CVSRTA Registered Valuers Association

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Dear Members,

CVSRTA RVA is glad to publish **Draft Valuation Standards for Valuation of Rights in Immovable Property (Land & Building)**

Valuation Standards are prepared in collaboration with the Centre for Valuation Studies, Research and Training Association, Mumbai.

We request you to provide your comments and suggestions for bringing more clarity and for adoption of this standards in practice with ease.

Please send your comments and suggestions to cvsrtarvo@gmail.com by **31st Augest 2024.**

Sunitkumar Gupta   Date : 14.06.2024

MD & CEO

DRAFT 1.1

STANDARDS FOR VALUATION

OF

RIGHTS IN IMMOVABLE PROPERTIES

(REAL ESTATE OTHER THAN AGRICULTURAL LAND, TEA-COFFEE-RUBBER PLANTATIONS AND FORESTS)

My Promises to ***deliver…***

Prepared by

CVSRTA
Registered Valuers
Association

in

collaboration

with

Centre for Valuation
Studies, Research &
Training Association

First Edition June, 2024

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To error is human. Improvement is a continuous process. Therefore, any mistake, error or discrepancy noticed may be brought to our notice, which shall be taken care of in the future editions.

Centre for Valuation Studies, Research & Training Association, India

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Note : Brief profiles of members of Standards Committee are given at the end of this document.

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Nelson J. Macwan

Secretary
Centre for Valuation Studies,
Research and Training Association

STANDARDS FOR VALUATION OF RIGHTS IN IMMOVABLE PROPERTIES (REAL ESTATE OTHER THAN AGRICULTURAL LAND, TEA-COFFEE-RUBBER PLANTATIONS AND FORESTS)

DEVELOPED BY

CVSRTA REGISTERED VALUERS ASSOCIATION

In collaboration with

CENTRE FOR VALUATION STUDIES, RESEARCH AND TRAINING ASSOCIATION (CVSRTA)

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PART – I : VALUATION STANDARDS

OBJECTIVES AND APPLICABILITY OF THE STANDARDS

CVSRTA has done pioneering work in imparting education in the disciplines of valuation of real estate (other than agricultural land, tea-coffee-rubber plantations and forest) as well as plant & machinery as they introduced the first full time courses in India on Valuation of Real Estate and ~~the first course in~~ Valuation of Plant & Machinery first of its kind in the world at Sardar Patel University, Vallabh Vidyanagar, Gujarat State in 1994. ~~and~~ Thereafter, ~~they~~ CVSRTA helped Shivaji University at Kolhapur, Maharashtra State in the introduction of the first distance learning course in valuation of real esate in the year 2008.

The objective of these standards is to make improvement in the current valuation practices by enhancing the level of professionalism.

There are no universities offering undergraduate courses and a very few universities are offering Post Graduate courses in valuation to qualify as valuers of real estate. Moreover, there is a tremendous dearth of faculties for teaching the core valuation subjects. This situation is insignificant in the present context in a large country like India and therefore there is a dire need for standards in the subject area.

Two peculiar issues that the Indian Valuers have to encounter are:

(i) ~~the~~ unauthorized construction
(ii) unaccounted money or parallel economy.

In our country, land and building method or summation method of valuation is widely used in which the depreciation is considered only for wear and tear of construction. The drawback in this method is that it does not take into consideration technological, functional and economic obsolescence, demand and supply. In order to make a property marketable, consideration of the cost to cure is very important. The standard 8 on cost approach covers this vital aspect.

Supreme Court of India and several High Courts have in many cases held that the guideline value as per Stamp-duty Departments of various States do not satisfy the criteria of willing buyer and willing sellers.

The Stamp duty valuations which are not scientific are prescribed under the valuation policies framed by the banks, property taxation and many fiscal statues including the Income Tax Act where value of property is required.

As the principles of valuation laid down under the various State Stamp Acts require improvement, Guidance Note 1 highlights the shortfalls in the principles of valuation laid down under the Stamp Acts of Gujarat, Andhra Pradesh, Karnataka, Kerala, Tamil Nadu & Maharashtra.

It is also note-worthy that the Acts promulgated by various State Governments for regularization of unauthorized construction are also held by the courts to be constitutionally valid.

In view of the prevalent scenario in India, these Valuation Standards are framed along with Guidelines for <u>application only to specified tangible assets but not for liabilities</u>. There may, however, be exceptional circumstances that will result in assets actually becoming a liability at the end of their lives and the value in hands can be a liability.

By setting out concepts, principles and procedures generally accepted internationally having regard to legal framework and practices prevalent in India, the purpose of these standards is to ensure transparency and uniformity in the execution of valuation assignments by establishing requirements for valuers and thereby increase public trust in valuation profession.

In order to ensure a common understanding, the glossary of terms useful in practice has also been included. Some terms, though not specifically used in this document, are included in the glossary as these may have to be referred to while conducting assignments.

While bringing independence, objectivity and transparency in valuer's approach is an integral objective of these standards.

These will be periodically reviewed, and modifications will be made to meet future requirements. These standards will certainly be useful for practitioners and users of tangible asset valuation services.

Mumbai
14th June , 2024

Rashmi K. Gandhi
Chairman

GLOSSARY OF TERMS

- **Book value:**
  It is the original cost of an asset after providing the depreciation for the period of use (as per the policy adopted by the company – by straight line method or diminishing balance method or any other method) as shown in books of account of the owner of the asset. It is accountant's method of indicating value of the asset after deducting depreciation in the books of account.

  In case of assets which is in use even after claiming 100% depreciation they are shown generally with book value of ₹ 1/-

- **Break-even point:**
  The level of operation of an enterprise at which gross income equals the sum of expenses incurred to keep the concern going.

- **Break-up Value:**
  When any running unit or an enterprise is closed down and sale of each individual asset is envisaged or planned separately, it is termed as break-up value of the property. Value of each asset is estimated separately in isolation of the other asset.

- **Bundle of rights in an asset:**
  The concept is of comparing asset ownership to a bundle of sticks with each stick indicating a distinct right of the asset owner, e.g., right to use, to sell, to give it on leave and licence, to lease out, to mortgage, or to choose to exercise none of these rights or to execute all the rights. The loss of any one of these rights could alter the value.

- **Capital assets:**
  Assets of permanent nature capable of generating income e.g., land, building, machinery, equipment, cash, receivables, inventories, current assets and the like

- **Cash flow analysis:**
  An analysis of anticipated movement of cash in or out of a business.

- **Cost:**
  The term "Cost" admits of a wide variety of application and assumes different senses in different uses or contexts as hereinafter explained. It represents the actual expenditure to create/manufacture.

  In case of real estate, the cost of land, material, labour, entrepreneurship etc. enter into cost of the product. In absolute terms it is a measurement of the expenditure necessitated to produce the product. This cost may not be the same that the prospective purchaser would be willing to pay. Thus "Cost" is a term used in relation to production and not exchange.

- **Direct cost:**

  It means expenditure for the labour and materials necessary to construct a new asset. Direct costs are also called the hard costs. A contractor's overhead and profit are generally considered hard costs.

- **Indirect cost:**

  It means expenditure for items other than labour and material. Indirect costs include administrative costs; expenses incurred by the owner for professional fees, financing, taxes, interest and insurance during construction. Indirect costs are also called soft costs.

- **Depreciation**

  Types of depreciation.

  - Depreciation due to wear and tear (physical depreciation).
  - Depreciation due to technological obsolescence.
  - Depreciation due to functional obsolescence.
  - Depreciation due to economic obsolescence.

  Physical depreciation: This is common form of depreciation. This is due to normal wear and tear and usage of the asset. All similar objects do not observe similar depreciation. Quantum of this depreciation depends on several factors as given below:

  (i) **Manner of usage:** If the property is properly used, it will observe normal depreciation but if property is used ignoring basic principles for its usage, it results in higher depreciation. We find that well maintained building has longer life span than the building which is subjected to negligence in repairs and maintenance for years.

  (ii) **Environmental aspect:** A building on sea shore deteriorates faster than the building away from sea shore. Similarly a factory building in chemical zone would wear out faster than the factory in engineering zone.

  (iii) **Natural force aspects:** Natural calamities like earthquakes, cyclone, tsunami or monsoon flooding, lead to sudden damage to property. Even otherwise these forces contribute to higher depreciation and higher wear and tear to the buildings.

  (iv) **Accidental aspects:** Serious damage is caused to the buildings due to fire, defects in structural design, bad quality of construction, these even lead to collapse of the structure. Even due to war or riot or bombing on the structures, serious damage to buildings is caused.

- **Economic life:**

  The period of steady return after which it is uneconomical to use a particular asset.

- **Eminent domain:**
  The superior right that resides with the government enabling it to take over private property for public purpose on the payment of compensation as per legal provisions.

- **Encumbrance:**
  Mortgage, tax, dues, charges, restriction, easement, reservation or similar covenant whether arising out of legal or contractual obligations or judicial pronouncements but not lien as such.

- **Effective age:**
  Age indicative of the condition of utility of an asset. This is usually limited to physical life or can be a reference to age within an economic life.

- **Equity-debt ratio:**
  It is the ratio of capital invested to debt incurred in acquiring an asset.

- **Evaluation:**
  A study of nature, quality, or utility of an asset in which value estimate is not necessarily required.

- **Foreclosure:**
  Mortgagee exercising his right by due process of law and forcing sale of the mortgaged asset to recover loan which mortgagor has defaulted.

- **Functional utility:**
  It is the capacity of an asset to be useful and to execute activity for which it is built as per prevailing market tastes and standards.

- **Highest and best use:**
  The utilisation of a property to its best and most profitable use. Highest and best use must satisfy four criteria viz., physical possibility, legal permissibility, financial affordability, and maximum profitability which result in highest property value.

  Inherent factors in determination of highest and best use of real estate are:
    - Time
    - Location
    - Market demand
    - Legal right to develop
    - Topography/resource quality of site
    - Technological feasibility
    - Financial or economic feasibility
    - Public utilities

- **Time:**
  The time factor is probably the most significant, especially in this era of governmental controls and regulations, and is related to many of the other factors. It is the foundation factor in the study of the highest and best use of real estate.

The relative importance of the time factor can be illustrated by the following example:

> In case of property development, the time when finance is available to buyers is the most appropriate time to develop the land.

- **Location:**
  The importance of the location factor is, generally, self-evident. If an industrial site is to be developed to its highest and best use, it must be located near a place of active labour supply where utilities must be available, and transportation facilities - both for manpower and goods - must be easily accessible. In many cases, truckage facilities are most important and necessary.

- **Market demand:**
  Analysis of market demand is necessary to determine whether the proposed use is "reasonably probable" given the supply and demand.

  In order to come to the conclusion of demand potential, the following study is necessary:
  - Market research for demand of product
  - An inventory of the project under construction
  - Population (workforce)
  - Tax savings
  - Industrial assistance
  - Legal right to develop
  - Public and private legal restrictions regulate the use of assets. This may be explained by the following categorization:

Public regulations	**Private regulations**
- Zoning regulation	- Deed restrictions
- Environmental law	- Easements
- Building code	
- Sub-division regulation	
- Compulsory acquisition for public purpose	
- Reservation for lower income group at subsidized rate	
- Rent control	

- **Legal right to develop:**
  There must be legal right to develop the property.

- **Topography/resource quality of site:**
  - **The following factors are also relevant ~~to be considered~~ in the realm of highest and best use of assets:**

- **Technological feasibility:**
  If the project takes too long a time to complete, its cost will overrun and it may not be within minimum quality requirement nor considered to be technologically feasible. There are following basic constraints that define why the project will not be feasible.

These are:

- Physical,
- legal,
- safety,
- materials and supplies,
- financial,
- crew and
- management.

Note: These constraints, even if curable, may not be economically viable.

- **Financial or economic feasibility:**
  It is based on whether the proposed project will attain a cash flow of sufficient quantity, quality and duration to allow investors to recover the capital invested and expected rate of return.

- **Public utilities:**
  All properties must have water, sewage disposal facilities and abundant supply of power.

➢ **Internal rate of return:**
It measures performance of an investment. It is the rate of return on capital that is generated or capable of being generated within an investment over a period of ownership. This is similar to yield rate.

➢ **Intrinsic value:**
The inherent worth of an asset.

➢ **Investment analysis:**
It is a study showing relation of price paid for purchase of assets with expected future benefits.

➢ **Investment property:**
It constitutes business enterprise comprising all tangible and intangible assets acquired for earning profit by way of regular annual income and/or capital gain.

➢ **Investment value:**
The value of property to a particular investor, or a class of investors, for identified investment objectives. This is a subjective concept that relates specific property to a specific investor or group of investors with identifiable investment objectives and/or criteria.

➢ **Investment yield:**
It is a gain from investment made in any asset which is expressed as an annual percentage which includes all of the income and the capital gain or loss from sale. In other words, it is Internal Rate of Return.

- **Law of decreasing return:**

  The logic which indicates that any additional expenditure beyond a certain limit will not produce a return commensurate with the additional investment.

- **Law of increasing return:**

  The logic which indicates that larger amounts of factors of production produce more income to a certain point.

- **Leverage:**

  A technique used by investors to enhance the return on their equity. They buy the property by investing small portion of their own money and the balance is borrowed. They mortgage the property to secure the capital. In other words, it is the effect of borrowed capital upon the rate of return on equity investment.

- **Life**

  In determining total life of the building valuer should consider following aspects viz.

  - Materials used in construction
  - Workmanship
  - Usage of building
  - Soil strata/foundation depth
  - Weather conditions etc.

  Materials used in building may increase or decrease total life of the building. Building made out of stones lasts longer than building with steel or timber. Steel corrodes and reduces life. Wood is damaged by white ants. However, in earthquake prone zones, earthquake resistant R.C.C. framed structure has longer life than stone built structure.

  Good workmanship enhances life of the structure. Poor workmanship and out of plumb structure reduces life of the building.

