WHY PROPERTY VALUATIONS VARY
DIFFERENT ANSWERS? THEY MAY BOTH BE RIGHT

The process of valuation, whether applied to real estate or some other form of property, is, by definition, an inexact science. A valuation is a statement of opinion of the worth of a certain property and differences in opinion are inevitable. While valuers accept this as a professional reality, it is important to understand why opinions are likely to vary and what should be regarded as a permissible margin of error.

Valuers' opinions will vary for one or more of the following reasons:
- exercise of professional judgment;
- different instructions; or
- mistake or negligence.

I will deal only with the first two reasons because almost all variations will fall into one of these groups.

Exercise of professional judgment

The process of valuation requires an inspection of the property, consideration of all relevant information, an analysis of comparable sales and an understanding of the market for the class of property. Some valuations are quite straightforward; for example, the valuation of a home unit in a block where a number of sales of similar units have recently taken place.

Most valuations, however, require the valuer to interpret sales of properties which are not identical or similar, but are only comparable in order to form an opinion about value. While sales analysis can be a sophisticated process, often carried out with computer assistance, the weight to be given to the results of comparisons is, in the end, a matter for the valuer's judgment.

The limits of permissible variation in valuers' opinions are often set at between 5 per cent and 10 per cent. I believe it is wrong to lay down firm rules about this. This margin will vary depending on the type of property, the number of comparable sales and the market. Narrow margins apply where there are a large number of sales of comparable properties. Wider margins can be professionally acceptable where the property is unusual, where there is a paucity of comparable sales or where the market is small or volatile.

In many cases, valuations are not tested against a market transaction, but there will be occasions where a sale of the subject property, within an appropriate period, may show a variation from the valuer's opinion. Watkins, in Singer & Friedlander Ltd v John D Wood & Co (1977) 26 The Valuer 400 at 401 said:

"The valuation of land by trained, competent and careful professional men is a task which rarely, if ever, permits a precise conclusion. Often beyond certain well-founded facts so many imponderables confront the valuer that he is obliged to proceed on the basis of assumptions. Therefore, he cannot be faulted for achieving a result which does not admit of some degree of error. Thus, two able and experienced men, each confronted with the same task, might..."
come to different conclusions without
anyone being justified in saying that
either of them has lacked competence
and reasonable care, still less integrity,
in doing his work.”

His Honour went on to say: “Any
valuation falling outside (of the permis-
sible margin) brings into question the
competence of the valuer and the sort of
care he gave to the task of valuation.”

Accordingly, the valuer will not be
negligent simply because he was wrong,
provided that his valuation falls within
what is, in the particular circumstances,
the permissible margin of error.

**Different instructions**

Only 30 years ago a valuation theory
– “one value for all purposes” – was still
being advocated by a large number of
valuers and academics. Using this theory,
it was necessary only to instruct a valuer
to value the property. There are many
reasons why such a simple approach to
valuation has no validity today.

Most valuations are carried out
because there is a need for an author-
itative statement about the market value
of the property. Market value has been
described as the “value in exchange”. This
short, simple definition has been expanded in a number of court judg-
ments, both in Australia and overseas. The judgment of Isaacs J in *Spencer v The
Commonwealth* (1907) 5 C.L.R. 418
is regarded as a landmark decision in valuation practice. At p440 the
judgment reads:

“To arrive at the value of the land
at that date, we have, as I conceive, to
suppose it sold then, not by means of a
forced sale, but by voluntary bargaining
between the plaintiff and a purchaser,
willing to trade, but neither of them so
ready to do so that he would overlook
any ordinary business consideration. We
must further suppose both to be perfectly
acquainted with the land, and cognisant
of all circumstances which might affect
its value, either advantageously or
prejudicially, including its situation,
character, quality, proximity to conveni-
ence or inconveniences, its surrounding
features, the then present value deemed
for land, and the likelihood, as then
appearing to persons best capable of
forming an opinion, of a rise or fall for
what reason soever in the amount which
one would otherwise be willing to fix as
the value of the property.”

In addition, it should also be
assumed that the property is to be sold
for cash, or on terms reasonably equiv-
alent to cash, and that the property
will be given suitable marketing to
attract buyers.

**Market value** is a basic concept in valuation practice. It answers the
question: “What can I expect to obtain
for my property?” The limitation of the market value concept is that it treats
the market as one amorphous mass of
people, when the reality is that the market
comprises many individuals, to some of
whom the property may have a value
which is discernably different from its
market value. The need for differentiation
may also arise from legislation or from
contractual arrangements.

Accordingly, in accepting instruc-
tions, the valuer has a responsibility to
answer the question: “Who wants to know
the value of this property?” The answer
may be an owner thinking of selling his
property or an intending mortgagee. The
owner wants to know what he can obtain
for his property (in other words, its market
value). The intending mortgagee, on the
other hand, will also wish to know the
market value – but viewed from his
perspective, with any doubt in the valuer’s
opinion to be resolved against the
property. Thus the market value of the
property from the point of view of an
intending mortgagee can be less than its
market value from the perspective of its
owner. There may also be occasions
where an intending mortgagee specif-
ically requires a valuation based on a
forced or “fire” sale.

Sometimes a property may have a
special value to its owner or to another
party. Special value is a different concept
from market value and the valuation
process in determining such special value
can be quite different from that of
determining market value.

Special values can be present in all
classes of property and can arise for a
number of reasons. It may be the added
value which an adjoining property has to
an expanding manufacturer, or the value
of a specialised facility, such as an
abattoir, to a profitable meat company.
Sometimes other names are used when
special interest valuations are required,
such as “in use”, “going concern” or
“replacement” value to the owner.

Depending on the property and its
location, there can be a substantial
difference between its market value and
its special value. While the owner of a
specialised facility might consider that
its special value, based on the cost of its
replacement, represents a proper asset
value, a lender or investment analyst
may be interested only in the market
value of the property.

In preparing his valuation report, the
valuer should set out his instructions, or
the basis on which his valuation has been
prepared, and any limitations imposed
in those instructions. Anyone relying on
the valuation will then clearly understand
the approach and the valuation basis.

Instructions are also important in a
rental valuation – is the rental being
assessed on an open-market basis, or is
it being assessed in accordance with the
terms and conditions of the lease?

In my experience, differing instruc-
tions have been the main reasons
for material variations in valuers’
conclusions. The first step in undertak-
ing a critical review of a valuation should be
to understand thoroughly the instructions
and any limitations to ensure that they
comply with what was expected.

From the point of view of the valuer,
a clear reflection of instructions and
assumptions is important, as the valuer
is not only liable for professional
negligence in contract to his client, but
also owes a duty of care to third parties,
within reasonable limits, who may act on
his valuation and subsequently suffer
loss or damage.