

A unified methodology in the application of the comparative approach - the necessity of buildings valuations in Albania

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Abstract

As real estate is one of the most valuable assets of any state and any individual, the valuation process takes on a special significance. Valuations are required of different interests in different types of property for different purposes. Among the methods used to determine the value of a property, the simplest and most direct method of valuation is direct comparison. The method is based on comparing the property to be valued with similar properties and the prices achieved for them, and allowing for differences between them to determine the market value. The art of the comparison method is the discovery of relevant data and the subsequent analysis. Comparison can be defined as ‘the act of comparing’ and to compare as “to examine in order to observe resemblances or differences”. As property is unique, no two are truly the same, the problem lies in the adjustment to be made to the comparable to fit the property being valued.

Are known and accepted (within certain limits) the differences in the values reported by different appraisers for the same property and for the same purpose of valuation, but daily contacts with appraisers and appraisals prove that there are significant differences in the reported values. These changes are not simply the result of judgments of different appraisers, but mainly the result of changes in the methodologies used for evaluation.

In this perspective the paper proposes the use of a unified methodology in the application of the direct comparison method in order to narrow such differences. The study includes residential and commercial buildings in the Tirana City.

Keywords: Comparison method, Valuation process, property.

1. Introduction

Albania entered the path of market economy in the early 90s. A novelty of this period was the return of real estate to a marketable commodity. The real estate market in Albania has undergone a dynamic development over the years, responding simultaneously to the economic and demographic trends.

Real estate is the land along with any permanent improvements attached to the land, whether natural or man-made. According to the Albanian Civil Code, the immovable properties are land, water sources and flows, trees, buildings, other land-related floating structures and anything that is firmly and continuously embedded in the ground or building. [3] Real estate represents one of the most valuable assets for both individuals and the state, it is often the most valuable investment a person owns, and the value of the real estate is a key indicator of an economy’s health. For this reason the process of determining the value of properties is of particular importance.

Properties are huge in number. diverse in types, shapes and size, as well as they have different uses. Residential real estate and along with the commercial real estate comprise the two primary categories of real estate property all over the world, and without a doubt, even in Albania. Residential property is any property that is used as, or is suitable for use as a residence. Commercial property is any property used exclusively for business-related

purposes or to provide a work space. Property valuations are needed for many different purposes, mainly for sale, purchase, mortgage, property transfer tax, revaluation, etc., and numerous types of value can apply to any property at one time. The most required in the valuation reports is the determination of the market value, which referring to the European Valuation Standards is “the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller acting independently of each other after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion”. [2] The methods that we use to arrive at the market value are the Direct Comparison Method, the Investment Method, the Profit Method, the Residual Method and the Cost Method. According to the International and European Standards all methods ultimately converge on three main valuation approaches, market approach, income approach and cost approach. [2],[3].

There are known and acceptable differences in the values reported by different appraisers for the same property, at a given point in time and for the same appraisal purpose. The various studies carried out in UK, USA and Australia showed that the acceptable range of valuation inaccuracy fall between +5% and +10% for UK and USA while Australia has +10% and +15%. [4] The daily contacts with appraisers and appraisals in Albania prove that there are significant differences in the reported values.

Studying residential properties and commercial properties, the paper proposes the use of a unified methodology in the application of the direct comparison method, the method used to evaluate the two main types of properties in Albania, as a way to narrow the differences in the reported values and to increase accuracy.

2. Valuation approaches

Valuations are required of different interests in different types of property for different purposes. Given a range of needs, the approach to the estimation of value in one case may well be inappropriate in another and so, over time, separate approaches or methods of valuation have developed. [5]

The variety of the properties, the variety of the interests in a property, the variety of the purposes for which valuations are sought correspond to several valuation methods. The following definitions of the main valuation approaches are set out in the glossary to the RICS Standards: [4]

- *Market approach.* An approach that provides an indication of value by comparing the subject asset with identical or similar assets for which the price information is available.
- *Income approach.* An approach that provides an indication of value by converting the future cash flow to a single current capital value.
- *Cost approach.* An approach that provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or construction.

Underlying each method is the need to make comparisons since this is the essential ingredient in arriving at a market view.

2.1. The market approach or comparative approach

This method is the most used method in the valuation of properties, the genuine market method, which in addition to being a genuine method in determining the market value of the sale of properties that have a market and the market value of rent for properties that have a market renting, is also a procedure within any other method. The Comparative approach (Comparison Method of Valuation) is the most common approach used for the appraisal of residential and commercial properties. This method supports the determination of the value in the direct comparison of the property, object of valuation, with similar properties which have been the subject of the market of sale or rent recently.

