAT DATE**

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## ***The complexity of simple comparison***

*Comparison plays a part in all valuations by all approaches (Market, Income and Cost) and is the lynchpin for determining market value. **TEGoVA 2020***

- Pricing to Market - An Investigation into the use of Comparable Evidence in Property Valuation – TEGoVA Report**  
**June 2020 - Downloadable from [www.tegova.org](http://www.tegova.org)**

# Hierarchy of Evidence

## **Direct transactional evidence - Hard information**

1. Recent Sale/let - valuer was party to the transaction
2. Recent Sale/let - a colleague was party to the transaction
3. Recent Sale/let - a colleague in a different company was party to transaction

## **Public Information – Soft information**

4. Publically available list of recent transactions in a professional magazine
5. Publically available list of recent transactions listed for free on the internet

## **Database - Soft information**

6. Private Subscription Service – List of recent transactions on the internet
7. Government Listing or Cadastre - transactions listed for free on the internet
8. Government Listing or Cadastre - transactions listed for a fee on the internet

## **Sale Price - Soft information**

9. Market information on the reported sale/letting of the property being valued

Continued ....

# Hierarchy of Evidence

## Asking Price - Soft information

10. Details of sales particulars with asking prices of similar properties
11. Purchase enquiries to the valuer/company colleagues for similar properties
12. Purchase enquiries to colleagues at other companies for similar properties

## Historic Evidence - Soft information

13. Evidence of historic transactions that may be used to extrapolate today's MV

## Market Sentiment - Soft information

14. General market discussions/commentaries with colleagues
15. Published market commentaries in magazines or on the internet

## Indices - Soft information

16. Free Property market indices, derived from aggregated information
17. Private Subscription Service – Property market indices

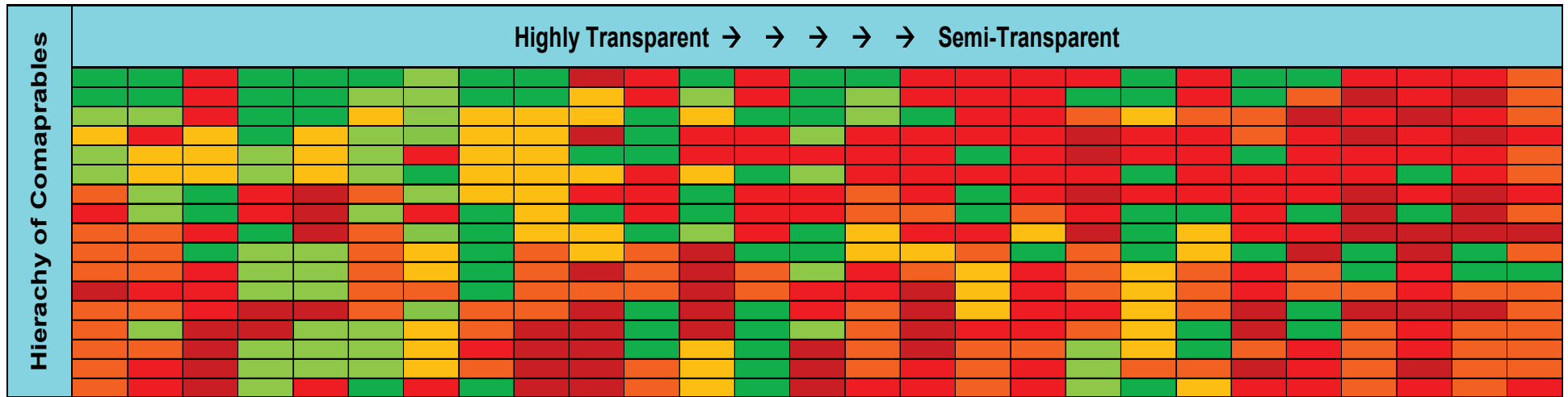
## AVMs - Soft information

18. Private Subscription Service – Value by an Automated Valuation Model
19. Publically available property pricing provided online

# TEGoVA Report – Comparable Evidence

- The report was commissioned as TEGoVA had debated what constituted “comparable evidence”.  
**Was it JUST transactional data or broader?**
  - Not all countries are the same. There are different “degrees of transparency”. A highly transparent market will have access to all forms of comparable data and, thus, the valuer has the luxury of using **hard** transactional evidence. However, in more opaque markets, such data may not be available and the valuer has to rely upon **softer** sources of comparable evidence.
  - There is a correlation between the ranking of data sources and the transparency of the market in question
  - Each market has to deal with the data availability within their specific country.

# Comparables - Veracity & Availability



## Use of Comparable Data vs Transparency of Market

- This graphic illustrates that as markets become more opaque the not only does the lack of comparable data increase (more reds) but the data which is considered the most useful in the transparent markets (more greens and ambers) become less available and used



# The Lack of Evidence

- ❑ **Coincidentally the TEGoVA report came out at a time when ALL markets were struggling with the lack of transactional evidence**
- ❑ **Previously transparent markets found themselves having to provide valuations in opaque conditions**
- ❑ **Material Uncertainty is interlinked with market transparency**
- ❑ **It also reemphasises that valuation is not easy - the complexity of simple comparison**
- ❑ **COVID has been a challenge to the markets but markets adjust and prices/valuations do so too**

# Overall Conclusions

- COVID is just a catalyst; it has accelerated change in many markets and valuers need to adjust their practices to reflect these changes in the estimated price (Market Value)
- The only difference is the speed of change
- Material Uncertainty is not a catch-all caveat to abdicate the valuer from their professional responsibility to provide market value
- It is simply a signpost to be used, where appropriate, in markets where there is abnormal uncertainty

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## ***Conclusions***

***The Property Valuation profession is facing unprecedented challenges as markets change rapidly due to the catalyst of covid***

**I have written short articles on all the topics discussed in this presentation. They are published in **The Property Chronicle** and are available for free at [www.propertychronicle.com/author/nickfrench/](http://www.propertychronicle.com/author/nickfrench/)**