  Proper maintenance and upkeep of the building and timely structural repairs of the building enhances life of building.

  Excessive usage of building increases wear and tear. Excessive wear and tear reduces the life of the building.

  Heavy vibrations within factory building reduces its life. Vibrations close to structure on account of heavy railway traffic or truck traffic also reduces life of the building.

  Design and foundation criteria of building also would increase or decrease life. Building foundations at shallow depth and in poor soil strata may cause settlement of structure and reduce life of the building. High rise R.C.C. framed buildings which are not designed with earthquake resistant features like shear walls and special footings, may have reduced life in earthquake prone areas.

  Weather conditions also affect life of the building. Building along seashore has high corrosion effect due to salty air and high humidity. Region having high rain fall also have reduced life of the building.

Poor soil like muddy or creek land or black cotton soil calls for specially designed foundation. If such foundations are not provided, building develops structural cracks due to uneven settlement and life of building is reduced.

There are following types of life of the building.

(i) Economic
(ii) Physical
(iii) Life due to legal constrains

(i) **Economic life** is the actual service life of the building. Well maintained building has more or less same years of economic life. Nevertheless, bad or neglected maintenance and excessive wear and tear reduces economic life of the property. Economic life of an R.C.C. framed building is normally considered to be 60 years. Economic life of a building indicates life of a building which is economic to use; where cost of repairs is not prohibitive.

(ii) **Physical life** of the building is the actual survival life of the building before it collapses. It may be either more or in some cases even less than the planned life of the building.

In case of old buildings which are in good structural condition and which have already outlived their planned life (Say 60 years), yet, total physical life is adopted for the purpose of depreciation. If the building is 80 years old, its total physical life is adopted at 100 years, estimating 20 years as future life of such good building.

Bad workmanship, use of inferior materials, careless alterations and over loading of structures reduce physical life. In some cases accidents like fire, explosion, earthquake, flood damage causes total collapse of the structure much before its planned life. On the other hand it is not uncommon to see palaces having 200 years and temples made of stone having 400 years or even more physical life.

(iii) Life due to legal constrains

Life of building in some case depends on legal constrains. The building with 60 years life may be erected on a leasehold land which has only 30 years lease period. As per terms of lease on expiry of lease period the building is to be demolished and open land is to be handed over to the lessor. Income from building would cease after 30 years. Valuer in such a case has to adopt total life of building as 30 years only even though its economic and physical life may be 60 years.

- **Life interest/Life estate:**

An interest in a property like occupancy or control limited to the life-time of a person other than owner and is terminated on the death of the designated person. It is also known as life tenancy.

- **Obsolescence:**

  Decline in value due to new inventions, changes in design or demand, improved methods of production, change in legislation and taste and preference of consumers. It may be technological, functional or economic.

  Chawl with common toilet are best example of obsolescence. In modern time people like self-contained tenements and not premises with common toilet. Individual small shops design may become obsolete in Metropolitan towns having shopping malls. Residential buildings in Industrial Zone and industrial building in Residential Zone become obsolete due to user restrictions although its economic life as well as physical life may be more.

- **Obsolescence - Economic:**

  An industrial building existing on a plot in commercial zone is an excellent example of economic obsolescence. Highest and Best use of land and building is not made. As the building is put to inferior usage of industrial instead of commercial user it results in an economic loss. Higher depreciation in such case is absolutely necessary.

  Policy of government to permit 100% T.D.R. over and above permissible F.S.I. on certain types of lands, resulted in severe economic obsolescence of the buildings. Several developers demolished even 20 years old building in good and sound condition for optimum use of the plot.

  Dilapidation of a building or heavy structural repair cost for a building is also example of economic obsolescence. The structure becomes uneconomic to maintain. Due to dilapidation, repair cost becomes prohibitive. Similar situation arises when rental value of premises in a particular locality falls severely either due to bad neighborhood or due to migration of population to buildings in newly developed towns having better amenities.

- **Obsolescence - Functional:**

  The buildings which have become outdated mainly due to their planning and designing and being unsuitable for current requirements are good examples of functional obsolescence. An old palace becomes obsolete for usage as there is no demand for such palaces in the market though they are in good structural condition. Due to the functional obsolescence many of such palaces have been converted to hotel users for which there is a high demand and usage in the market.

  Old chawl buildings with common toilet blocks is yet another excellent example of functional obsolescence. Such buildings are outdated in planning and design. Now-a-days people require self-contained tenements and flats. Today’s trend of constructing new shopping Malls and Multiplexes is likely to make present shopping centers and single screen theatres obsolete in a few years’ time.

- **Obsolescence - Technological:**

  The load bearing buildings with thick walls are now-a-days usually not preferred in urban areas. Now there is a trend to live in high rise R.C.C. framed buildings having thin partition and external walls. This is now possible due to technological advancements. Timber structures are also now replaced by R.C.C. framed or steel framed constructions. Wooden windows are replaced by aluminum windows. Due to modern technologies, new building materials and planning concepts have made it possible to design and erect even intelligent buildings.

- **Reproduction cost, Replacement cost and Reinstatement Value**

  As these words are many times used interchangeably, it is necessary to thoroughly understand the meaning of each one.

  - **Reproduction cost** - the cost of construction, at current prices, of an exact duplicate or replica, using the same material, construction standards, design, layout and quality of workmanship, and embodying all of the deficiencies, super adequacies, and obsolescence of the subject building. When depreciation is deducted then the resultant amount is called Depreciated Reproduction Cost.

  - **Replacement cost** – the cost of construction, at current prices, of a building having utility equivalent to the building valued but built with modern materials and according to current standards, design and layout. This is Replacement Cost New (RCN). When depreciation is deducted from RCN the resultant amount is called depreciated replacement cost.

  - **Reinstatement Value is synonymous of Replacement Cost New.**

- **Secured loan or advance as defined in clause (n) of Section 5 of Banking Regulation Act, 1949**

  "a loan or advance made on the security of the assets the market value of which is not at any time less than the amount of such loan or advance".

- **Useful life (sometimes referred to as normal useful life):**

  (a) the estimated period over which a depreciable asset is expected to be economically used, or the benefits represented by the asset are expected to be economically derived, in the business of the entity.

  or

  (b) the estimated total service, expressed in terms of production units that is expected to be economically obtained from the asset when employed in the business of the entity.

- **Distress Value:**

  Value of a property offered for immediate sale by its owner, who is under legal compulsion for immediate recovery of legal dues from him. The sale under this situation is called distress sale of the property. There is absolute urgency to liquidate assets. Owner may be in financial difficulty due to which he has been unable to meet legal or social liabilities. This value is quite often lower than market value of the property.

- **Forced Sale Value:**

  Forced sale value is an estimate of the gross amount that the tangible assets would fetch when the seller is forced to sell the assets compulsorily without proper marketing time / exposure time. There is an urgency to sell and the seller does not have control of sale process (generally sales by the banks/ courts/receivers, etc.).

  Note: So far as price obtainable in the forced sale condition is concerned, it is very difficult to predict because one is attempting to define a moving target. Is forced sale the one which is expected to take place within 3 months, 2 months, 1 month, 1 week or 1 day?

- **Going Concern Value:**

  It is an estimate of the price of the running business of an industrial or commercial establishment, in an open market, with its all tangible and intangible (including Goodwill) assets as well as all liabilities of the enterprise on the date of valuation. It is an estimate of the business assets as a whole block and the pre-condition is that the business unit must be profit- making and a running unit. It is also assumed that the unit will continue to operate in future i.e. continued use of all assets. Total break-up value of each individual asset of the enterprise plus goodwill value of the business may or may not be same as the Going Concern Value of the enterprise.

- **Liquidation Value - orderly:**

  It is an estimate of the price that would be realized by putting up the property for auction sale in the market. The sale under public auction is carried out after proper advertisement and due publicity. Such auction may be under an order of the Court or under provision of a statute. But it is generally a case of sale by unwilling seller and willing buyer. The enterprise may be a running unit or a closed unit. If adequate time (which is less than required as per market value definition) is given to liquidate the assets, it is known as Orderly Liquidation Value.

- **Insurable Value**

  The value of assets at which they are considered to be insured. The value may be subject to provision in the policy.

- **Special Value**

  Certain property may command an excellent location in highly developed area or enjoying unique advantages not enjoyed by any other property. Due to prime location and absence of supply of any other similar property in the vicinity, the said property will be sold at premium i.e. at a fancy price. This is the monopoly value or a special value due to its unusual and peculiar advantages.

- **FSI/FAR**

  The terms FSI (Floor Space Index) and FAR (Floor Area Ratio) are often used interchangeably, representing the same concept. Both refer to the ratio of the total built-up area permitted on a plot of land to the area of the plot itself.

VALUATION STANDARD 1 (VS 1)
COMPETENCE OF VALUERS AND SCOPE OF WORK

COMPETENCE OF VALUERS

1.1 Valuers of real estate having requisite academic qualifications and relevant experience can carry out valuations and provide such service for a fee or eligible to practice as a valuer under any lwa for time being in force.

1.2 The Valuer must possess sufficient knowledge and expertise while accepting valuation assignments. Valuer shall also disclose past, present or foreseeable future relationships, either with the Client or the asset to be valued, that could lead to or be construed as possible conflicts of interest, and the same shall be disclosed while accepting an instruction to carry out valuation.

1.3 The Valuer shall ensure that he has sufficient knowledge, experience and competence to complete the assignment in accordance with these Standards and generally accepted valuation principles.

1.4 The Valuer shall maintain the identity as an Independent Valuer. An “Independent Valuer” shall be one who has no, either directly or indirectly via partners, co-directors or close family, significant financial interest in the client company or vice versa and who has additionally no fee-earning relationship in the past three (3) years or at present, other than the valuation fee, and has disclosed in writing any involvement past or present with the subject property(ies) or interested or connected parties over the previous three (3) years. Valuers preparing valuation reports under any regulatory framework shall ensure that they meet the definition of an “Independent Valuer” as defined under applicable regulatory framework and shall give a declaration to such an effect.

1.5 A Valuer shall not accept an instruction to carry out a valuation of assets if his or her firm is involved in the sale or purchase of the assets, in any capacity within one (1) year of the completion of the sale or purchase.

1.6 The Valuer shall disclose any past, present or foreseeable future relationship with either the property to be valued or the Client that may lead to or be construed as possible conflict of interest.

1.7 The Valuer shall also ensure that (s)he meets any other legal or regulatory requirements, which may be required by the Client or their advisors.

1.8 The purpose of this Standard is to ensure that only Valuers who have sufficient knowledge, technical skills and expertise to complete all aspects of a valuation competently shall carry out valuations. For those who are unable to meet these criteria, after proper disclosure in the scope of work, they should seek the assistance of specialists (or other such qualified valuers and/or experts depending on the nature of assignment) who possess sufficient knowledge, experience and competence, and would thus meet with the needs or requirements of the Client.

The “other legal or regulatory requirements” are those which may be required by the Client in accordance with the uses to which the valuation report may be put or that is legally required.

SCOPE OF WORK

1.9 The terms of reference must have clarity between the valuer and the client on the following points, amongst others:

- Purpose and intended use of valuation;
- Effective date of valuation opinion;
- Basic issues of identification of the assets and its relevant characteristics, identification of rights, title and interest, inspection of assets, applicable basis of value and valuation;
- Information to be furnished by the client;
- Members of team with their qualifications, and nature and extent of reliance on any other expert for any specific aspect of the assignment;
- Fees and duration of the work;
- Disclosure of any connection or previous involvement of the valuer with the client or the subject assets that could limit the valuer's ability to provide an unbiased valuation.

In certain cases where the scope of work may change during the course of the assignment, the necessary changes should be informed to the client at an appropriate time before completion.

VALUATION STANDARD 2 (VS 2)
INSPECTION, DATA COLLECTION AND ANALYSIS

2.1 Proper inspection and collection of data are the pre-requisite of any valuation exercise.

Valuers are expected to carry out an adequate inspection and referencing of the property which is to be valued, to collect and to collate all relevant data about the property to enable them to estimate proper value of the property under consideration.

2.2 The Valuer or his Designated Assistant shall carry out the following inspection:

(a) The Valuer or his Designated Assistant shall inspect the property. Details such as title number, survey number, coordinates at entrance of the property, Taluka, District, State and address must be noted.

(b) While the Valuer is not expected to undertake a structural survey, he is required to draw attention to any visible major defects, which are obvious from visual inspection.

(c) He must also ensure, in the inspection of buildings, that an internal as well as external inspection is carried out and details as are visible from inspection, such as use, accommodation, building construction, installations, state of repair of buildings and such installations, amenities and services are accurately reported.

In the event that an internal inspection of the building is not possible, the Valuer must state this clearly in the valuation report and that his valuation is subject to such limitation.

(d) Where the Valuer does not himself inspect the property, he must be familiar with the locality, the type of property and the relevant market condition to enable him to satisfactorily verify his Designated Assistant's inspection report and findings.

(e) The Valuer shall identify the rights to be valued in a property from the title deed by which property is acquired. If there is any doubt on rights then he has to consult the legal practitioner.

(f) Where the title details of the property to be valued are not maintained, kept or are not available then this fact should be reported.

(g) The valuation report shall disclose any assumption(s) in relation to title details, where the title is not available.

(h) Where a valuation is affected by condition(s) in the title, it must be clearly explained in the report, so as to enable the reader to understand the underlying reasons for the Valuer's findings, opinions and conclusion.

2.3 The valuation of a property depends on the collection and analysis of all relevant information. Therefore, a proper inspection and referencing of the subject property and the neighborhood are important. Though a Designated Assistant is allowed to carry out the inspection and collection of data, however, the Valuer has to take responsibility for the accuracy of all the data used in the valuation.

2.4 The valuers have to encounter the property falling under following categories in actual practice and data to be collected depends on the type of property under consideration and intended use of the report.