The method is based on a similar comparison with similar ones. Each property is unique in itself, so they can never be completely similar. Even if at first glance the properties appear to be similar, close inspection of the properties reveals the fact that they are different.

The key to valuation accuracy is the knowledge of the prices that have been obtained recently for similar properties with which comparison can be made. The art of the comparison method is the discovery of relevant data and the subsequent analysis.

A simple market-based comparison alone is insufficient. Comparison can be defined as ‘the act of comparing’ and to compare as ‘to examine in order to observe resemblances or differences’. As the above definitions suggest, the valuer has to examine resemblances and differences and make appropriate adjustments to reflect these differences. In valuation, these differences can be described as the factors affecting value or the value determinants. [6] The smaller the similarity between the properties being compared, the more adjustments need to be made and the greater the chance of making a mistake. It is clear that various allowances for differences in quality have to be made. The level of the allowance is subjective and requires the expertise of an experienced and knowledgeable valuer. The method is simple in its general approach but is dependent on considerable valuation judgment for its application. [5] The valuer needs a good understanding of the factors affecting the value, which can be grouped as physical factors (geographical and property-specific factors), legal factors (tenure and lease terms) and economic factors (supply and demand, time, risk and return). [6] Because there are many differences in legal, economic and physical characteristics of the assets in other transactions and asset being assessed, it may be necessary the adjustment of price information from other transactions to reflect these differences and any assumption to be adapted in the undertaken evaluation process.

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3. Causes of inaccuracies in the assessment

The valuation can be defined as : “ The art, or science, of estimating the value for a specific purpose of a particular interest in property at a particular moment in time, taking into

account all the features of the property and also considering all the underlying economic factors of the market, including the range of alternative investments”. [7] Valuation could also be defined as “ The art of expressing opinions in a mathematical form in order to arrive at the value of a particular interest in a particular piece of property at a given moment of time”.

The valuation is the process of making judgments and forming opinions. The art is the skill of knowing which information to be used, the science part is the analysis of data gathered and the mathematical calculations of value.

The principal issue in valuation accuracy is standardizing the information set to ensure that all Valuers are equally informed. Valuations are a function of information. The better the information set the better the valuation. If a group of Valuers each have a different view of the market then the distribution of valuations would have a wider variance than those which are based on similar information. The spread of valuations will depend upon the completeness of the information set. In fact it is the difference in interpretation of the information which leads to possible transactions.[8]

Referring to the literature[3], but also the perceptions and opinions of Albanian appraisers, it result that there are several factors that causes of valuation inaccuracy:

- access to market information is difficult
- different expert opinions
- errors in surveys
- insufficient depth of investigation
- use of different methodologies
- client pressure or influence

Most of the factors that affect inaccuracies in the assessment can be eliminated if the appraiser has a good professional training and apply the code of professional ethics.

Albanian appraisers in their daily work are based on European Standards and International Standards of real estate assessment in the absence of Albanian Standards, but the standards define the methods and bases of evaluation and do not specify the methodology to be followed to achieve the value.

4. Application of the comparison method in Albania

Residential real estate along with the commercial real estate comprise the two primary categories of real estate property all over the world, and without a doubt, even in Albania. The comparison method is widely used in Albania in valuing properties of the above categories. The process of determining the value is difficult, as the properties are diverse, as there are countless internal and external qualities and characteristics of the properties as well as the factors that affect the value of a property. The more elements, from the above, are taken into account in the evaluation, the more accurate the value will be. It is impossible for different appraisers to simultaneously consider the same factors and the same characteristics, even if something like this happens, the weight of their participation in the

value is different. In the absence of a methodology which could determine the main factors to be considered in the process of determining the value and the weight of their participation in the value, everything is left to the appraiser, who includes those factors that seem to him most importantly and makes adjustments based mainly on his individual opinion.

4.1. Residential properties

The valuer needs a good understanding of the factors affecting the value, which can be grouped as physical factors (geographical and property-specific factors), legal factors (tenure and lease terms) and economic factors (supply and demand, time, risk and return). [6]. The most common features that an appraiser use to make comparisons are: the address, type and style of property, the age of property, the size of accommodation, the number of bedrooms, the number of garages, or the facility for parking space, the general conditions, any additional features, etc. [9] Attributes which are likely to affect house prices include: physical attributes such as the numbers of rooms, the type of property (detached house, terraced house, etc) and presence of amenities such as central heating, a garage or a garden; location attributes such as the region of the country in which the property is located; and neighborhood attributes in the form of the type of area (e.g owner occupied outer suburb, industrial town, or inner city council estate) in which the property lies.[10]

Based on the above and based also on my personal experience as an appraiser and also based on the Albanian appraiser`s perceptions and experiences, the characteristics that are important and that have to be taken into consideration in comparisons and adjustments are appreciated as the followings: the location, the surface area, the number of rooms, the number of balconies, the age, the property conditions, the flat floor number , etc. According to the previous works, age and quality of building cannot go together as factors that explain differences in value. The assessment of the property conditions automatically takes into account the age, the quality of the building and its maintenance.

