FACTORS OF VALUE

The economic concept of value is not inherent in the commodity, good, or service to which it is ascribed. Rather, it is created in the minds of the individuals who make up the market. The relationships that create value are complex, and values change when the factors that influence value change.

Typically, four interdependent economic factors create value:

1. Utility
2. Scarcity
3. Desire
4. Effective purchasing power

The four factors interact in the marketplace to influence the relationship of supply and demand.

Utility

Utility is the ability of a product to satisfy a human want, need, or desire. All properties must have utility to tenants, owner-investors, or owner-occupants. Residential properties satisfy the need for shelter and commercial properties generate income. Both may have design features that enhance their attractiveness. These features are called amenities. The value of amenities is related to their desirability and utility to an owner-occupant or tenant-occupant. The value of ownership may be measured from the prices paid for residences. The value to a tenant can be converted into income in the form of rent. The benefits derived from income-producing properties can usually be measured in terms of cash flow. The influence of utility on value depends on the characteristics of the property. Size utility, design utility, location utility, and other specific forms of utility can significantly influence property value.
utility
The ability of a product to satisfy a human want, need, or desire.

scarcity
The present or anticipated undersupply of an item relative to the demand for it. Conditions of scarcity contribute to value.

desire
A purchaser’s wish for an item to satisfy human needs (e.g., shelter, clothing, food, companionship) or individual wants beyond essential life-support needs.

effective purchasing power
The ability of an individual or group to participate in a market, i.e., to acquire goods and services with cash or its equivalent.

The benefits of real property ownership are derived from the bundle of rights that an owner possesses. Restrictions on ownership rights may inhibit the flow of benefits and, therefore, lower the property’s value. Similarly, a property can only achieve its highest value if it can legally perform its most useful function. Environmental regulations, zoning regulations, title restrictions, and other limitations on the rights of ownership can enhance or detract from a property’s utility and value.

Scarcity
Scarcity is the present or anticipated supply of an item relative to the demand for it. In general, if demand is constant, the scarcity of a commodity makes it more valuable. For example, land is still generally abundant, but useful, desirable land is relatively scarce and, as a result, has greater value.

Desire
Desire is a purchaser’s wish for an item to satisfy human needs (e.g., shelter, clothing, food, companionship) or individual wants beyond the essentials required to support life.

Effective Purchasing Power
Effective purchasing power is the ability of an individual or group to participate in a market – that is, to acquire goods and services with cash or its equivalent. A valid opinion of the value of a property includes an accurate assessment of the market’s ability to pay for the property.

Supply and Demand
The complex interaction of the four factors that create value is reflected in the basic economic principle of supply and demand, which is discussed in more detail in the following chapter. The utility of a commodity, its scarcity or abundance, the intensity of the human desire to acquire it, and the effective power to purchase it all affect the supply of and demand for the commodity in any given situation.

Demand for a commodity is created by its utility and affected by its scarcity. Demand is also influenced by desire and the forces that create and stimulate desire.
Although human longing for things may be unlimited, desire is restrained by effective purchasing power. Thus, the inability to buy expensive things affects demand.

Similarly, the supply of a commodity is influenced by its utility and limited by its scarcity. The availability of a commodity is affected by its desirability. Land is a limited commodity, and the land in an area that is suitable for a specific use will be in especially short supply if the perceived need for it is great. Sluggish purchasing power keeps the pressure on supply in check. If purchasing power expands, the supply of a relatively fixed commodity will dwindle and create a market-driven demand to increase the supply for which there is latent or pent-up demand.

THE HISTORY OF VALUE THEORY

The development of modern value theory began in the 18th and 19th centuries when economic thinkers of the classical school first identified the four agents of production – labour, capital, coordination, and land, which are discussed in more detail in the following chapter – and examined the relationships between the basic factors that create value and supply and demand, e.g., utility, scarcity, desire, and effective purchasing power. Classical theory was largely based on the contributions of the physiocrats, whose ideas were put forth in reaction to the mercantilist doctrines that dominated earlier economic thought.

Mercantilism focused on wealth as a means of enhancing a nation’s power. National wealth was equated with an influx of bullion into the national treasury. Mercantilists sought to maintain a favourable balance of trade by selling goods to accumulate gold, the chief medium of exchange. Between the 15th and 18th centuries, economic activity in Western Europe was associated with overseas exploration, colonization, and commerce. Mercantilist doctrine promoted strong, central economic controls to maintain monopolies in foreign trade and ensure the economic dependency of colonies.