2.4.1 Open Land

Residential, Commercial and Industrial

- Freehold
- Leasehold

2.4.2 Built-up Properties

Residential property (other than apartments) / commercial property office building (other than office apartments) / industrial property (other than industrial unit in a multi-storied industrial building):

- Entire building occupied by owner
- Entire building occupied by the tenant protected under rent act
- Entire building occupied by the tenant not protected under rent act
- Entire building occupied by lessee
- Partly occupied by owner and partly by the tenant protected under the rent act
- Partly occupied by owner and partly by the tenant not protected under the rent act
- Partly occupied by owner, partly by the tenant protected under the rent act and partly by the tenant not protected under the rent act
- Partly occupied by owner and partly by the lessee
- Partly occupied by owner, partly occupied by the lessee, partly occupied by tenant protected under the rent act and partly by the tenant not protected under the rent act
- Buildings falling under above categories where FSI is fully utilized / partially utilized.

Residential ownership apartments in a multi-storied building. Office premises in a multi-storied commercial building, industrial premises in a multi-storied industrial building and shops on ground floor in a multi-storied residential, commercial and industrial buildings

- Occupied by owner
- Occupied by the tenant protected under rent act
- Occupied by the tenant not protected under rent act
- Occupied by lessee

Hotel Buildings

- Operated by owner
- Operated by Franchisee
- Operated by Lessee

Cinema Theatres and multiplexes

- Operated by owner
- Operated by Franchisee

- Operated by Lessee

Nursing Homes
- Operated by owner
- Occupied by the tenant protected under rent act
- Occupied by the tenant not protected under rent act
- Occupied by Lessee

Petrol Pumps
- Operated by owner
- Operated by Lessee
- Petrol pump is owned by the Company and operated by Dealer.

2.4.3 Any other type of the property not covered above

2.5 The information required to carry out the valuation of above property is outlined as under.

2.5.1 Open Land

(a) Area and shape of land
  - Dimension of each side of the plot
  - Frontage on roads and widths of roads
  - Location coordinates

(b) Demarcation of land

(c) Level of land and cost of levelling, if any

(d) Tenure of land - Is it Freehold or Leasehold land?

(e) In case of leasehold following details to be considered.
  - Name of lessor
  - Name of lessee
  - Date of commencement of lease
  - Period of lease
  - Date of termination of lease
  - Premium paid
  - Ground rent per annum
  - Covenants of lease with regard to
    - Termination of lease
    - Renewal of lease
    - Payment of unearned increase in the event of sale or transfer
    - Conditions of transfer

(f) Is land affected by Land Reforms Act, Coastal Regulation Zone, and Revenue Code of the state Government? Or any other Acts.

(g) Zoning of land as per Master plan /Development plan

(h) Development plan / Master plan / Planning proposals affecting the land such as reservation for public purpose like health facilities, playgrounds, recreation garden, road widening, new road, transport facilities etc. Give details, if any.

(i) What is permissible FSI / FAR? How much is it utilized? If balance FSI is available, then is it possible to consume? What is permissible ground coverage?

(j) Development Control Rules, Bye-laws, affecting land values.

(k) In case of industrial property – what is the industrial locational policy of the Government for expansion as well as establishment of new industry.

(l) To collect data regarding sale transactions in the vicinity which have taken place in nearby areas and compare the sale instances with property in question with regard to various factors affecting value of the assets.

2.5.2 Built-up Properties

Is it owner occupied / vacant / rented / leased / given on leave and licence or any other manner permissible under the law? Specify if there is any other occupancy.

The built-up properties are to be valued as per any of the three approaches market, income and cost based on the facts and circumstances of the case.

VALUATION STANDARD 3 (VS 3)
MARKET VALUE BASIS OF VALUATION

3.1 The transactions of properties normally take place at market value. This is the amount a property would fetch if offered for sale in the open market on the date of valuation under the circumstances that meet the requirements of the definition of Market Value.

3.2 It is essential that the property under valuation required to be viewed as if for sale in the open market, in contrast to being evaluated as part of a going concern or for some other purpose.

The Valuer shall use the market value basis of valuation unless specifically instructed to do otherwise or purpose itself requires valuation other than market value e.g. for Capital Gain Tax computation or for estimating compensation under Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, etc.

3.3 Definition of Market Value

The Law Commission of India, 1958 under Para 45, defined 'market value' as –

> *the price, which a willing vendor might reasonably expect to obtain from a willing purchaser. The disinclination of the vendor to part with his 'land' and the urgent necessity of the purchaser to buy must alike be disregarded and both must be treated as persons dealing in the matter at arm's length and without compulsion.*
>
> Explanation : 'land' means any type of assets.

However, it is worth mentioning that there are certain statutory liabilities, for example, property tax which can be recovered from the sale of the property. Therefore, it is essential that tangible asset valuers specify whether these liabilities have been considered or not in the valuation exercise.

In addition to the various factors considered above, there are following two important considerations while valuing a property.

(i) The valuer while estimating market value of the property should ensure that assumptions and limiting conditions are minimum.

(ii) The valuer should give reasons for adoption of a particular approach to value, while undertaking valuation for market value.

For additional information, please refer to Paragraph 6.2 of standard VS 6 Market Approach

VALUATION STANDARD 4 (VS 4)
VALUATION BASES OTHER THAN MARKET VALUE

4.1 In majority of the cases, valuers are required to carry out valuation as per the market value definition given in VS 3. However, there are circumstances that require valuation on the basis other than VS 3 i.e. bases other than Market Value. It is important that both the Valuer and valuation users clearly recognize the difference between valuation on the basis of market value and the valuation based on the basis other than Market Value (valuation basis other than market value is conventionally known as Non-Market Value based valuations). It is important to understand the differences between these concepts because both these bases are applicable under different situations.

4.2 This Standard is focused on bases of valuation other than Market Value.

4.3 For certain specific purposes of valuation where it will be necessary for the Valuer to use a basis of valuation other than the market value, the valuer shall specifically mention this fact in the report and also shall differentiate that the valuation is not a Market Value estimate.

4.4 Specialized properties by virtue of the fact that they are rarely, if ever, sold in the open market are to be valued on the Depreciated Reproduction / Replacement Cost (DRC) basis, subject to potential profit / demand and supply. However, computation of potential profit is not within the scope of assignment of tangible asset valuer because potential profit cannot be ascertained without consideration / valuation of all the assets in the balance sheet.

The Valuer should qualify every valuation on the DRC basis as being subject to adequate potential profitability of the business having due regard to the value of the total assets employed and the nature of the operation. The estimation of potential profitability is outside the scope of tangible asset valuer.

4.5 Properties may be required to be valued on bases other than Market Value, or may exchange hands at prices, which do not reflect Market Value as defined. Such alternative bases may either be reflections of a non-market perspective of utility, or of unusual and non-market conditions. Examples include Going Concern Value, Special Value, Forced Sale Value etc. and also statutory requirement like-valuation under Income Tax Act, Land Acquisition, Rehabilitation and Resettlement Act, 2013.

The examples of valuation which are based on the basis other than market value are:

(a) Depreciated Reproduction / Replacement Cost (DRC). DRC is a method of valuation which is based on an estimate of the current Market Value of land for its existing use plus the current gross replacement (or reproduction) costs of improvements less allowances for physical deterioration and all relevant forms of obsolescence and optimization. The result, which is Non-Market Value, is referred to as the Depreciated Replacement Cost estimate. This result is subject to the adequate potential profitability or service potential/demand and supply.

The Valuer should qualify every valuation on the DRC basis as being subject to adequate potential profitability of the business having due regard to the value of the total assets employed and the nature of the operation.

(b) Insurable Value.
(c) Forced Sale Value.
(d) Special Value.
(e) Investment Value.
(f) Going Concern Value.

VALUATION STANDARD 5 (VS 5)
APPROACHES AND METHODS OF VALUATION

5.1 It is now a well-established fact that immovable property market is an integral part of the investment market and therefore, the same factors which influence the investment market will influence the immovable property market.

Properties / Real Estate can be classified under three basic groups, keeping marketability in view.

(i) Income Fetching Marketable Properties: Rented properties whether residential, commercial or industrial, hotels, cinemas or industrial properties fall under this group.

(ii) Non-income Fetching Marketable Properties: Owner occupied bungalows, apartments / flats, shops, offices, factories fall under this category.

(i) Non-income Fetching Non-Marketable Properties: Religious and public buildings like temple, church, school, college, public buildings, museum, town hall, fire station and government buildings which are neither sold nor let out, fall in this category.

Note: In the above classification, income fetching properties are those which are fetching income at the time of valuation and not the property, which are capable of fetching income but not fetching at the time of valuation.

Based upon different characteristics of above referred three types of properties, three different approaches of estimating value of the property are evolved.

Investment property	**Marketable non-investment property**	**Non-marketable non-investment property (service property)**
• Leasehold land • Rented property (residential house/shop/ office) on a freehold or leasehold land • Cinema / theatre • Hotel, motel • Petrol pump • Leased plant-machinery	• Self occupied property (residential house/ shop/ office) on a freehold or leasehold land • General purpose plant-machinery	• Religious properties – temple, church, mosque • Non-profit oriented educational property • Public property – town hall etc. • Charitable hospital • Specialised plant-machinery
Value Ingredient of Investment property are: ***Utility, marketability, liquidity***	Value Ingredient of Marketable Non-Investment property are:	Value Ingredient of Non Marketable Non-Investment property are:
Generally valued by Income Approach	**Generally valued by Market Approach**	**Generally valued by Cost Approach**

Income Approach: This approach is generally useful to value income fetching marketable properties.

Market Approach: This approach is generally recommended for all marketable properties, whether income-yielding or not.

Cost Approach: This approach is generally adopted for non-income fetching and non-marketable property.

All the three approaches to valuation involve comparison of various legal, physical, social and economic factors / aspects, as also of advantages / merits and disadvantages / demerits arising out of these various factors. In order to ensure that none of those factors and their advantages and disadvantages are overlooked or lost sight of, it is advisable that a valuer should first step in the shoes of the client and think about the problem i.e. of property, its advantages and disadvantages and market value of the same from the other angle also. Thinking from points of view of both (or all) sides will ensure better and fairer estimation of market value of a property.

All these three approaches are not exclusive of each other. In income approach, market rent i.e. income is estimated by comparison. In market approach, sales analysis is carried out. While in cost approach, value of land is estimated by sale comparison and that of building by contractor's method as explained later.

5.2 **The selection of a method of valuation is the prerogative of the valuer.** Based on the facts and circumstances of each case, the valuer shall select appropriate method of valuation. <u>It is not necessary to estimate market value of a property by adopting all the three approaches to valuation, unless the valuer himself desires to cross-check with alternative approach</u>. **In any case, however, temptation to arrive at an average value should always be scrupulously or strictly avoided.**

VALUATION STANDARD 6 (VS 6)
MARKET APPROACH

6.1 Market Approach

The market value may be determined from sales of comparable properties, proximate in time, the date of acquisition, similarly situated, and possessing the same or similar advantages or disadvantages.

6.2 Primary Considerations

In Real Estate Market, Valuer first considers the four basic qualities of the property, while estimating its value. Valuer should ask following questions about the property to be valued.

(i) What is the utility of the property? **Utility** means existing and anticipated **benefits** due to ownership, possession and use of property.
(ii) Is it scarcely available or abundant in supply?
(iii) How much is its 'demand' in the market?
(iv) Is it 'transferable'?

Market Approach is basically operating on the **"Principle of Substitution"**. Valuer has to find out from the market about the availability of identical property or nearly similar property to the property which is under valuation. He should also find out actual sale price or asking price of such similar property. Then valuer has to compare both properties and estimate market value of subject property after making appropriate adjustments, based on available evidence.

This principle of substitute product and comparison with the required products is already operating in the consumer product market. Same principle with a little change is operating in Real Estate Market. This is true for sale or purchase of the open plot of land or land with buildings as well as for sale or purchase of flats, shops, offices and industrial galas (units), etc.

One may perhaps find two exactly similar consumer products in the market. But there are no two exactly identical properties in this world. They may differ in size, shape, area, location and situation (placement), improvements, ownership, usage, topography, legal or in many other respects. These variations or the differences call for adjustment in values while comparing properties.

The subject property is compared with similar / substitute properties recently sold or available for sale in the market. Some factors which may be positive factors may tend to increase price of the property while other factors which may be negative factors may tend to reduce the price of the property.

The sale instances relied by the valuer must be genuine and it is the duty of the valuer to ensure that the sale instances relied are genuine.

The following information will be useful in this regard

(i) Buyer should be a willing buyer and he should not be compelled or forced buyer in urgent or immediate need of the premises. He should not be a forced purchaser as we find in case of purchase of undivided share of co-owner in a property jointly held with the other co-owners.

(ii) Seller should also be a willing seller and not a seller forced to sale property by extraneous / external circumstances. Negotiated or auction sales by Banks for recovery of mortgage debt are forced sale by unwilling sellers (mortgagors). Sales by a person in distress are also examples of unwilling and forced seller.

(iii) In order to find out whether such sales in reality are distress sale or not, personal enquiries during site inspection are necessary. Mere mention in sale deed may not be proof of a forced sale.

(iv) Transaction has to be at arm's length.

In market approach, while comparing properties, generally "Highest and Best Use" of the property potentials has to be considered to estimate Market Value on the relevant date. Many a time we come across property which is put to inferior use (e.g. property falling in industrial zone but can be put to residential use). Such an inferior use is required to be valued considering the best permissible use, ignoring actual use or continued subsisting use of the property. Value of a property put to continued inferior use is bound to give lower value as compared to the market value on the basis of Highest and Best Use.

6.3 Factors to be considered in Market Approach

In order to estimate fair price of a commodity in the market, buyer as well as seller consider various characteristics of the product viz. its use, its physical benefit, service life, etc. Similarly for Real Estate viz. land or land with building/s; buyer and seller consider various characteristics of properties viz. its usage, its service life (for building) its resale value, benefit of infrastructure amenity and civic amenities etc.