I have previously proposed the use of two models for determining the price:[11]

$$P = 40567.1 - 24437.85*L + 622.6*SA + 1278.84*F + 11546.57*C \quad (1)$$

$$P = 77188 - 28678.3*L + 12856.7*NR + 1777.9*F + 10320.4*C + 11777.7*NB \quad (2)$$

Where:

- P* – sales price;
- S* – size of accommodation;
- L* – location;
- NR* – number of rooms;
- F* – flat;
- NB* – number of balconies;
- C* – property condition;

Both models are proposed as suitable for all type of apartment building, whereas the first model was proposed as the most suitable model for the apartments of old buildings. [11]

Such models are not permanent and we have to determine them every time the market changes. The market value of a property is a function of market conditions and the conditions of the property itself, conditions which are constantly changing and therefore the use of a model defined over time would not be very appropriate, or should be the model was first honored and then passed to the calculation, which very few of the appraisers can do. That is why we have advanced with our studies trying to offer simpler ways.

According to a recent study conducted by me regarding the factors that mostly affect the value of residential properties, as of their importance are the Location, the Surface Area and the Conditions. However, there are also some other factors that impact the value in a lower scale such as the Number of rooms, the Flat floor number and the Number of balconies. These last factors can be neglected according to the purpose of valuation or other specifics of valuation and property-object of valuation.[12]

4.2. Commercial properties

Commercial properties include offices and retail spaces (shops). Both types of properties are found either as individual units, or grouped in the so-called Business Center and Shopping Center.

It is found that the attributes of office buildings that are important and have to be taken into consideration in comparisons and adjustments are as following:the location, the configuration, the internal specification, the parking spaces, the exterior specification and the physical depreciation and the model is: [13]

$$R = -17.49+3.93*C+ 2.23*IS + 1.59*PS + 2.13*ES + 3.39*PD-4.71*L \quad (1)$$

Where:

- R* – rent price;
- IS* – internal specification;
- PS* – parking spaces;
- ES* – exterior specification;
- L* – location;
- PD* – physical depreciation;

Recently I have conclude the factors that impact on the value of the rent of shops within a Shopping Center are the shop surface and the position/location of the shop on the floor.[13]

5. Conclusion and recommendations

The differences in the values reported by different appraisers for the same property and for the same purpose of valuation are not simply the result of judgments of different appraisers, but also the result of changes in the methodologies used for evaluation. Albanian appraisers in their daily work are based on the European Standards and the International Standards of real estate assessment in the absence of Albanian Standards, but these standards only define the methods and bases of evaluation and do not specify the methodology needed to be followed in order to achieve the value. Therefore it is necessary to unify the evaluation

methodology to have accurate results. This unification is very important when using the direct comparison method as it is a method where the evaluation process is almost entirely art and there are very few mathematical calculations.

Models are not permanent and they have to be determined every time the market change. The market value of a property is a function of market conditions and the conditions of the property itself, conditions which are constantly changing and therefore the use of a model defined over time would be not very appropriate, or should be the model was first honored and then passed to the calculation, which very few of the appraisers can do.

As an initial step in the efforts to give a unified methodology I recommend:

For residential properties taking into account three factors as essential ones, in every evaluation such as the Location, the Surface area and the Conditions as they are not only essential but they also have a significant impact on the value. The Number of rooms, the Flat number and the Number of balconies, as less important factors and with less impact on value can be neglected according to the purpose of valuation or other specifics of valuation and property-object of valuation.

For office buildings properties, the attributes that are important and have to be taken into consideration in comparisons and adjustments are as following: location, configuration, internal specification, parking spaces, exterior specification and physical depreciation.

For shops within Shopping Centers the attributes that are important and have to be taken into consideration in comparisons and adjustments are the surface of the shop and the location/position on the floor.

All the above can be seen more as an aid for the professional appraisers to enable assessments with the least possible changes. The value is the most likely price to be carried out in the market, while the price itself is the value for which the property changes owners. The price at which a property finally changes hands depends on the degree of interest potential buyer/buyers show in it.

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