Physiocratic thinkers of the mid-18th century objected to the commercial and national emphasis of mercantilism. They stressed other considerations in formulating a theory of value. Agricultural productivity, not gold, was identified as the source of wealth, and land was cited as the fundamental productive agent. The physiocrats also identified the importance of factors such as utility and scarcity in determining value.1

The Classical School

The classical school expanded and refined the tenets of physiocratic thought, formulating a value theory that attributed value to the cost of production. The Scottish economic thinker Adam Smith (1721-1790) suggested that capital, in addition to land and labour, constituted a primary agent of production. Smith acknowledged the role

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1 A physiocrat was a member of an 18th century group of French economists who held that agriculture, rather than manufacturing or trade, was the source of all wealth and that agricultural products should be highly priced. Francois Quesnay (1694-1774) and Anne Robert Turgot (1727-1781) put forth an individualistic, agrarian-based concept of economic behaviour without centralized state control. They stressed the necessity of free trade and popularized the phrase laissez-faire, “to let people do as they choose”, which underscores their individualistic approach. See Roll, E. 1964. A History of Economic Thought, 3rd ed. Englewood Cliffs, N.J.: Prentice-Hall, Inc. p134.
of coordination in production, but did not study its function as a primary agent. He believed that when the agents of production were brought together to produce a useful item, value was created.

In The Wealth of Nations (1776), the first systematic treatment of economics, Smith considered value as an objective phenomenon. By virtue of its existence, an item was assumed to possess utility. Scarcity also imparted exchange value to goods. The “natural price” of an object generally reflected how much the item cost to produce. In contemporary appraisal practice, the classical theory of value has influenced the cost approach.

Later economic thinkers who are regarded as members of the classical school offered theoretical refinements on the cost of production theory of value, but none contested its basic premises. David Ricardo (1772-1823) developed a theory of rent based on the concept of marginal land and the law of diminishing returns. Land residual returns were referred to as rent. Ricardo’s theory contributed significantly to the concept of highest and best use and the land residual technique used in the income approach to value.

John Stuart Mill (1806-1873) reworked Adam Smith’s ideas in The Principles of Political Economy (1848), which became the leading economic text of its time. Mill defined the relationship between interest and value in use, which he referred to as “capital value”; the role of risk in determining interest; and the inequities of “unearned increments” accruing to land. Confident in his analysis of the cost of production theory, Mill asserted, "Happily, nothing in the laws of value remains for the present or any future writer to clear up; the theory of the subject is complete.”

Challenges to the Classical Theory

In the second half of the 19th century, two serious challenges to classical value theory were put forward. One was the labour theory of value, an extreme position advocated by Karl Marx (1818-1883). Marx claimed that all value is the direct result of labour and that increased wages to labour would lower capitalistic profits. Marx envisioned an inevitable struggle between the social classes that would eventually result in a violent political upheaval.

The other challenge was presented by the marginal utility, or Austrian, school, which was critical of both the classical and Marxian theories. The central concept of marginal utility links value to the utility of, and demand for, the marginal, or additional, unit of an item. Thus, if one more unit than is needed or demanded appears in a given market, the market becomes diluted and the cost of production becomes irrelevant. Value is regarded as a function of demand, with utility as its fundamental precept. Marginal utility is the theoretical basis for the concept of contribution.


The Neoclassical Synthesis

These formidable challenges to the classical theory of value inspired economists to reconsider the issue. In the late 19th and early 20th centuries, the neoclassical school successfully merged the supply-cost considerations of the classicists with the demand-price theory of marginal utility. Alfred Marshall (1842-1924) is credited with this synthesis, which forms the basis for contemporary value theory. 4

Marshall compared supply and demand to the blades of a pair of scissors because neither concept could ever be separated from the determination of value. He stressed the importance of time in working out an adjustment between the two principles. Marshall maintained that market forces tend toward equilibrium where prices and production costs meet. Utility-demand considerations operate in the limited span of a given market. In the short term, supply is relatively fixed and value is a function of demand. Cost-supply considerations, however, extend over a broader period, during which production flows and patterns are subject to change. Marshall believed that a perfect economic market would eventually result and that price, cost, and value would all be equal.5

Marshall was the first major economist to consider the techniques of valuation, specifically the valuation of real estate. In this regard, his writings and the writings of those who built upon his work are the source of the distinction between value theory and valuation theory, i.e., the method of estimating, measuring, or forecasting a defined value. Marshall anticipated and developed many of the concepts employed in contemporary appraisal practice. These concepts include the determination of site value through capitalization of income, the impact of depreciation on buildings and land, and the influence of different building types and land uses on site value.