Various characteristics of the property and various market forces influencing determination of price in the Real Estate Market can be broadly classified into following four groups.

(i) Economic Factors.
(ii) Physical (Technical) Factors.
(iii) Social Factors.
(iv) Legal Factors.

These factors are explained below.

<u>Economic Factors :</u>

Economic factors could be of Micro level (Local aspects) or Macro level (National aspects)

Micro economic factors include factors such as local population, employment opportunities, changes in services, trade and commerce, per capita income at District/City/State level, paying capacity of local residents, trend of growth of city /expansions, etc.

Macro Economic Factors would include factors such as Domestic Savings. Fixed capital formation in construction and Real Estate Sector, Flow of Capital Investments in Bank Fixed Deposits, Shares, Debentures, Government Securities, etc.

Other economic factors are as under.

* Demand and supply of properties.
* Income fetching capacity of the property.
* State and Central Govt. policies for land development.
* Economic and Taxation policies of Government.
* Income and wage level of residents, trends for saving and paying capacities of people in the locality.
* Money market situation.
* Cyclical boom and recession periods in real estate market.
* Expected rental yields and returns on investment in real estate.
* Maintainability of high rental.
* Inflation or deflation in nations economy.
* Availability of money (Loan) on credit from Banks and other institutes and interest rate offered for such loan advances.
* Burden of property tax and other maintenance outgoings.
* Better alternative use against current inferior use.
* Employment opportunities and development potential in area.
* Availability of alternative or substitute asset in the market.

Physical (Technical) Factors :

The physical and technical factors include the following aspects.

* **Land characteristics:** Size, shape, plot area, frontage, vista, orientation soil type, topography, accessibility, etc.

* **Infrastructure facility:** Good network of roads, water supply, system, power supply and telecommunication links.

* **Prominence and placement:** Main road, by-lane, dead end road, remote area location.

* **Building characteristics like :**
  - R.C.C. framed, steel framed or load bearing structure.
  - Expected future life and age of structure.
  - Deterioration and present condition.
  - Specification of building. (Civil, electrification and plumbing items).
  - Aesthetics and workmanship quality.
  - Intelligent building and green building concepts.
  - Obsolescence due to change in technology or change in life style.
  - Maintenance and repair liability.

* **Functional aspect:** Optimum use of inner space with minimum wastage of lobby space, good planning and design of room placement and good circulation for movements of occupants, adequate light and ventilation for all rooms, high utility value, modern habitation style.

* **Amenities**: Swimming pool, garden, lift, security system, intercom facility, car parking facility, Health club, Children's play area.

* **Environmental aspect** : Noise and smoke pollution level, sea or lake frontage, nuisance due to railway track, industries or airport, climatic conditions (hot, humid, cool, dry climate).

* **Natural calamity**: Earthquake prone areas, flooding and cyclone hazards, Tsunami prone areas.

* **Soil conditions**: Rocky soil, hard murum, black cotton soil, reclaimed soil or filled up ground.

Social Factors :

* **Locality**: Poor class, middle class, posh areas (life style and living standards of residents of the locality).

* **Neighbourhood:** Well developed, less developed, slum like, cremation ground, dumping ground, nuisance due to community hall, cinema, school on adjoining plot.

* **Civic amenities:** Proximity of shops, mall, market, school, cinema, community hall, hospital, railway station, bus stand, garden.

* **Population:** Density in area and population growth, congestion.

* **Means of communication:** Railway, road way or water ways.

* **Prestige aspect:** Prestigious building, prominent location, renowned personality like film star or celebrity or Sport champion or famous industrialist or wellknown politician as neighbour.

* **Political factor:** Linguistic or religious communal unrest.

* **Racial habitation:** Parsi colony, mohmedan locality, hindu colony catholic colony. Brahmanwada, etc.

* **Religious factor:** Proximity of temple, church, mosque, place of worship.

* **Personal factors:** Sentimental considerations, beliefs in 'Vastu' principles or Feng Sui norms, liking for specific neighbourh Speculative intent.

* **Stigma aspects:** Haunted house, dislike for vyagramukhi junction plots, fear due to past history of cyclone, Tsunami, earthquake, case history of murder or suicide on property, previous use of land as kabrastan or cremation ground.

* **Legal Factors** :
    * Social legislation like the Rent Control Act 1948. (Frozen rent)
    * State Land Reform Acts/Urban Land Ceiling Act/Revenue code
    * Ecological Restriction like Coastal Regulation Zones.
    * Transfer of Property Act with lease provisions.

* Covenants under lease or conveyance deed.

* Indian Easement Act for licensees.

* Civil procedure code for claim for damages.

* Land Acquisition Act.

* Laws Governing Building Construction like Development Control Rules / Building Bylaws/Town planning and Zoning Regulations.
  (F.S.I. norms, open space regulations, height rules, user restrictions)

* Laws Governing Land: Town Planning Act/Municipal Corporation Act/ Rent Act., Revenue Laws

* Law on earthquake resistant building.

* Reservations under different Acts.

* Safety distance from industrial belt, hazardous store etc.

* Height restriction rules near Air Port Area.

* Safety distance rules from high tension lines, railway tracks, highways. Water courses and nallahs, eco sensitive zones.

6.4 Process of Valuation in Market Approach – Steps Involved

The process of valuation in the market approach involves following steps:

- Collect data in respect of recent instances of sale of similar land / properties in the vicinity from different sources and weed out non-genuine sales.

- Select comparable and genuine instances of sales which are proximate in time as well as proximate in situation with the property under valuation.

  Visit physically the sites and locations of all the properties involved in the genuine instances of sale and record all favourable and unfavorable aspects of these properties.
- For the purpose of deciding genuineness of sales, sale documents may be referred. During inspection of site / properties, contact and enquire with sellers or purchasers may be done to find out whether the sale was genuine and was not a forced sale or distress sale though it has been executed in normal business-like circumstances. Analyse and workout rate of sale in each of the genuine instances of sale.

- Compare each of the properties involved in instances of sale with the subject property and give appropriate weightages to the rates of sale for favourable and unfavorable factors. Also assign appropriate weightages for major attributes like time factor, size /area of property, situation and location aspects, specification or age factor for building, utility and infrastructure services, etc. Care should be taken by the valuer to assign weightages according to the importance and the priorities attached by the local people in the locality in which the subject property and properties sold are situated.

- Priorities for size of flat or the specifications would be quite different in poor class localities and in posh areas.

- Freehold properties are to be compared with freehold properties.

- Leasehold properties are to be compared with leasehold properties.

- Properties occupied by the tenants protected under the Rent Control Act to be compared with properties occupied by the tenants protected under the Rent Control Act.

- Properties occupied by the tenants not protected under the Rent Control Act to be compared with properties occupied by the tenants not protected under the Rent Control Act.

- Deduct the cost of immediate repairs, if any.

VALUATION STANDARD 7 (VS 7)
INCOME APPROACH

7.0 Income Approach

7.1 The term 'Income Approach to Valuation' itself suggests that the income from a property forms the basis for estimating value of the property. To explain the income approach to valuation in a very simplistic manner, it can be stated that the net income from a property is considered as interest yielded (at a certain rate of interest) by the amount or capital invested in purchasing that property, i.e. value or price paid for purchasing that property. In mathematical form, it is stated as under:

Capital Value of a Property (C.V.)	=	Net Income from Property (N.I.)	x	Multiplier which depends on the rate of interest expected to be yielded by the investment in the property (Year's Purchase – Y.P.)

C.V. = N.I. x Y.P.

The multiplier Y.P. is the summation of the present worth of series of income of Re. 1/- receivable every year, at the end of 1^{st} year, 2^{nd} year, 3^{rd} year ……….. up to …n^{th} year, for a period of 'n' years at a compound interest at a certain rate of interest and the same is given in Valuation Tables. It is however not intended to deal with mathematics of valuation here. It is an attempt to explain the basic logical thinking behind estimation of value of a property by income approach.

The real problems arising in such a simplistic solution to estimation of value are:

(i) Proper estimate of the net income, which is due to tangible as well as intangible aspects.

(ii) Estimation of the appropriate rate of interest, which can reasonably be expected to be yielded by a particular type of property. Income from a property and appropriate rate of interest depend respectively on the concepts of benefits and security.

7.2 Estimation of Income

Once it is accepted that the rents actually paid by tenants to landlords are true and correct indicators of fair rents, then the income from the property can be estimated by collecting data regarding instances of rentals in respect of other comparable properties in the vicinity by comparing the accommodations of properties let out with the accommodation of property to be valued.

While relying on any rental instances it is to be assured that they are genuine one.

The fair rent in respect of the property can thus be estimated by comparing property under valuation with the properties involved in instances of rentals.

7.3 Steps Involved in the Income Approach

Estimation of market value of a property by Income Approach, involves the following steps:

(i) Collection of data regarding transactions of sale and rentals which have recently taken place in the locality.

(ii) (a) Inspection of site, local inquiries and collecting information regarding recent instances;

(b) Inspection of properties involved in genuine instances of sale and rentals and the property to be valued and collecting relevant information in respect of factors of comparison.

(iii) Estimation of net income of the property to be valued after deducting outgoings such as property taxes, repairs and maintenance, insurance and collection charges as applicable.

(iv) Estimation of appropriate remunerative rate of interest (i.e. security) by analysis of instances of sale.

(v) Estimating fair market value of the property to be valued by capitalizing net income by single or dual rate of interest depending on whether the income is perpetual or terminable.

(vi) Deduct cost of immediate repairs, unpaid taxes and other liabilities (e.g. mortgage dues) from capitalized value, if any.

7.4 Rent Control Act

It is note-worthy to mention about the rent acts in India and their effect on future cash flows. This is mainly due to the fact that rent control acts of many states provide that the rent cannot be enhanced/cannot be enhanced more than specified percentage, if tenant is ready and willing to pay the rent and abides by the provisions of rent act then landlord cannot get the vacant possession. Moreover, tenancy is heritable. For this purpose, it is essential to study the rent act by the valuer. Under such circumstances future rental income remains almost stable even though vacant/owner occupied property in nearby area are capable of fetching market rent which is much more than statutory rent paid by the tenants protected under the rent control act.

Even in case of properties occupied by the tenants who are not protected under the Rent Act balance period of tenancy will have bearing on rent estimation. This is due to the fact that it is not obligatory on the part of tenants to vacate the premises before tenancy expires.

Thus, estimation will depend on the fact that whether rent can be enhanced or not. This aspect must be considered by the valuer before estimating rent.

7.5 Discounted Cash Flow (DCF) methods

The income stream is projected with explicit assumptions about rental growth and discounted back to a Net Present Value (NPV) using an appropriate discount rate; the scheme is deemed viable if NPV exceeds the total development costs. The discount rate includes an allowance (profit margin) for the management requirements and risk of investing in a development project rather than an existing fully let property.

DCF theory holds that the value of all cash flow generating assets – from fixed-income to investments to an entire company – is the present value of the expected cash flow stream at an appropriate discount rate. The formula for this is usually given something like this:

$$PV = CF_i / (1+k) + CF_2 / (1+k)^2 + \ldots [TCF / (k - g)] / (1+k)^{n-1}$$

Where:

PV	=	present value
CF_i	=	cash flow in year i
k	=	discount rate
TCF	=	the terminal year cash flow
g	=	growth rate assumption in perpetuity beyond terminal year
^{n}	=	the number of periods in the valuation model including the terminal year

7.6 Operating Cash Flow Projections

The first and most important factor in calculating present value by DCF technique is estimating the series of operating cash flow projections. There are number of inherent problems with earnings and cash flow forecasting that can generate problems with DCF analysis; some of them are:

- All the input costs
- Inflation
- Interest rate
- Sales realization of the products
- Discount rate and the growth rate assumption

Small, erroneous assumptions in the first couple of years of a model can amplify variances in operating cash flow projections in the later years of the model.

Capital Expenditure Projections

Capital expenditures can be largely discretionary; in a recessionary year, a company's management may rein in capital expenditure plans (the inverse may also be true). Capital expenditure assumptions are, therefore, usually quite risky. While there are a number of techniques to calculate capital expenditures, such as using fixed asset turnover ratios or even a percentage of revenues method, but small changes in model assumptions can widely affect the result of the DCF calculation.

7.7 Discount Rate and Growth Rate

Perhaps the most contentious assumptions in a DCF model are the discount rate and growth rate assumptions. There are many ways to approach the discount rate in an equity DCF model; one of them is weighted average cost of capital of the firm. This approach is quite theoretical and may not work well in real world investing applications. When choosing a method to estimate the discount rate, there are typically no sure-fire (or easy) answers.

Perhaps the biggest problem with growth rate assumptions is when they are used as a perpetual growth rate assumption. Assuming that anything will hold in perpetuity is highly theoretical. In addition, a company's growth rate will change, sometimes dramatically, from year to year or even decade to decade. Seldom does a growth rate gravitate to a mature company growth rate and then sit there forever.

Thus, DCF valuation is very sensitive to assumptions connected with perpetual growth rate and discount rate. A minor change in assumptions can considerably vary as mentioned before, the results of DCF valuation and the value so generated will not be proper.

It is suitable only when there is a high degree of assurance about upcoming cash flows. But if the company's operations lack discernibility, it becomes problematic to forecast sales, operating expenses and capital investment with certainty. While projecting cash flows for the next few years is difficult, pushing them out perpetually (obligatory for DCF valuation) becomes practically impossible. However, the probability assigned future values are often used to take care of this problem though it is not giving the accurate values. As such, DCF method is liable to be guesstimate rather than an estimate.

One major concern of DCF is that the terminal value includes far too much of the total value. Even a slight variation in the assumptions on terminal year can have a major effect on the final valuation.

DCF valuation is an ever-changing goal that demands constant care and modification. If any prospects about the company change, the fair value will change accordingly.

Under the circumstances when DCF model is used it is essential to review the calculations at the end of each year to find out variance in what was estimated for the year and actual performance during the year.

