

International Valuation Standards and Land Administration

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SUMMARY

International Valuation Standards (IVS) have achieved a leading position in guiding and harmonizing international valuation activities. The core areas of the standards are the assessment of market value in voluntary transactions and in financial reporting. The standards do not directly apply to valuations carried out through national legislations, e.g. valuations done by the authorities, or in compulsory purchase. However, it would be important that the valuations would lead to full and just compensations. The article will discuss how international valuation standards can enhance valuations done by the authorities or in coercive acquisitions, and what kind of expectations and needs e.g. FIG could have to international valuation guidance.

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1. INTRODUCTION

Thirty years ago a third of the world's population lived in cities, now already a half, and the number is estimated to increase to two thirds. Considering that the total number of population is still heavily increasing the urban areas are facing a severe growth pressure. This is seen, e.g. in the increase of slums. The aim of the UN Habitat is to break the growth of slums in twenty years and here also FIG is doing their bit. (e.g. Reuterswärd 2005)

The significance of land management is emphasised along with the growth of the cities but so are also the problems. Land should be efficiently acquired but also the rights of the individual owners should be protected or at least not violated. This leads to the need for valuation, as ownership and use of land are matters of economic value. The needs for valuation are especially emphasised in valuations carried out by the authorities and in coercive acquisitions. The International Valuation Standards are undoubtedly advantageous in valuation but are necessary not adequate to cover the special needs of land management. In such cases FIG may have something to offer.

2. INTERNATIONAL VALUATION STANDARDS

International Valuation Standards (IVS) are maintained and published by International Valuation Standards Committee (IVSC) established in 1981. The present name of the Committee was adopted in 1994. The members of the Committee consist of valuation associations from ca. 50 countries.

The first international standards were published in 1985. Since 2000 the standards have been renewed and considerably developed through financing from outstanding international sponsors. The present standards are maintained in close co-operation with the International Accounting Standards (IAS/IFRS). Along with the EU Degree by which the IAS will become as the basis of the financial statements of EU listed companies the significance of the valuation standards has been remarkably emphasized.

The goal of the IVSC is to offer comprehensive and vigorous standards encouraging international real estate investments and enhancing the vitality of the international market by contributing to the transparency of economic reporting. The aim is to facilitate international real estate transactions and improve the market by encouraging the transparency of economic reports and the reliability of valuations for lending purposes, related not only to transfers of ownership but also to compulsory purchase and taxation. Further, to act as worldwide professional reference and thus assist the valuers in meeting the demand of the international real estate market and the requirements of economic reports, and to produce valuation standards and economic reports that also meet the needs of the newly industrialized countries. The standards represent the accepted or the best policy of valuation business, i.e. the

generally accepted valuation principles (GAVP). The IVS and the national standards complement and encourage each other. In differences between the principles the distinctions and their impacts shall be explained. The standards presume competence and proficiency from the valuers and prompt for supplementary education. (IVS2003)

The standard of 2005 (IVSC 2005) has three actual standards

- IVS 1: Market Value Basis of Valuation
- IVS 2: Valuation Bases Other Than Market Value
- IVS 3: Valuation Reporting

and two valuation applications

- IVA 1: Valuation for Financial Reporting
- IVA 2: Valuation for Lending Purposes

Further, the book of standards contains e.g. an Introduction which presents the general codes of conduct, guidelines for the general valuation approaches and principles, explains the topic concepts, and gives guidelines for special needs through 14 Guidance Notes:

- GN 1: Real Property Valuation
- GN 2: Valuation of Lease Interests
- GN 3: Valuation of Plant and Equipment
- GN 4: Valuation of Intangible Assets
- GN 5: Valuation of Personal Property
- GN 6: Business Valuation
- GN 7: Consideration of Hazardous and Toxic Substances in Valuation
- GN 8: Depreciated Replacement Cost (DRC)
- GN 9: Discounted Cash-Flow (DFC) Analysis for Market and Non-Market Based Valuations
- GN 10: Valuation of Agricultural Properties
- GN 11: Reviewing Valuations.
- GN 12, Valuation of Specialised Trading Property
- GN 13, Mass Appraisal for Property Taxation
- GN 14, Valuation of Properties in the Extractive Industries

The standards have also been published on the IVSC web pages (www.ivsc.org), where they are freely downloadable.