Marshall is also credited with identifying the three traditional approaches to value: market (direct) comparison, reproduction or replacement cost, and capitalization of income. Irving Fisher (1867-1947), an influential American economist associated with the neoclassical school, fully developed the income theory of value, which is the basis for the income capitalization approach used by modern appraisers.6

Modern Appraisal Theory

Scholars and business professionals interested in economic thought read the writings of Marshall, Fisher, and other economists of the late 19th and early 20th centuries. At the same time, the field of real estate appraisal was emerging and a few practitioners were gaining experience estimating market value and other kinds of value for properties of various types. In the 1920s and 1930s, several events helped to establish appraisal as a young, but viable, real estate function.

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2.6 The Appraisal of Real Estate - Third Canadian Edition

One motivating force was the introduction of land economics as an academic discipline. Land economics developed from the interrelationship of several disciplines and attracted scholars and students who contributed significantly to real estate and appraisal literature over the next 40 years.\footnote{This influential group included Richard T. Ely (1854-1943), the founder of land economics as an academic subject, Frederick Morrison Babcock (1898-1983), Ernest McKinley Fisher (1893-1981), and Arthur J. Mertzke (1890-1970). Ely, Babcock, and Fisher contributed to the Land Economics series published by the National Association of Real Estate Board (now the National Association of Realtors), which was the first major publication effort designed to provide real estate professionals with current technical information. The first texts in this series were Fisher’s Principles of Real Estate (1923), Ely and Moorehouse’s Elements of Land Economics (1924), and Babcock’s The Appraisal of Real Estate (1924).}

The publication of Real Estate Appraising by Arthur J. Mertzke in 1927 was a significant event in appraisal history. This publication adapted Alfred Marshall’s ideas to develop a tangible link between value theory and valuation theory. Mertzke translated economic theory into a working appraisal theory, helped establish a clear emphasis on the three approaches to value, and explained the use of capitalization rates as indices of security. The pre-eminence of the three approaches to value in the appraisal process was underscored in publications by K. Lee Hyder, Harry Grant Atkinson, and George L. Schmutz.\footnote{Hyder, K.L. 1936. “The Appraisal Process.” The Appraisal Journal. January 1936; Atkinson, H.G. 1936. “The Process of Appraising Single-Family Homes”. The Appraisal Journal. April 1936; and Schmutz, G.L. 1941. The Appraisal Process. North Hollywood, CA: the author.} Their works established systematic procedures for applying the direct comparison, cost, and income approaches. Schmutz presented a model in which appraisal activity leads to a conclusion of value, which was later incorporated into The Appraisal of Real Estate, first published by the American Institute of Real Estate Appraisers in 1951.

Appraisal theory and the language used to describe that theory have continued to evolve. Today’s education requirements are stringent and appraisers make use of many analytical methods and techniques. Applying these methods and techniques to an expanding database presents new challenges and raises questions as to how applicable the valuation model is to actual appraisal assignments, how well it analyzes the forces that affect value, and how accurately it interprets the actions and motivations of market participants.

DISTINCTIONS AMONG PRICE, COST, AND VALUE

Contemporary appraisers make careful distinctions among the related terms price, cost, and value. The term price refers to the amount a particular purchaser agrees to pay and a particular seller agrees to accept under the circumstances surrounding the transaction. A price, once finalized, refers to a sale or transaction price and implies an exchange. In other words, price is an accomplished fact.