VALUATION STANDARD 8 (VS 8)
COST APPROACH

8.1 The cost approach to valuation mainly consists of estimating the value of land and building separately and adding the two values to arrive at total value of the property. The main method under this Cost Approach is Land and Building Method which is also as Contractor's Method or Structural Cost Method or Physical Method or Depreciated Cost Method.

In fact, Valuation is a process of estimating the value of rights of various parties in a property as per the terms of agreement. Moreover, it is necessary to see that result does not turn out to be a brick mortar valuation.

But in our country land and building method of valuation is widely used in which depreciation is considered only for wear and tear. The drawback in this method is that it does not take into consideration technological, functional and economic obsolescence, demand and supply. In order to make property marketable cost of cure of these factors is very important.

This standard directs the valuers to consider all the aspects so that value by cost approach does not lead to brick mortar valuation.

8.2 The Cost Approach considers only the supply side and neglects demand side. It is therefore advisable to adopt Cost Approach when market and income approaches are not applicable, as a last resort.

8.3 Land with building will need adjustment in estimated total value because land married with structure does not fetch same price in market as an open plot of land or virgin land.

8.4 The modern design, planning, specification, and aesthetics of the building many a time out-weighs age factor or depreciation aspect. This is the reason why good old buildings fetch much less price in the market than its value worked out by cost approach. Even if appropriate depreciation for age of the building is allowed market worth does not correspond to worked out value.

8.5 If the property is not put to highest and best use (full F.S.I. not consumed) sometimes existing building in plot has to be valued at scrap cost instead of depreciated cost, even though its physical and economic life is more.

8.6 Building cost estimated by Cost Index Method is controversial. There are too many adjustments and additions. Again, adoption of Delhi based cost index for all India towns is illogical and improper. Because even in same city the cost of construction of identical buildings will be different due to soil bearing capacity being different at two different locations and other aspects.

8.7 Therefore, when cost approach is used it is essential for valuer to consider whether the property is marketable at the value worked out for land and depreciated replacement cost (where depreciation is considered on account of wear and tear only). If not, then in order to make it marketable, the additional factors need to be considered as outlined later.

8.8 The properties included in the category Non-income fetching Non- marketable properties include religious properties like temples, masjids, churches, gurudwaras, educational buildings like schools, colleges and public buildings like town, halls, government and municipal offices, etc. which are neither let out (not fetching any income) nor sold (not marketable) and therefore cannot be valued either by Market or by Income Approach; will have to be valued by the Cost Approach. Hospitals and monumental buildings can also be valued by this method.

8.9 This method involves the following four steps in estimating value of a property:

1) To estimate fair market value of open land under valuation by comparison with the open lands in the neighbourhood which have been recently sold or purchased. (a)

2) To estimate either cost of reproduction or cost of replacement of development i.e. building, as new, at the present day scheduled rates of construction at the site where building is located. (b)

3) To estimate fair allowance for depreciation for wear and tear and to deduct the same from cost of reproduction/replacement cost of building. (c)

4) Allowance for functional and economic. (d)

5) Market value of property = (a + b) – (c+d)

   Please refer to glossary of terms for obsolescence.

VALUATION STANDARD 9 (VS 9)
PROPERTY UNDER DEVELOPMENT

9.1 Introduction

In the context of this standard, development properties are defined as interests where redevelopment delivers the highest and best use, or where improvements are either being contemplated or are in progress at the valuation date and include:

(a) the construction of buildings,

(b) previously undeveloped land, which is being provided with infrastructure,

(c) the redevelopment of previously developed land,

(d) the improvement or alteration of existing buildings or structures,

(e) land allocated for development in a statutory plan, and

(f) land allocated for a higher FSI uses or higher density in a statutory plan or as per Development Control Regulations.

The residual value or land value of a development property can be very sensitive to *changes* in assumptions or projections concerning the income or revenue to be derived from the completed project or any of the development costs that will be incurred. This remains the case regardless of the method or methods used or however diligently the various inputs are researched in relation to the valuation date.

This standard discusses the approach to the valuation of property under following scenario:

- The proposed development is of a cleared, or greenfield site
- The site is to be redeveloped by removing all, of the existing buildings and erecting new buildings.

There are mainly following two approaches to the valuation:

- Sales Comparison Approach in which the sale price of land for comparable development; or
- Residual method.

Both the above approaches are used in practice. However, the degree to which either, or both, are appropriate depends upon the nature of the development under consideration, and the intricacy of the issues.

Valuation by sales comparison is basically objective, it is based on an analysis of the price realised for sites with broadly similar development potentials. The residual method is subjective and it requires the valuer to make a number of assumptions – any of which can affect the outcome in varying degrees.

9.2 Valuing by the sales comparison method:

This method requires the comparison of sites and the following factors are relevant:

- values are likely to differ significantly within a small geographical area;
- the state of the site and accompanying remediation costs are very site specific and it can differ significantly between greenfield and brownfield, and between brownfield, sites;
- site and construction costs, for example, in terms of infrastructure and service requirements differ;
- the price may be affected by planning obligations; and
- in a rapidly changing market, the date of the sale of the comparable is relevant.

Generally, high density or complex developments, urban sites and existing buildings with development potential, do not easily lend themselves to valuation by comparison. The differences from site to site (for example in terms of development potential or construction cost or premium cost) may be sufficient to make the analysis of transactions problematical. The higher the number of variables and adjustments for assumptions the less useful the comparison. Comparison is rarely appropriate where construction has begun and specifically if it is a redevelopment of a existing building / society condominium.

Where the comparative method is used it is assumed that the valuer adopts standard valuation techniques. However, some of the elements of a residual valuation may also be relevant to a valuation on this method. It is hence suggested as the use of these methods should be restricted to green field project and not for projects which are under constructions and where sales have started and part amount has been collected by the Developer/Owner.

9.3 Residual Method

The method most frequently used for appraising the viability of development schemes is the residual valuation, the basic concept is straight forward and the method simple to use. Difficulties arise not in the method itself but in estimating the value of the many variables that go into the valuation. This is where the skill and experience of the valuer is so important.

Development schemes may comprise the development of new buildings on green field or cleared sites, redevelopment of built-up sites involving the demolition of existing buildings and their replacement by new buildings, the alteration extensions or improvement of existing buildings (normally referred to as refurbishment of commercial buildings or rehabilitation of residential buildings), or a combination buildings of all three. In all cases the residual valuation would be used to assess financial viability.

Residual Value Equation:

In simplistic terms, residual method of valuation means the development value of land, the residual valuation will estimate the maximum purchase price of a site by deducting the expected total costs of development, including an allowance to cover risk and profit, from the expected price that the completed development could be sold for in the market. The residual valuation could therefore be expressed in the form of a simple equation where the answer is the residue, or sum left over, after deducting costs of development from the value of development.

	Sale price of completed development	A
Less	Cost of development (incl. profit allowance)	B
Equal	Residue for purchasing land	C
i.e. C	= A - B	

It is also important to remember that although the residual valuation can be expressed as a simple equation there may be considerable difficulty in accurately estimating the component parts of the equation. For example what was simply referred to as the costs of development may encompass a variety of different elements such as demolition costs, building costs, landscaping costs, professional consultants fees, finance costs, letting and sale fees, premium payable to Municipal Corporation/Councils, Cost of purchase of FSI/TDR etc. These items are all variables and accurately estimating their values over a development period which may be many years duration is not an easy task. Furthermore, with so many variables in the equation slight changes in a few of them will almost certainly result in a wide range of answers, owing to the sensitivity of the residual valuation. Hence, valuers are supposed to analyse the above cost thoroughly before concluding the residual value.

The following aspects are to be considered during any land valuations

A. Inspection and site-specific information

The valuer shall take into consideration following aspects:

Extent of the site –frontage, width and depth, gross and developable areas;

- Shape of the site and ground contours – in the form of a topographical survey;
- Efficiency of existing building(s) (if to be retained);
- Any matters that may result in abnormal costs (such as constrained site conditions, and poor or limited access), from development and occupational perspectives.
- Geotechnical conditions, although a valuer is not to be an expert in the above field, however if any Geotechnical conditions are observed during site inspection the same may be noted in the report & bought to the attention of the user of the report.
- Availability of roads, public transport, mains drainage, water, gas, electricity and telephony;
- Evidence of third party interests in the property, whether actual or implied by law; Incase if valuer observe any encroachment or any third party right is created, the same may be noted in the report & bought to the attention of user.

- Physical evidence of the existence of rights of way, easements, encumbrances, overhead power lines, open water courses, mineral workings, tunnels, filling, tipping, etc.;
- Details of easements, restrictive covenants, rights of way, rights to light, drainage or support, registered charges, etc. which are observed during site inspection and also if mentioned in the Title report
- The effect of heritage act/archaeological features if any
- The valuer should read the Land title and check if there are any restriction on transfer or Sale.

In case of any pre-sales or pre-lessees or any pre-commitment which have been executed which are conditional to the project the valuer shall take into consideration such transactions while estimating the value of completed project. Due care shall be taken by the valuer that such pre-sale agreement or rent reflect that those would be agreed between the market participants as on date of valuation.

B. Existing planning matters

The following matters may need investigation:

- The existence of a current planning permission and its validity.
- Zoning
- Permissible FSI/FAR.
- Development Control Regulations as applicable
- Regulations that specify the extent to which development of the site might be permissible without the need for a planning application or consent;
- Any special controls that may apply to the site or buildings included (for example, conservation area designation, green belt, tree preservation orders, listed buildings, permission from National Wild Life Board, permission from Ministry of Environment & Forest, permission from CRZ point of view, permission from Heritage Committee, permission from Ministry of Defense, permission from Civil Aviation Department related to height, permission from Forest, permission from National & State Highways, permission from Gas Pipe line authorities, permission from Metro Rail and Mono rails, permission from Hydraulic Engineers for pipe lines, permission from Railway Authority, permission Archeological Survey of India, permission from Irrigation Department, Distance to be maintained from dumping ground.
- Enviornmental Issues.

C. Assessing the development potential

Matters that may be considered include:

- The period estimated to complete the new buildings;
- Achieving a high efficiency ratio (net internal area expressed as a percentage of the gross external area).

Although the valuation is required of the actual site there may be a possibility of increasing the development potential by acquisition of, or merger with, adjacent land. Conversely, it may be necessary to acquire adjacent land or rights over adjacent land before the proposed development could take place.

D. The development programme

An outline programme may be provided but its achievability needs to be assessed. It might include the following components:

- The pre-construction period;
- The principal construction period;
- The post-construction period;

In case after the completion of the project if the properties are to be held as investment properties for which there are no pre-leasing agreements and if stabilized occupancy level is less than 100% the valuer shall study the market and shall make allowance for additional marketing costs, incentives etc.

E. Analyzing the market

While bearing in mind the development potential, it is essential to establish the potential demand for the optimum alternative forms of development that may be possible. Clearly it is inappropriate to consider building a high specification office block in an area where there is limited demand for such a property.

Matters to be considered, but not exclusively:

- the location;
- access and transport routes;
- car parking amenities;
- amenities which can attract tenants and/or purchasers;
- the scale of the growth in terms of sale or lettable packages;
- the form of the development; and
- market supply/demand , proposed competing developments near by .

F. Acquisition costs

These include agents' fees, legal costs and stamp duty land tax that would be incurred on the acquisition of the land prior to the commencement of the development.

G. Site-related costs

It is necessary to consider the costs to be incurred before the main construction activity can proceed. These include:

- the cost of meeting any environmental issues. (Whilst this can relate to any remedial works it can also reflect important conservation or flood protection requirements. Such costs have to be provided by an appropriate expert);
- there may be an obligation to remove contamination, and the consequential waste management obligations, and special environmental provisions to abate noise or control emissions; Such costs have to be provided by an appropriate expert
- there may be ground improvement works needed before the main construction period begins to make the site safe for development (liaison with a civil and/or structural engineer may be necessary);
- any archaeological investigation costs may be borne before the main contract is let (the time to undertake such work and its cost needs to be understood); Such costs have to be provided by an appropriate expert
- diversion of essential services and highway works and other off-site infrastructure costs;
- the costs of conforming to appropriate health and safety regulations during the course of the development; and

If appropriate, it may be necessary to estimate the costs incurred in securing vacant possession, acquiring necessary interests in the subject site or adjacent property, extinguishing easements or removing restrictive covenants, rights of light compensation, party wall agreements. Realistic allowances have to be made, reflecting that the other parties expect to share in the development value generated.

H. Construction Costs

The individual items that go to make up the total cost of construction will obviously varies depending on the complexity and size of the development scheme. The major component of this figure is the payment to be made to contractors. The valuer while undertaking the valuation should take into consideration the contractual amount, however if there are any major escalations as per the market conditions the same should be considered while estimating the construction cost.

However, if there are no contracts signed the valuer should take into consideration the current cost for developing the building structures with suitable assumptions towards the escalation in cost during the life cycle of the project.

I. Contingency

In all cases the inclusion of a contingency allowance to cater for the unexpected is essential. The quantum which is usually reflected as a percentage of the building contract sum is dependent upon the nature of the development, the procurement method and the perceived accuracy of the information obtained.

Typical ranges for contingency are between 0-5% on new build, with Greenfield sites being at the lower end. For refurbishment schemes, depending on the nature of the scheme, contingency levels are likely to be higher- typically at between 5-10% of build costs. These are only indicative percentages the valuer may independently decide the same by considering the present market conditions.