The International Valuation Standards are strongly concentrated on market based valuation, although the requirements of economic reporting are also focal.

”Market Value is the 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.” (IVS2003)

IVS is not an actual textbook explaining the application of specific valuation techniques. Rather it describes what the valuer should do and how to perform in valuation tasks and

reporting. It is greatly a matter of securing the quality of the valuation process. The standards reach out for professionally prepared high-quality, comparable, easily accessible, and reliable reports. As regards to internal logics the standards are placed below national legislation and other regulations, although they may give instructions for e.g. expropriations, at least for those cases where national legislation does not offer specific enactments.

3. EXPROPRIATION RELATIVE TO LAND MANAGEMENT

In societies based on private ownership expropriation of private property for the public benefit has normally been enabled by legislation. It is seen necessary to limit private rights when required for the public good. Otherwise a landowner could use his monopolistic position and block development when refusing of a voluntary transfer of his land, or claiming for an unrealistically high compensation. The landowner may also, for one reason or another, be missing or legally incapacitated. Another reason for expropriation is the need to ensure the efficiency of land acquisition, e.g. when acquiring areas for roads. Prior to the modern data registers and equipment the control of projects encompassing large areas has been very laborious.

Therefore, considerable benefit may be achieved by expropriation in land policy implemented by the authorities. Except for an increase in the efficiency of the measures, expropriation might also be used for acquiring the land required for urban development to public ownership in advance, so the land would be available when needed. Planning would be easy when planning public land. Land increment could also be obtained as public good, as the land would be acquired before its value is increased due to construction expectations. On the other hand, increment could possibly be restrained by assigning land favourably to the users. Virtanen (1988 and 2004) refers in addition to neutrality, expertise and reasonable rapidity as the benefits of expropriation.

However, expropriation is normally not the primary method for land acquisition, but presumes that the land acquisition has not been possible in any other, i.e. voluntary or less injurious way. This means, for example, that land readjustment has to be used instead of expropriation if it fulfills the objectives desired. Further, it is stated in some countries that expropriation shall not be used if the inconvenience for private outweighs the public advantage. (See e.g. Kalbro 2001 p. 14 ; Viitanen 2002)

In practice, expropriation is not a widely used method in land acquisition. One of the frequently stated reasons is the complexity of the process, long duration and expensiveness, i.e. the inconvenience of the process (e.g. Larsson 1997). Considering the provisions set for expropriation, it is easy to see that the process may function rigidly. On the other hand, there are countries where it has been made rather well functioning. This means that there are potentials for beating the process difficulties (see Viitanen 2004). Another stated reason is the disfavour of the method, interference with private ownership by compulsion is not considered appropriate. It is the ultimate alternative. The political decision-makers seem to fear the drop of their popularity if they are in favour for resorting to expropriation. One of the reasons may be the actual problems with compensating the losses of the persons coming in for expropriation. Further, there are other means for advancing the implementation of urban land,

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such as various taxes and charges or their deductions, credits and subsidies, and agreements and counseling.

4. EXPROPRIATION REGARDING THE PROPERTY RIGHT OWNER

The critical point concerning expropriation may be the question of compensation. Will the compensation statutes, valuation methods and manners really lead to full and just compensation? The rules for compensation depend on the legislation in each country. The main idea seems to be that the property right owner's financial situation shall remain the same despite the expropriation. No one should be poorer because of expropriation but also not richer. However, only economic values will be compensated but non-economic not. On the other hand, there is no strict rules that the owner has to be able to purchase a similar property for the same price as compensated although the basic idea of compensation strives to this, and normally this can even be excepted. (e.g. Wiiala 1966 p. 22, 56; Hyvönen 1998 p. 407-410)

The full compensation shall cover the objective value (market value) of the expropriated property, the depreciation of the value of the retaining property (severance), and other damages and costs which will weaken the financial situation of the expropriated owner (e.g. Wiiala 1966; rather similarly Denyer-Green 1998). The compensation for the property can also be calculated as a difference of the value of the property before and after the expropriation.