Generally the circumstances of a transaction reflect conditions within one or several markets because a property might have demand from more than one market. A market is a set of arrangements in which buyers and sellers are brought together through the price mechanism. A market may be defined in terms of geography, products or product features, the number of available buyers and sellers, or some other arrangement of circumstances.
Chapter 2 - The Nature of Value

A real estate market is created by the interaction of individuals who exchange real property rights for other assets such as money. Specific real estate markets are defined on the basis of various attributes:

- Property type
- Location
- Income-producing potential
- Typical investor characteristics
- Typical tenant characteristics

Other attributes recognized by those participating in the exchange of real property

Examples of specific real estate markets might include new, single-unit residences selling for $250,000 in a well-defined neighbourhood or older apartment buildings located near the central business district and available for renovation.

Many people use cost and value synonymously, but appraisal practice requires more precise definitions. The term cost is used by appraisers in relation to production, not exchange. Cost may be either an accomplished fact or a current estimate.

Costs may be identified with the project phase to which they pertain, i.e., either actual construction cost or overall development cost. Construction cost of components or the entirety normally includes the direct costs of labour and materials, as well as indirect costs such as administrative fees, professional fees, and financing costs. Development cost is the cost to create a property, including the land, and bring it to an efficient operating state. Development cost includes acquisition costs, actual expenditures, and the profit required to compensate the developer or entrepreneur for the time and risk involved in creating the project.

Real estate-related expenditures are directly linked to the price of goods and services in competitive markets. For example, the costs of roofing materials, masonry, architectural plans, and rented scaffolding are determined by the interaction of supply and demand in specific areas. Thus, they are subject to the influence of social, economic, governmental, and environmental forces.

Value can have many meanings in real estate appraisal: the applicable definition depends on the context and usage. In the marketplace, value is commonly perceived as the anticipation of benefits to be obtained in the future. Since value changes over time, an appraisal reflects value at a particular point in time. Value as at a given time represents the monetary worth of property, goods, or services to buyers and sellers. To avoid confusion, appraisers do not use the word value alone. Instead they refer to more specific terms such as market value, fair value, use value, investment value, and assessed value. Market value is the focus of most real property appraisal assignments.


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MARKET VALUE

The concept of market value is of paramount importance to business and real estate communities. Vast sums of debt and equity capital are committed each year to real estate investments and mortgage loans that are based on opinions of market value. Real estate taxation, litigation, and legislation also reflect an ongoing, active concern with market value issues. In virtually every aspect of the real estate industry and its regulation at local, provincial and federal levels, market value considerations are essential to economic stability.

CUSPAP requires that an appraisal report must include a relevant definition of the value found and a citation of the source of the definition. A number of different definitions of market value can be found in a variety of sources, including appraisal texts, real estate dictionaries, professional standards, federal regulations, lease and option-to-purchase agreements, and court and tribunal decisions. Despite differing opinions on individual aspects of the market value definition, it is generally agreed that market value results from the collective value judgments of market participants. An opinion of market value must be based on objective observation of the collective actions of the market. Since the standard measure of these activities is cash, the increases or diminutions in market value caused by financing and other terms of sale are measured against an all-cash value.

The definition that follows incorporates the concepts that are most widely accepted, such as willing, able, and knowledgeable buyers and sellers who act prudently as of a given date, and this definition gives the appraiser a choice among three bases: all cash, terms equivalent to cash, or other precisely revealed terms. The definition also requires increments or diminutions from the all-cash market value to be quantified in terms of cash.

Market Value

The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.

This definition represents the concept of value in exchange, a concept made explicit in the market value definition developed by the International Valuation Standards Committee (IVSC) and used in the International Valuation Standards. These standards define market value as:
Chapter 2 - The Nature of Value 2.9

[T]he 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 after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.\textsuperscript{10}

The general valuation concepts and principles guiding the International Valuation Standards reiterate the concept that market value “reflects the collective perceptions and actions of a market”, not the “preconceived view or vested interest of a particular individual”. The market value basis of valuation of the International Valuation Standards is consistent with other discussions of market value in professional standards.

In addition to the requirements of professional standards, to clarify the nature of value reported, an appraisal report might need to set out the following items:

- Identification of the specific property rights to be appraised.
- Statement of the effective date of the value opinion.
- Specification as to whether cash, terms equivalent to cash, or other precisely described financing terms are assumed as the basis of the appraisal.
- If the appraisal is conditional upon financing or other terms, specification as to whether the financing or terms are at, below, or above market interest rates and/or contain unusual conditions or incentives. The terms of above- or below-market interest rates and/or other special incentives must be clearly set forth; their contribution to, or negative influence on, value must be described and estimated; and the market data supporting the opinion of value must be described and explained.