J. Fees and Premium expenses

The incidence of fees and expenses can vary significantly according to the size and complexity of the development. The following items may need consideration:

- The fees for professional consultants to design, and manage the project development – The development team normally includes: an environmental and/or planning consultant, an architect, a quantity surveyor and a civil and/or structural engineer. Additional specialist services may be supplied as appropriate by mechanical and electrical engineers, landscape architects, traffic engineers, acoustic consultants, project managers and other disciplines, depending on the nature of the development.
- fees may be incurred in negotiating or conforming to statutory (for example Building Regulations) or planning agreements;
- the costs of conforming to the relevant health and safety regulations during the course of the development;
- premiums payable as per Development Control Regulations as applicable, cost of purchasing FSI / TDR etc as applicable.
- legal advice and representation at any stage of the project;
- lettings and sales expenses – where the development is not pre-sold, or fully pre-let, as a single unit this item includes incentives, promotion costs and agents commissions. The costs of creating a show unit in a residential development may also be appropriate.
- rent free periods, whether as an incentive or recognizing the tenants fitting out period. These may be reflected by either:
    - continuing interest charges on the land and development costs until rent commencement. This approach is usually favored by the financing arrangers; or
    - taking account of the costs in the valuation of the completed development. This approach is usually favored by investors because there is an assumption that market conditions will not change;
- costs related to the raising of development finance (these can include the lender's monitoring surveyor's fees and legal fees); and

- in some cases, the prospective tenant/purchaser may incur fees on monitoring the development (these may have to be reflected as an expense where they would normally be incurred by the developer).

K. Interest or financing costs

Interest is incurred on land and development costs. It is either paid when due or deferred (rolled up) throughout the projected programme during the pre-contract, contract, and post-contract stages. An allowance is to be made to reflect the opportunity cost of the monies, even if the developer is funding the project through his own equity, on the assumption that the completed fully let and income producing development is to be sold, or long-term finance obtained on its transfer to the developer's investment portfolio. This allowance is also included where the development is to be owner occupied.

It is usual for interest to be treated as a development cost up to the assumed letting date of the last unit, unless a forward sale agreement dictates otherwise. In the case of residential developments, the sales of individual units may occur at various stages during the development and appropriate assumptions have to be made regarding cash flow, both inward and outward. The rate of interest adopted reflects the levels adopted in the market for the type of scheme involved.

The approximate timings for the pre-construction, principal construction and post construction periods have to be determined. The valuer is recommended to liaise with the client, such professionals as might be appointed, to assess an appropriate, realistic time frame for each of the phases. Care should be taken to understand the realistic time frame for achieving the sales of the project.

Conventionally the chosen interest rate is usually compounded, either quarterly or annually in line with the current market practice.

L. Holding costs

The attendant costs (excluding interest) in holding the completed building up to the assumed date of the final letting or sale, including such items as insurance, security, cleaning and fuel. A proportion of the service charge on partially let properties may have to be included together with any potential liability for empty rates.

M. Pre Sales

In case of any pre-sales or pre-lessees or any pre-commitment which have been executed the valuer should take into consideration such transactions while estimating the price or rent as reflected in the pre-sales or pre-lessees or any pre-commitment.

N. Marketing Cost:

The valuer should take into consideration appropriate marketing cost and any commissions paid to brokers

O. Period of Construction:

The valuer should take into account the expected date of completion of project, he may refer to current physical status of the project while estimating the same, he should also mention the completion date of the project as per RERA.

P. Development Profit

A developer who invests his capital, borrowed or otherwise, in a project naturally expects interest on his capital, reward for his labour and profit for the risk he is undertaking. It is likely that :

- Value of land may go down due to war, riots, or economic crisis;
- Cost of development may escalate;
- Not able to sell flats / offices within his own (investor's) circle without advertisement in newspapers;
- Inspite of advertisement, considerable time elapses.
- Regularity changes affecting the approval and completion time.

and thus he may not realise interest expected on his blocked up capital. Hence, a reasonable profit should be taken into consideration by the valuer and also, the valuer may take into consideration current stage of the project, for example whether the project is nearing completion or just launched and decide the developers profit accordingly considering the risk involved.

Note : RBI discourages the Discounted Cash Flow Method of Valuation has been discouraged for under constructions projects, hence it is recommended that valuers should not adopt DCF for under construction Real Estate projects.

Points to be taken into consideration for valuation under Residual Method are shown in Appendix - A

Appendix - A

Points to be taken into consideration for Residual Valuations

Details of planned scheme

- Total buildable area:

Gross development value (GDV)

- The income that is likely to be received over the period of development
- Expected sale value and ground rents with supporting evidence
- Expected rental values with supporting evidence
- Details of likely incentives, rent-free periods, voids
- Anticipated sales rates (per month)

Costs

- Expected construction cost
- Demolition costs
- Site preparation costs
- Costs associated to get vacant possession if any
- Planning costs
- Construction schedule and phasing
- Rates for obtaining finance
- Professional fees, including:
  - Architect
  - Town Planner
  - structural engineer
  - mechanical/electrical engineer
  - project manager
  - brokerage
  - legal fee
- Land cost
- Premium Cost as payable under Development Control Regulations, Cost of purchasing FSI / TDR or any other form of FSI.
- Cost related to Corpus fund and rents to be payable to tenants in case of redevelopment project.
- Any other costs not referred above

Schedule of Development

- Site clearance and pre-construction
- Construction Cost
- Period of development
- Period for Sales/Marketing

Feasibility cashflow

- Income /capital receipt
- Total Costs

- Phasing (where appropriate)

Standard feasibility proxies

- Profit on cost
- Yield achieved due to development
- Internal rate of return (IRR)

Planning application details

- Plans/sections/elevations (as relevant)
- Design and access statement

Accompanying Report (basic outline)

- Executive summary
- Details of site location
- Description of scheme
- Planning consents
- Summary of market information
- Development cost and programme
- Approach/Methodology
- Yields and results

Concluding Remarks

VALUATION STANDARD 10 (VS 10)
VALUATION FOR LIQUIDATION

10.1 BACKGROUND

a) The explanation for terms Fair Value and Realizable Value:

Fair Value means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

Fair value requires the assessment of a price that is fair between two specific parties, taking into account the respective advantages and disadvantages that each party will get from the transaction. For example, synergies between two parties may mean that price that is fair between them is higher than the price that might reasonably be obtainable in the market. Therefore, Fair Value is often interpreted as a form of special value.

The example for this is given below:

There was a cement plant (X) for sale and the same was valued scientifically by a valuer and market value as on 31st December 2021 works out to say, (A). This value is estimated in a such way that it can also be used for secured lending.

The owners of cement plant (Y) were interested in buying the plant (X). The sellers were tough bargainers, and they were aware of urgent need of the purchasers. The owner of cement plant (Y) purchased the plant at 1.75 (A).

Here the price paid is 1.75A and same is a special price paid by a party with its own subjective consideration.

This transaction at a price of 1.75A falls under the category of Fair Value defined earlier. However, market value remains at A only and therefore fair value and market value cannot be used interchangeably.

In India, under Direct Tax Acts, words used are 'Fair Market Value' and not the 'market value' and hence there is a general feeling that 'Fair Market Value' indicates market value without unaccounted money. <u>This is not correct at all.</u> Because in USA and Canada the term used is 'Fair Market Value' (not the market value) where there is hardly any problem of unaccounted money.

Market Value / Fair Market Value / Open Market Value which are satisfying the criteria of 'willing buyer' and 'willing seller' have the same meaning as Market Value defined by Law Commission of India/IVS.

In case if any different definition is given in any statute, then in that case the definition given in the statute becomes market value for that statute.

Net Realizable Value means Market Value less all costs related to:

- Holding costs during expected marketing period,
- All selling costs related to disposition of the assets, and
- The cost of funds or rent loss during the anticipated marketing period.

Holding costs include, but are not limited to, real estate taxes, insurance of assets, liability insurance, utilities, and normal repairs and maintenance.

Selling costs include, but are not limited to, brokerage, commissions, closing costs and any other such costs.

It is pertinent to point out that holding costs and selling costs are not limited to mentioned above but any other legitimate costs also need to be considered.

Realizable Value (RV) is the net amount available in the hands of the owner after meeting all the liabilities/costs in respect of sale.

When owner sells his right in the assets, he creates a liability for payment of Capital Gains Tax as per applicable law.

The amount remaining in the hands of the owner after meeting all the above expenses is subject to Capital Gains Tax. The net amount that remains with the owner after considering all the costs referred above including payment of Capital Gains Tax is actually net realizable value.

Therefore, net realizable value is Market Value/Fair Market Value less all the costs referred above.

b) Let us now examine what is the **meaning of the term liquidation and the definitions of liquidation value and other related terms** given by Insolvency and Bankruptcy Code 2016 of India (IBC), International Valuation Standards Council (IVSC) and Indian Banks' Association (IBA).

   i. **Liquidation,** in finance and economics, is the process of taking a business to an end and distributing its assets to the claimants. It is an event that normally occurs when a company is insolvent, meaning it cannot pay its debts when they are due.

   ii. Definitions of liquidation value and other related terms as per Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) REGULATIONS, 2016

Regulation 2(1) (hh) defines **fair value** as under:

"Fair value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion.

Market Value is defined by the International Valuation Standards Council (www.ivsc.org) as under:

Market Value *is the estimated amount for which an asset or liability should exchange on the valuation date* between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

If Regulation 2(1) (hh) under IBC is read with definition of market value under IVS then one can infer that terms used as 'Fair value', 'Market Value' and 'Realizable Value' are having same meaning.

"Fair value" means the estimated realizable value of the assets of the corporate debtor, if they were to be exchanged on the insolvency commencement date….	**'Market Value** is the estimated amount for which an asset or liability should exchange on the valuation date….
….between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.	

The above discussion leads us to following conclusion:

Fair Value under IBC = Market Value under IVS = Realizable Value under IBC.

Realizable value is not defined under IVS for real estate as well as for plant and machinery.

Regulation 2(1)(k) of IBC defines **liquidation value** as under:

"Liquidation value" means the estimated realizable value *of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date.*

Liquidation Value defined under IBC also means the **realizable value under liquidation scenario**.

Fair value under Regulation 2(1) (hh) is **Realizable value** and **Liquidation Value** under Regulation 2(1)(k) is also the **Realizable value**.

This gives the impression that **fair value** is the **liquidation value**.

The term realizable value (RV) is defined under Paragraph 10.1 earlier and according to that RV = MV less cost involved in sale of assets.

Now, Regulation 35(1)(a) stipulates **how to determine fair value and liquidation value.**

Fair value and liquidation value shall be determined in the following manner:

the two registered valuers appointed under regulation 27 shall submit to the resolution professional an estimate of the fair value and of the liquidation value computed in *accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor;*

On one hand, IBC defines terms like 'Fair Value' and 'Liquidation Value' and on other hand states that such values are to be computed in accordance with internationally accepted valuation standards, **where such terms are defined differently.** It is also interesting to know that the practice followed globally for estimating liquidation/forced sale values is different than laid down by International Valuation Standards Council (internationally accepted valuation standards).

IVSC has defined **Liquidation Value** referring to marketing time, etc. Definition of Liquidation value as per IVSC will be found later.

So far as marketing time is concerned, it varies for wide spectrum of real estate each having its own characteristics like nature, design, configuration, and marketability.

There is no real estate wise literature available which gives the information for marketing time. But it is the skill of the expert of respective real estate.

iii. Definitions **of liquidation value and other related terms as per** International **Valuation Standards Council**

According to International Valuation Standards 2022 published by the International Valuation Standards Council (Page nos.6, 26, 28, 29 and 30 of IVS 2022) - **Liquidation value** is the sum of money that would be obtained on the sale on piecemeal basis. This will take account for the following:

(a) the *costs* of bringing the assets into saleable state
(b) the costs of removal

Liquidation value can be determined under two different approaches:

(i) an orderly deal
(ii) a forced deal

(i) an **orderly deal** means:

- It has a typical marketing period which is reasonable but less than the time required as per market value definition to find a buyer.
- The reasonable time will depend on type of assets and conditions prevalent in the market.
- **The vendor is compelled to sell on as is where is basis.**

(ii) a **forced deal** means:

A deal with a reduced marketing period.

- The buyer is under the compulsion to sell, **and hence proper marketing time is not possible,** and purchasers may not be able to undertake proper due diligence.

- It is necessary to identify the reasons for the constraints on the seller if an indication of price obtainable under forced sale circumstances is required and also the consequences of failing to sell in the specified time by setting out appropriate assumptions.

- The forced sale reflects most likely price that a particular asset is likely to get under all of the following circumstances:

  - Consummation of a transaction within a short period.
  - The asset is exposed to market circumstances prevalent as of the date of assessment or assumed timescale within which the deal is to be finished,
  - Both the purchaser and the vendor are acting carefully and knowledgeably,
  - The seller is under pressure to sell,
  - The buyer is typically determined,
  - Both parties are behaving with understanding that what they have considered is in their best benefits,
  - A typical **marketing effort is not viable** because of the brief short time.

<u>According to IVS</u>

(a) *Liquidation Value is to be estimated on <u>piecemeal</u> basis.*

There is no clarity on what the meaning of ‘piecemeal’ is.

A company may possess tangible assets consisting of land, buildings and plant and machinery. Does ‘piecemeal’ mean land, buildings, and machinery each is to be sold separately?

There may be several buildings and several machineries on one plot of land. Does it mean each building and machine to be sold in piecemeal?

Similarly, a company may have several parcels of land with buildings and machineries located at more than one location, then what the meaning of **piecemeal** basis is?

(b) The costs of bringing the assets into saleable state to be considered.

The vendor is compelled to sell on as is where basis under orderly liquidation is. Then what is meaning of directing the valuers to estimate the costs of bringing the assets into saleable condition?

The valuers are also directed to estimate cost of removal. Again, how is this relevant when assets are sold on as is where is basis?

(c) Under the forced sale scenario, the valuers are directed to identify the reasons for the constraints on the seller, if an indication of price obtainable under forced sale circumstances is required and also to identify the consequences of failing to sell in the specified time by setting out appropriate assumptions.