The main rule for the assessment of compensation for the property acquired is the market value (e.g. Denyer-Green 1998 p. 175; Kalbro 2001 p. 15). The basic valuation method is the sales comparison method, although the income method and in certain situations with no market activities the cost method may also be used. Norell (2001 p. 131 ff.) intercedes, in addition, the market simulation method. This seems to mean that guidance in the international valuation standards would be very practical in determining compensations. However, rather serious discredit to the applicability of the market value methods to determining compensations has been shown. It is claimed that the use of purchase prices systematically leads to too low values (Werin 1978 and 1982 in Kalbro & Sjödin 1993). According to Lind (1997) especially when the compensation is based on prices during a low cycle the compensation may be so low that the expropriated owner is not able to buy a similar property with the compensation but will suffer a loss. Also Norell (2001) suggests that when determining fair compensation there may be justification for using a certain margin of safety in relation to an amount estimated by conventional valuation methods. (See also Viitanen 2002; Larsson 1997)

In addition to methodical reasons there are grounds for bringing out some basic principles for determining a compensation. The general conditions for compensability state the circumstances where the liability to compensate arises and who has the liability. According to Virtanen (1988 p. 136) the following requirements have to be fulfilled in order to pay compensation:

- Economic principle

- The loss must be economic, sentimental values are not compensated.
- Luxury value may be compensated.
- Causality principle
 - The loss and the implementation of the expropriation project must have an acceptable causal connection.
- Legality principle
 - Interests protected by law are only compensated.
 - Berry picking based on "everyman's right", for example, is not compensated.
 - Compensation is paid only for such a way of use, which is permitted by the law.
 - Somebody has to be liable to compensation.
- Interested party principle
 - Entitled to compensation is only the party concerned.
- Logicality principle
 - The hypotheses and argumentations related to the compensation must be consistent.
- Probability principle
 - Should the compensation be determined on the basis of anticipated development, this shall be probable
 - Compensation must not be based on hopes or groundless arguments.
- Ascertainability principle
 - The loss must be clearly ascertained.
 - Minimal losses are not compensated.

Further, the compensation must be based on what the conveyor loses, not on what the expropriator gets.

Many of these principles may lead to problematic situations. In many countries the registration of the proprietary rights and usufructs is still rather uncertain and the various licenses are poorly documented or the need for such licenses is poorly understood among the citizens. For example, within the so-called informal settlement the compensations would remain totally non-paid. Practical examples also show that compensations are not always paid or their payment is delayed e.g. due to the expropriator's lack of money. People lose their dwellings and even their living necessities, i.e. their cultivated parcels, without being able to buy new ones. There are also regions where new viable pieces of land are not available, even though the compensation is paid. There is no supply and no functioning market (see e.g. Ndjovu 2003). In situations like these expropriation based on compensation in money seems not to be applicable, but methods adaptable to the circumstances are required.

5. CONCLUSIONS AND RECOMMENDATION

Although expropriation may contain many favourable aspects and it is a necessary tool in some cases it also relates to many problems. One of these is the determination of full and just compensation. The Valuation Standards of the International Valuation Standards Committee technically give very good initiatives for proper valuation approach also in expropriation situations, especially when the compensation is based on market value. Market value as the basis of compensation, however, relates to certain serious weaknesses, which at the worst may lead to the loss of proprietary and possessory rights at no compensation or at insufficient compensation. On the individual level this may be a tragedy. To these issues the IVS have no answers.

During the past years FIG has given many guidelines and recommendations, which are in favour of better land management and sustainable development (e.g. Marrakech Declaration 2004). Expropriation and the related determination of compensation seem to be an area, which is very closely linked with land management, land development, creating an effective infrastructure, and guaranteeing access to land, but where methodical and practical guidance seems to be small. FIG has at least three commissions directly involved with guidances on expropriation. These are Commissions 7 to 9 (Cadastre and Land Management, Spatial Planning & Development, Valuation and the Management of Real Estate), and Commission 1 (Professional Standards Practice) as the coordinator of general affairs. In my opinion FIG should also take an active attitude towards this issue and Commission 9 make an initiative proposal for furthering the case.

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BIOGRAPHICAL NOTES

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