Although these requirements include non-cash equivalent financing terms within the scope of the market value of appraised property rights, these rights are valued in relation to cash. Increments or diminutions in market value attributable to financing terms are measured against an all-cash standard, and the dollar amount of variance from the cash standard must be reported.

Citable definitions of market value can be found in provincial and federal regulations, laws, or publications. For example, the following definition is from the federal government’s Expropriation Act (R.S. 985 c. E-21):

the value of an expropriated interest is the market value thereof, that is to say, the amount that would have been paid for the interest if, at the time of its taking, it had been sold in the open market by a willing seller to a willing buyer.

A similar definition is contained in the Expropriation Act of British Columbia [RSBC] Chapter 125:

The market value of an estate or interest in land is the amount that would have been paid for it if it had been sold at the date of expropriation in the open market by a willing seller to a willing buyer.

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In addition to the IVSC definition, CUSPAP provides:11

One definition of market value is:

The most probable price which a property should bring in a competitive and open market as of the specified date under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

The definition may be expanded by adding:

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

- buyer and seller are typically motivated;
- both parties are well informed or well advised, and acting in what they consider their best interests;
- a reasonable time is allowed for exposure in the open market;
- payment is made in terms of cash in Canadian dollars or in terms of financial arrangements comparable thereto;
- the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

The intended use of an appraisal dictates which definition of market value is applicable to a specific assignment. Client wishes or instructions do not change the basic requirement that the appraiser must identify an appraisal’s intended use and cite an appropriate definition of market value for that use. Appraisers must understand why a particular definition of market value should be used, apply that definition according to established standards, and communicate these requirements clearly to the clients they serve.

OTHER TYPES OF VALUE

Appraisals of the market value of real property are the most common assignments, but appraisers are also called upon by clients to develop opinions of a variety of other types of value.

Fair Value

When the accounting profession refers to the value of an asset, it uses different terms and definitions; recently, these have been undergoing change. Historically, the accounting profession in Canada and the United States has used the depreciated purchase price for reporting the value of corporate assets for tax purposes and for use in financial statements. Canadian accounting practises followed Generally Accepted Accounting Principles, or GAAP, that for practical reasons were highly standardized relative to those in the United States. In some other countries, entities report

asset values having a basis in the marketplace, pursuant to International Accounting Standards, or AS, (maintained by the International Accounting Standards Board, or IASB). As at 2001, IASB defined fair value as:

The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

For reasons that include improved transparency and consistency, interest in asset accounting based on current value has grown in Canada, accelerated by auditing scandals from 2000 to 2004 involving asset values reported by some publicly traded companies.

In 2006, the Canadian Institute of Chartered Accountants adopted a definition of fair value as:

The amount of the consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act.

This definition effectively harmonized Canadian GAAP with International Financial Reporting Standards (IFRS) with respect to the recognition and measurement of financial assets and financial liabilities. The Canadian accounting profession continued to adopt further IAS policies, which were themselves changing to standardize guidance for financial statements. In May 2008, the IASB issued a policy proposal that defined fair value as:

the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

This definition is very similar to a market value opinion as appraisers have long defined the term. Like market value, fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities. It is not a forced transaction, e.g., a forced liquidation or distress sale. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant who holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date, i.e., an exit price.

Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

1. Independent of the reporting entity, i.e., they are not related parties

2. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
3. Able to transact for the asset or liability
4. Willing to transact for the asset or liability, i.e., they are motivated but not forced or otherwise compelled to do so

The fair value of the asset or liability should be determined based on the assumptions that market participants would use in pricing the asset or liability.

A fair value measurement assumes the highest and best use of the asset by market participants, considering the use of the asset that is physically possible, legally permissible, and financially feasible at the measurement date. The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset, specifically:

1. In use. The highest and best use of the asset in use would provide maximum value to market participants principally through its use in combination with other assets as a group.

2. In exchange. The highest and best use of the asset is in exchange if the asset would provide maximum value to market participants principally on a stand-alone basis.

The real estate appraiser may need to report both values so that the user of the report can make an informed decision.

The International Valuation Standards point out that fair value and market value are not necessarily synonymous in the International Financial Reporting Standards, where market value is used in differing contexts.