The valuers are working as per the instructions received from the clients. Then how valuers are concerned on the reasons for constraints of seller/clients and consequences of failing to sell?

iv. The **views** of **Australian Property Institute (API) and Property Institute New Zealand (PINZ) and Singapore Institute of Surveyors and Valuers (SISV)** on forced sale value are given below:

API and PINZ

(a) **The terms 'forced sale value' and/or 'distress sale value' are considered improper and not backed by the institutes.** However, advise prepared by a valuer estimating a likely price realizable, based on an agreed set of circumstances may be provided, subject to agreeing and detailing all assumptions and necessary qualifications.

(b) Market constraints inconsistent with market Value.

(c) When an estimate of realizable price is made with market constrains (commonly known as forced sale value) is not consistent with market value and represents likely price achievable in a 'non-market' situation. This estimate is with special assumptions such as:

- Reduction in the marketing period than normally required
- Seller is not a willing seller.

(d) It further says in any event if the Valuer is requested to carry out valuation with constraints then in that event the <u>Valuer and clients should be aware that there is a difference in the market value and price realizable under constraints and it must be further made clear that the advice is not on the valuation but an opinion based on client's specific instructions whereby Valuer will have to rely on his experience and understanding of the market with the facts and circumstances on hand.</u>

SISV

As stated in the 'Valuation Standards and Guidelines' by Singapore Institute of Surveyors and Valuers, **the Forced Sale Value "is generally not easily predictable by a Valuer because of the nature and extent of subjective and conjectural assumptions that must be made in formulating such an opinion.** <u>Therefore, Valuers shall not provide a Forced Sale Value unless specifically requested by the clients. In all such instances, the Valuer shall provide the assumptions on which such value is based.</u>**"**

v. **There** is a reference of **realizable value and distress value** in the literatures of IBBI and IBA.

According to IBA Handbook of Valuation 2011 definitions of liquidation value related terms are as under:

(a) **Orderly Liquidation Value is Realisable Value,** and it further says that the sale to take place under reasonable period of time and seller is compelled to sell.

(**Note:** Under IBA definition of orderly liquidation value seller is compelled to sell and there is no mention of price realized from a properly advertised and conducted public auction. But IBA under forced liquidation value has mentioned price realized from a properly advertised and conducted public auction as mentioned under (b) below.)

(b) **Forced Liquidation Value is Distressed Value** that could be typically realized from a properly advertised and conducted public auction, with the seller being **compelled to sell with a sense of immediacy** on as is where is basis.

(**Note:** According to IBA under orderly liquidation value there is no reference of price realized from a properly advertised and conducted auction but under forced liquidation there is a reference of price under sale by auction. But according to IVSC under forced sale a normal advertising/ selling/marketing effort is not feasible due to the short exposure time.

vi. **The** confusion created by the definitions given by various institutions mentioned earlier:

(a) IBA prepared the Handbook in 2011 by adopting various terms from IVS 2007. Subsequently IVS has revised various terms, but IBA has not periodically revised as per IVS.

(b) IBC directs valuers to estimate fair value (i.e., Realizable value as per IBC) and liquidation value computed in accordance with internationally accepted valuation standards.

As said earlier in paragraph 11.2.2 that the procedure laid down by International Valuation Standards (IVS) for computation of forced sale/liquidation values is not followed by majorities of the countries. As majority of the countries are not following practice prescribed by IVS indicates that there are practical difficulties in following the practice prescribed under IVS.

(c) In fact**, Fair Value** means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

Fair value requires the assessment of a price that is fair between two specific parties, taking into account the respective advantages and disadvantages that each party will get from the transaction. For example, synergies between two parties may mean that price that is fair between them is higher than the price that might reasonably be obtainable in the market. Therefore, Fair Value is often interpreted as a form of special value.

(d) Realizable value **(**RV) = Market Value of Asset **–** Cost selling of the asset.

(e) According to IBC, RV = Market Value defined by IVS.

(f) As per Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) REGULATIONS, 2016:

Fair value under Regulation 2(1) (hh) is **Realizable value** and **Liquidation Value** under Regulation 2(1)(k) is also the **Realizable value**.

This gives the impression that **fair value** is the **liquidation value**. This is not correct.

(g) Realizable Value is not defined in the IVS.

It is the valuer's job to study the market as on the date of valuation and give the opinion as to best price obtainable depending on the time within which the transaction is expected to be completed by the seller.

10.2 In View of facts mentioned above, this standard covers the following topics.

- Liquidation
- Fair Value
- Realizable Value
- Market Value
- Orderly Liquidation Value
- Forced Sale Value

- Valuer's views on special purpose buildings or any other building for which there is hardly any market.
- Clients to instruct valuer for time limit in absence of availability of building wise literature which gives the information for time required to sale buildings falling under various categories / wide spectrum of buildings.

10.3 **Liquidation** in finance and economics, is the process of taking a business to an end and distributing its assets to claimants. It is an event that normally occurs when a company is insolvent, meaning it cannot pay its debts when they are due.

10.4 These terms Fair Value and Realizable Value are defined under paragraph 10.1 background

10.5 The terms Market Value, Orderly liquidation value and Forced sale value, are explained by a chart below.

Transaction between willing buyer and willing seller wherein both the parties have acted knowledgeably and prudently after proper market inquiry and without compulsion

Market value

Orderly liquidation value	**Forced sale value**
Sale takes place in a condition where marketing time given is less than required.	Seller is forced to sale the asset compulsorily with no proper marketing / exposure

Market Value definition is given earlier.

Orderly liquidation value is an estimate of the gross amount that the tangible assets would fetch in an auction-style liquidation with the seller needing to sell the assets. The term ‘orderly’ implies that the liquidation would allow for a reasonable time to identify buyers, and the seller would have control of the sale process. The marketing time is less than required for a sale as per market value definition and more than required under forced sale conditions.

Forced sale value is an estimate of the gross amount that the tangible assets would fetch when the seller is forced to sell the assets compulsorily without proper marketing time / exposure time. There is urgency to sell, and the seller does not have control of sale process (generally the banks / courts / receivers, etc. and thus **the seller is not a willing seller**).

For estimation of final value time plays an important role under orderly liquidation or forced liquidation concept. The forced liquidation value concept reduces time to a minimum and, therefore, price realized reflects this. An orderly liquidation concept can realize higher prize due to the increased time involved and by using an experienced liquidator.

So far as price obtainable in the forced sale condition is concerned, it is very difficult to predict because one is attempting to define a moving target. Is forced sale the one which is expected to take place within 3 months, 2 months, 1 month, 1 week or 1 day?

In absence of availability of literature which gives the information for marketing time required to sale buildings of wide spectrums under different situations like ‘**willing buyer’** and **‘willing seller’** and **orderly liquidation** and **forced sale** it is necessary that valuers are instructed by the clients on time limit by which transaction for sale is to be completed.

In case of special purpose buildings and in case of any other building if there is hardly any second-hand market then in that case Valuer's views on following is necessary:

(a) If a building is specially designed, then the degree of specialty.
(b) Does it suffer from limited marketability? If yes, how much?

VALUATION STANDARD 11 (VS 11)
VALUATION REPORTS

11.1 The valuation is communicated to the Client in the form of a report. As the Client acts on Valuation Report or certain third parties without any reference to the Valuer (unless a specific reservation has been made), it shall be clear and not misleading.

The valuation report must convey to the reader a clear understanding of the opinion expressed by the Valuer, the basis of the valuation used and the assumptions and information on which it is based.

The report should be in a language which can be understood by a layman too.

11.2 The valuation report must provide sufficient information to permit those who read and rely upon the report to fully understand its data, reasoning, analyses and conclusions. It must state any assumptions and limiting conditions upon which the valuation is based.

11.3 The format of the Valuation Report set forth in this section will constitute the basic outline and content of a valuation report. This format provides the client with the best method for understanding the Valuer's reasoning and conclusions and assists the valuer in analyzing the problem logically.

The amount of data to be included in a report depends on the type of property valued and the judgement of the valuer. A report that fails to convey necessary background information cannot provide a sound basis for decision making. Subheadings should be used to organize the data to aid both the client and the valuer.

The reasons leading to the Valuer's conclusions must be clearly stated to help the client understand the report.

The valuation report provides the estimates and conclusions necessary to meet the objectives of the client.

11.4 FORMAT OF THE REPORT

The format of the report must include the following points and sections.

Introduction

(i) ***Title Page to*** **include:**

- Name of owner(s)
- Address of the property
- Name of the individual making the report
- Name of the person to whom the report is addressed

(ii) ***Letter of Transmittal.*** **A normal letter, including:**

- Date and source of authorization to prepare the report
- Identification of interest valued
- Purpose of Valuation
- Effective date of the valuation
- Any other particulars or factors that need to be drawn to the attention of the reader
- Value conclusion

- Signature of valuer. (While more than one valuer may work on the appraisal assignment the Letter must only be signed by the valuer designated responsible for the value conclusion.)

(iii) ***Table of Contents.*** This is a requirement for reports containing numerous headings and several pages.

(iv) ***Photograph*** –Where the valuation includes substantial buildings, a single-enlarged front/side-angle view of the major improvements is required. Additional photographs of the subject(s) should be included in the addenda. Original photographic prints only should be in all copies of the Valuation Report.

(v) ***Summary of Important Facts and Conclusion.*** Should be limited to important facts and value conclusion.

Factual Data

(vi) ***Definition of the Valuation Problem***

- Purpose of the valuation
- Definition of value required
- Property rights and interests valued
- Effective date of the valuation

(vii) ***Identification of the Property.*** This includes not only any municipal address but also a legal description to clearly identify the property.

- If the legal description is of a lengthy nature, it may be referred to and included in the addenda.

- It is important that the identification of the property be such that, if there is no actual municipal address, sufficient identification data is given over and above the legal description to clearly identify the property, perhaps with reference to other established points.

(viii) ***Area and City Data***. These data may be minimized but should clearly indicate the geographic location of the community and include any social or economic data pertinent to the valuation.

(ix) ***Neighborhood Data.*** Analysis will vary in importance in relation to the type and form of the valuation. In all cases the social and economic effects on the neighborhood must be considered in varying degrees. While many valuations will merely require a brief explanation of its physical data, a fully reported analysis of the neighborhood and its trend as it affects the subject property is required in all cases.

(x) ***Site Data.*** **Include:**

- Size, shape and frontage
- Location of the site with respect to side streets, within the block or within the neighborhood
- Details with respect to topography, easements, soil conditions where applicable, mineral deposits where applicable, adjacent properties either side of the subject property and opposite to the subject property, and remarks in respect to whether or not they are detrimental to or harmonious with the subject property
- Any particular hazardous factors inherent in the immediate location of the property, i.e. floods, odours, etc.

(xi) ***Site Improvements.*** These include such items as landscaping, driveways, retaining walls, and other factors of improvement to the site, with the exception of the actual buildings constructed on the site.

(xii) ***Services Available to the Site.*** **These include:**

- The actual municipal services and utilities available or whether the property is serviced with a well and septic tank: The later condition may be included in site improvements.
- The size and capacity of the services, where the subject property is to be redeveloped or is vacant land. This is particularly important in relation to highest and best use.

(xiii) ***Description of the Buildings.*** The extent and detail of the descriptions of the buildings depend on the type of report, but the minimum requirements are to indicate:

- Type of building and age
- Basic type of structure and building materials used in the main components
- Dimensions by square metre measurements
- Description of the rental areas, and the type of occupancy
- Type and style of equipment for building service
- Physical condition, and quality as a basis for depreciation

(xiv) ***Annual Property Taxes.*** Given when Income Approach is the method relied on. Optional in other cases.

(xv) ***History.*** A brief summary of the ownership of the property including:

-
- Prices paid for the property if occurring during a reasonable period of time prior to the date of the valuation
- Any major additions or alterations carried out

(xvi) ***Lease Details.*** Details of any lease, sublease, or rentals, such as:

- Terms
- Rental payments
- Type of lease
- Who is responsible for what expenses
- Area to which the lease is applicable
- Name(s) and occupation(s) of the tenant(s)
- If the lease is of such a nature that it requires reporting in detail, then merely a reference is needed in this section and a copy or extracts of the pertinent details of the lease can be included in the Addenda.

(xvii) ***Zoning****.* Describe the zoning for the general area and, in particular, the subject property.

- Indicate any potential rezoning.
- Since legal land use is one of the predetermining factors of the highest and best use, the zoning and the relationship of the property subject to the zoning, i.e. conforming or nonconforming, and other factors in respect to land use as required under zoning or other land use restrictions, are of the utmost importance and must be clearly defined.
- Include copy of pertinent zoning map in Addenda.

Analysis and Conclusion

(xviii) ***Valuation Analysis.*** This constitutes an explanation of the reasons and thinking behind the methods used in the valuation.

(xix) **Vacant *Land Value.*** The following information is required in the report:

- The indicated value of land should be supported by confirmed sales of similar lands having a similar optimum use.
- Differences must be analyzed, adjustments fully explained, supported and summarized in chart form.
- Listings and offerings may be used as supporting data only. Minimum sales data should include:
  - Registered deed number
  - Price
  - Date of sale
  - Size/area
  - Shape
  - Topography
  - Zoning
  - Rate per unit
  - Other factors

- A comment should be made on the value of the subject property indicated by properties under sale instances.

(xx) ***Valuation by Cost Approach.*** When used, this section shall be in the form of comparative data arranged in sequence beginning with the reproduction or replacement cost, supported by basis on which reproduction/replacement is worked out. The depreciation should be explained in narrative form and broken down wherever possible into physical deterioration (depreciation due to wear and tear), functional and economic obsolescence.

Land shall be valued by sale comparison approach as explained above.

(xxi) ***Valuation by Income Approach.*** When used, the data used must be factual and supported, and shall include:

- An estimated gross economic rent
- Allowance for vacancy
- An itemized estimate of expenses/outgoings
- The capitalization process, explained and supported by statement of sources of rates and factors from the market.