**Use Value**

Use value is the value a specific property has for a specific use. In estimating use value, the appraiser focuses on the value the real estate contributes to the enterprise of which it is a part, without regard to the highest and best use of the property or the monetary amount that might be realized from its sale. Real property has both a use value and a market value, which may be the same or different depending on the property and the market. For example, an older manufacturing plant that is still used by the original owner may have considerable use value to that owner but only a nominal market value for another use. Use value may vary depending on the management of the property and external conditions such as changes in business operations. For example, a factory designed around a particular assembly process may have one use value before a major change in assembly technology and another use value afterward.

Use value appraisal assignments may be performed to value assets (including real property) for mergers, acquisitions, corporate financial reporting, or security issues. This type of assignment is sometimes encountered in appraising industrial real estate when the existing business includes real property.

Court decisions and specific statutes may also create the need for use value appraisals. For example, some jurisdictions require agricultural use appraisals of farmland for property tax purposes (i.e., value based on productivity) rather than
USE VALUE, VALUE IN USE, AND INVESTMENT VALUE OR WORTH

The term value in use is often used by appraisers synonymously with use value, but the former term has specific meanings in other contexts, which can cause confusion. The International Financial Reporting Standards defines value in use as "(t)he present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life." This definition is quoted in the International Valuation Standards (IVS) in relation to valuation for financial reporting.

Earlier editions of the International Valuation Standards included a different definition of value in use as part of International Valuation Standard 2: Bases Other Than Market Value, but that definition was recently deleted, eliminating the possible confusion between value in use and investment value or worth. The current definition of investment value or worth is not specifically related to financial reporting as value in use now is in IVS.

Opinions of value based on highest and best use. Some option to purchase agreements in lease documents call for valuation of a property under a specified use (generally that of the tenant).

Use value appraisals often involve limited-market properties, i.e., properties of a type that has relatively few potential buyers at a particular time. Large manufacturing plants, railroad sidings, and research and development properties are examples of limited-market properties that typically appeal to relatively few potential purchasers. Many limited-market properties, such as houses of worship, museums, schools, public buildings, and clubhouses, include structures with unique designs, special construction materials, or layouts that restrict their functional utility to the use for which they were originally built. These properties usually have limited conversion potential and, consequently, are also called specialized, special-use, special-purpose, or special-design properties.

Limited-market properties may be appraised based on their current use or the most likely alternative use. Due to the relatively small markets and lengthy market exposure needed to sell such properties, there may be little evidence to support an opinion of market value based on the current use. If a market exists for a limited-market property, the appraiser must search diligently for whatever evidence of market value is available.

If a property’s current use is so specialized that there is no demonstrable market for it but the use is viable and likely to continue, the appraiser may render an opinion of use value if the assignment reasonably permits a type of value other than market value. Such an estimate should not be confused with an opinion of market value. If no market can be demonstrated or if data is not available, the appraiser cannot develop an opinion of market value and should state so in the appraisal report. However, it is sometimes necessary to render an opinion of market value in these situations for legal purposes. In these cases, the appraiser must comply with the legal requirement, relying on personal judgement and whatever direct market evidence is available and making explanations and disclosures that are relevant and that can fully inform the intended users of the appraisal. Note that the type of value developed is not dictated by the property type, the size or viability of the market, or the ease with which that value can be developed. Rather, the intended use of the appraisal determines the type of value to be developed.
Just as use value should not be confused with market value, it should be distinguished from investment value, discussed next.

**Investment Value**

Investment value represents the value of a specific property to a particular investor. As used in appraisal assignments, investment value is the value of a property to a particular investor based on that person’s or entity’s investment requirements. In contrast to market value, investment value is value to an individual, not necessarily value in the marketplace.

Investment value reflects the subjective relationship between a particular investor and a given investment. It differs in concept from market value, although investment value and market value indications sometimes may be similar. If the investor’s requirements are typical of the market, investment value will be the same as market value.

When measured in dollars, investment value is the price an investor would pay for an investment in light of its perceived capacity to satisfy that individual’s desires, needs, or investment goals. To render an opinion of investment value, specific investment criteria must be known.

**Business Value**

A going concern is an established and operating business with an indefinite future life. For certain types of properties (e.g., hotels and motels, restaurants, bowling alleys, manufacturing enterprises, athletic clubs, landfills), the physical real estate assets are integral parts of an ongoing business. The market value of such a property (including all the tangible and intangible assets of the going concern, as if sold in aggregate) is commonly referred to by laymen as business value or business enterprise value, but in reality it is market value of the going concern including real property, personal property, and the intangible assets of the business. (See Figure 2.1.)

Appraisers may be called upon to develop an opinion of the investment value, use value, or some other type of value of a going concern, but most appraisals of the value of the going concern relate to market value. Due to the nature of the different types of value included, the appraiser should be careful that he or she has the experience and competence to complete this type of valuation assignment. It may be necessary for the real estate appraiser to collaborate with a personal property appraiser or a business appraiser or both on such an assignment.

Traditionally, the term going-concern value has been defined as the value of a proven property operation. The current definition of the term highlights the assumption that the business enterprise is expected to continue operating well into the future (usually indefinitely).
In contrast, liquidation value assumes that the enterprise will cease operations. Going-concern value includes the incremental value associated with the business concern, which is distinct from the value of the tangible real property and personal property. The value of the going concern includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labour, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the property, including both the real property and the personal property attributed to business value (see Figure 2.2).

It may be difficult to separate the market value of the land and the building from the total value of the business, but such a division of realty and non-realty components of value may be required by the intended use of the appraisal. When an appraiser cannot effectively separate the market value of the real estate from its business value, it is appropriate to state that the reported opinion of value includes both market value and business value and that the appraiser has not been able to distinguish between them. Only qualified practitioners should undertake these kinds of assignments, which must be performed in compliance with appropriate CUSPAP standards.

**Public Interest Value**

Public interest value is a general term covering a family of value concepts that relate the highest and best use of property to non-economic uses. Public interest value is driven by social, political, and public policy goals. It is not based on economic principles. Rather, public interest value is based on a non-economic highest and best use.
Public interest value has sometimes been referred to as natural value, intrinsic value, aesthetic value, scenic value, preservation value, and similar terms.

Large amounts of public funds are at stake over what has been a highly controversial issue. Proponents of the public interest value concept recommend a redefinition of highest and best use and market value (to recognize preservation or conservation as a highest and best use), extension of the market concept to include public agencies and conservation groups, and adoption of alternative valuation models. Opponents contend that because non-economic uses are not responsive to market forces, such uses cannot give rise to market value, the basis of which can only be economic highest and best use. They argue that the application of public interest value concepts invariably results in opinions of value that exceed those derived from economic highest and best use analyses. Opponents further point out that government is a different type of market participant, not constrained to follow market economic rules.

The notion of public interest value does have an important potential application when it is defined and applied in public benefit terms. For example, a highway department acquiring private land for a highway might adopt a policy of determining market value of each parcel to be acquired. Then, in the public interest, the highway department determines it appropriate to offer 25% more than market value to avoid potential transaction and litigation costs that would be required in expropriations. This formula would demonstrate that the first 100% was the department's opinion of market value and the last 25% (of the 125% paid) was paid in the public interest rather than directly for market value. Government buildings that have increased security structures that exceed normal market needs are an example of how costs that exceed the normal costs of office buildings may be justified in public interest value terms. These are only two of many examples that may illustrate how the decisions of individual market participants regarding market value differ from the construct and basis of decisions that are made by or on behalf of the public.
Chapter 2 - The Nature of Value

Assessed Value

Assessed value applies in ad valorem taxation and refers to the value of a property according to the tax rolls. Assessed value may not conform to market value, but it is usually calculated in relation to a market value base. Some assessing jurisdictions estimate both an assessed value and a market value.

Insurable Value

Insurable value is the value of an asset or asset group that is covered by an insurance policy. Insurable value may be based on the replacement or reproduction cost of physical items that are subject to loss from hazards. This value is often controlled by provincial law and varies from province to province.

Actual Cash Value

Actual cash value is an insurance concept that refers to the calculation of compensation due in an insurable loss. Strictly defined as replacement cost minus normal depreciation, actual cash value is determined in the courts through a review of legal precedents. A building on a site where market conditions favour redevelopment to a higher and better use might have little actual cash value, even though it has a remaining physical value.\(^{12}\)

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