(xxii) ***Valuation by Direct Sales Comparison Approach**.* When used, the following rules apply to this approach:

- Sale instances used must be verified.
- Sufficient explanation and data must be provided on each property under sale instance so that comparison can be made
- Differences must be analyzed, adjustments fully explained and supported, to indicate the reasoning behind the value estimates, and summarized in chart form.

(xxiii) ***Certification.*** The standard form of certification, certifying that the valuer has inspected the property and has no interest in the same. While more than one valuer may work on the valuation the certification must only be signed by the valuer designated responsible for the value conclusion.

Supporting data like plans/photographs/sale instances relied or any other information relied/ or any other relevant to be annexed with the report.

11.5 **Limiting** conditions that directly affect the valuation must be explained clearly where appropriate.

11.6 It is the valuer's responsibility to prepare valuation report in compliance with the Valuation Standards and adequate disclosure of information that supports the conclusion should be made in the report. The above are minimum requirements to be contained in a valuation report. In specific cases, the valuation report should comply with additional requirements as specified by the user of the report or the client.

Note: Assumptions and limiting conditions prescribed by IBBI to be followed in addition to the above.

Profiles of members of Standards Committee

(a) Rashmi K. Gandhi

- Graduate in civil engineering from BVM Engineering College, Sardar Patel University, Vallabh Vidyanagar, Gujarat
- Awarded H.P. Gold Medal by Sardar Patel University for securing First rank in B.E.(Civil) examination.
- Founder Member – Centre for Valuation Studies, Research and Training Association (CVSRTA)
- Fellow – Institution of Valuers
- Member – Institution of Engineers
- Former Council Member – Institution of Valuers
- Practicing civil engineer, architect and valuer since 1961.
- Designed all types of structures –residential, factories and colleges
- Government registered valuer of real estate with more than 60 years of experience of valuation of wide range of properties-residential, commercial and industrial for large corporate like Bajaj, Mafatlal, Pittie, GP Goenka, Britannia and many others
- Appeared as an Expert Witness in number of valuation assignments and clients derived benefits.
- Author of book-Elements of Valuation of Immovable Properties
- Former Editor, Indian Valuer and conducted popular Question/Answer column ‘In my opinion’
- Presented more than 50 papers/articles in conferences and lectured throughout India.
- Member of a team of valuers pioneer in introducing academic course in RE valuation in Sardar Patel University, Shivaji University
- Assisted the universities in preparing study material for real estate valuation
- Helped Insolvency and Bankruptcy Board of India (IBBI) in establishing examination system for their examinations in the disciplines of land and building and plant and machinery and prepared study material running in 4000 pages for both these disciplines with the help of members of CVSRTA.

(b) Kirit P. Budhbhatti

- Graduate in electrical engineering from BVM Engineering College, Sardar Patel University, Vallabh Vidyanagar, Gujarat and have passed an examination in valuation of real estate conducted by Institution of Surveyors (India).
- Former President – Institution of Surveyors
- Former Council Member – Institution of Valuers
- Founder Chairman (1998-2007) International Plant and Machinery Valuation Conference Committee (IPMVCC). The IPMVCC organized the first conference exclusively on PME valuation in Anand, Gujarat, India in 1998 subsequently once in two years in KL, Sydney, HK, London respectively and thereafter other parts of the world.
- Founder Member – Centre for Valuation Studies, Research and Training Association (CVSRTA)
- Fellow – Institution of Surveyors
- Fellow – Institution of Valuers
- Member – Institution of Engineers
- Government registered valuer of real estate as well as plant & machinery with more than 50 years' experience. Valued wide spectrum of industries for various purposes for Hindustan Unilever, Murugappa, TATA, RPG, Arvind Mafatlal etc.
- Author of books on plant and machinery as well as real estate valuation
- Involved in preparing basic document for International Valuation Standards Committee (IVSC) on Plant, Machinery & Equipment Valuation in 1994-95
- Delivered lectures in Asia, Africa, America, Australia, and Europe
- Pioneer in introducing academic course in PME valuation in Sardar Patel University, India which is unique in the whole world and real estate valuation in India.
- Assisted the universities in preparing study material and teaching both for real estate and plant & machinery valuation courses.
- Helped Insolvency and Bankruptcy Board of India (IBBI) in establishing examination system for their examinations in the disciplines of land and building and plant and machinery and prepared study material running in 4000 pages for both these disciplines with the help of members of CVSRTA.
- Former Member-Committee appointed by the Govt. of India for regulating valuation profession.
- Queensland Government Australia accepted his suggestions for improvement in plant and machinery valuation profession.
- Recognized by BVM Engineering College as – JEWEL OF BVM
- Yoga Teacher and Sadhaka of Yoga Institute-Mumbai-400 055

(c) Nelson J. Macwan

- Graduate in civil engineering from BVM Engineering College, Sardar Patel University (SPU), Vallabh Vidyanagar, Gujarat and law from SPU
- Post graduate in valuation of plant & machinery as well as real estate from BVM Engg. College and ISTAR, SPU respectively
- Founder Member – CVSRTA
- Member – Institution of Surveyors
- Fellow – Institution of Valuers
- Academician – Lecturer in Post Graduate courses in valuation of plant &

machinery as well as real estate offered by Sardar Patel University (1996-2008) and former visiting faculty for Master of Valuation (Real Estate), Shivaji University, Kolhapur

- Wide spectrum of industries valued for various purposes (2008 – till today) for Murugappa, Elecon, Hindustan Unilever, etc.
- Prepared study material for PM and RE valuation courses
- Presented papers in real estate valuation conferences
- Member – Multi Faculty Board for Master of Valuation (Real Estate), Shivaji University, Kolhapur
- Helped Insolvency and Bankruptcy Board of India (IBBI) in establishing examination system for their examinations in the disciplines of land and building and plant and machinery and prepared study material running in 4000 pages for both these disciplines with the help of members of CVSRTA.

(d) Sundeep H. Bikhchandani

- B.E (Hons) degree from BVCOE, Mumbai University.
- Diploma in Business Management from Narsee Monjee Institute of Management Studies.
- Masters of Valuation Real Estate and is a recipient of Gold Medal awarded by Sardar Patel University for securing 1st rank in post graduate degree course in Valuation of Real Estate.
- Master of Valuation in Plant & Machinery.
- Regular Speaker at various seminars and has been invited by universities, Banks, NBFCs for providing training programs in the area of valuation and Technical Due-Diligence of Real Estate Projects.

- Visiting faculty at Niranjan Hiranandani School of Management and Real Estate, Teaching MBA (Real Estate)
- Presented a paper on obsolescence in 5th International PME Conference in London in 2007.
- Founder Member – CVSRTA
- Member – Institution of Surveyors
- Fellow – Institution of Valuers
- Member – Royal Institute of Chartered Surveyors (RICS)
- Consultants for various Real Estate Funds, NBFC and Banks

(e) Jigesh J. Mehta

- Post-graduate in civil engineering and Graduate in law
- Post-graduate in valuation of plant & machinery
- Member – CVSRTA
- Fellow – Institution of Valuers
- Authored several articles in monthly journal of Institution of Valuers
- 25 years' experience in Valuation and executed the large assignments for corporate including Reliance Industries, Murugappa Group, ABG Shipyard Ltd., Hindustan Unilever Ltd., Breweries.

(f) Sunitkumar Gupta

- Post-graduate in valuation of Real Estate
- Co-author of Stamp Duty Ready Reckoner for last 25 years
- Co-author of Property Tax Ready Reckoner.
- He has interviewed Senior Government Officials of Stamp Duty and Registration Department which was published in the Times of India and other leading News papers of Mumbai. Leading Newspapers relay on his opinion in the matters of stamp duty, registration and property tax.
- Contributed more than 25 articles on stamp duty & registration which were published in various leading new papers of Mumbai.
- Spoke on stamp duty & registration related subjects at many of the seminars & lectures organized by Western India Regional Council of Institute of Chartered Accountants of India
- Specialized in valuation of immovable property in Mumbai as on 1-4-1981 & 1-4-2001.
- Worked as associate to Mr. Santosh Kumar, very prominent and senior Govt. Regd. Valuer, for the valuation of very high value properties. like office premises in World Trade Centre at Colaba, UTI Tower at Bandra, Simplex Mill at Mahalxmi etc.

PART- II GUIDANCE NOTES

GN1 Guidance Note on Valuation Under Stamp Acts in Various States

GN2 Guidelines on Valuation of Real Estate published by CVSRTA

GUIDANCE NOTE 1 (GN 1)
VALUATION UNDER STAMP ACTS IN VARIOUS STATES

1.1 Background

Ready reckoners maintained by Stamp Duty Departments for levying Stamp Duty are generally known as circle rates / guidelines rates and in Gujarat, it is known as Jantri.

It is a well-known fact that valuation of property for levying stamp duty throughout our country needs lot of improvement.

The main reason for this sorry state of affairs is the absence of proper training in property valuation and even if training is provided, there is always an apprehension in continuing the same practice by the officer on completion of training.

From personal experience by interacting with senior officials handling valuation in the states of Gujarat, Maharashtra, Andhra Pradesh, Karnataka and Uttar Pradesh, it was found that none of the officers handling valuation was having either a degree in valuation or proper training and experience in valuation.

From Jantries prepared in Gujarat in the years 2008 and 2011, it will be noticed that there is a lot of scope for improvement.

The situation is similar throughout India as explained hereinafter.

1.2 'Market Value' is defined as under in Gujarat Stamp Manual

> "Market Value in relation to any property which is the subject matter of an instrument of transfer means the price which such property would have fetched **if sold in the** open market **on the date of execution of such instrument**."

Manual of Stamp Duty and Registration in Andhra Pradesh by M. V. Durgaprasad - Third enlarged edition, prescribes similar definition of Market Value.

Meaning of the term 'If sold'

It has been held, "If sold in the open market does not contemplate actual sale or actual state of market but only enjoins that it should be assumed that there is an open market and property can be sold in such a market."
(Ref.: Ahmed G.H. Ariff vs. C.W.T. 76 ITR 471)

"If sold, creates a fictional position which the Tax Officer must assume. It is a hypothetical case which is contemplated by these words. Let the price be determined by economic forces – sale to be open to competition. Adequate publicity or advertisement prior to sale, are given as criteria of open market."
(Ref.: Purshottam Amarsey vs. C.W.T. 88 ITR 417)

Meaning of the term 'on the date of valuation'

As the market condition is different on different dates, the estimate of market value has to be time specific of a given date.

1.3 The **principles** to be taken into consideration for determination of market value (as per The Gujarat Stamp Manual,1991, are given herein after.

1.4 The principles of valuation to be taken into consideration as per Tamil Nadu Stamp Act, **The** Karnataka Stamp Act, 1957, The Kerala Stamp Act, 1959 and Manuals of Stamp Duty and Registration in Andhra Pradesh are same as given in Gujarat Stamp Manual 1991.

1.5 The **links** for the principles of valuation to be taken into consideration are as under:

Andhra Pradesh
https://www.latestlaws.com/bare-acts/state-acts-rules/andhra-pradesh-state laws/andhra-pradesh-stamp-prevention-valuation-instruments-rules-1975/

Karnataka
https://www.karnataka.gov.in/karigr/Pages/(PREVENTION-OF-UNDERVALUATION-OF-INSTRUMENTS)--RULES,-1957.aspx

Kerala
https://www.eaadharam.in/p/stamp-duty-and-registration-fee-act-and.html

Tamil Nadu
http://www.bareactslive.com/TN/tn1053.htm

Gujarat
https://stampsregistration.gujarat.gov.in/assets/downloads/acts_23041984.pdf

Maharashtra
https://maharashtrahousingandbuildinglaws.com/the-maharashtra-stamp-determination-of-true-market-value-ofproperty-rules-1995/

Note: The principles of valuation laid down in Maharashtra Stamp Act -determination of True market value Rules are different than the principles laid down in Gujarat, Andhra Pradesh, Karnataka,Kerala and Tamil Nadu. Therefore, Maharshtra Rules are dealt with separately hereinafter.

1.6 **Supreme Court of India and several High Courts have in many cases held that the** guideline **value as per Stamp-duty Departments of various States do not satisfy the criteria of willing buyer and willing sellers.**

BSNL v. M/s. Nemichand Damodardas [2022 SCC Online SC 815] - The Court opined that the prices mentioned in the Ready Reckoner for the purpose of calculation of the stamp duty, which are fixed for the entire area, cannot be the basis for determination of the compensation under the Land Acquisition Act where market value satisfying the criteria of **'willing buyers'** and **'willing sellers'** is to be reported

In several other cases such as *Lal Chand v. Union of India [2009 15 SCC 769]*, *Jawajee Nagnatham v. Revenue Divisional Officer- Adilabad-A.P. [1994 (4) SCC 595]*, *Land Acquisition Officer, Eluru v. Jasti Rohini [1995 (1) SCC 717]*, *U.P. Jal Nigam, Lucknow through its Chairman v. M/s. Kalra Properties (P) Ltd. Lucknow [1996 (3) SCC 124]* and *Krishi Utpadan Mandi Samiti, Sahaswan v. Bipin Kumar [2004 (2) SCC 283]*, the Supreme Court has held that market value under Section 23 of the Land Acquisition Act cannot be fixed on the basis of the rates mentioned in the 'Basic Valuation Registers' maintained for the purpose of detection of undervaluation and collection of proper stamp duty.

Therefore, where market value is to be estimated satisfying the criteria of **'willing buyers'** and **'willing sellers'** as outlined in Ind VS 3 earlier, stamp duty valuation cannot be adopted.

International Valuation Standards (IVS) requires market value satisfying the criteria of **'willing buyers'** and **'willing sellers'.**

IBA Handbook 2011(IBA) requires market value satisfying the criteria of **'willing buyers'** and **'willing sellers'.**

Section 5(n) of banking regulation Act,1949 (BR Act) refers to requires market value satisfying the criteria of **'willing buyers'** and **'willing sellers'.**

Therefore, stamp duty valuation cannot be adopted when valuation as per definition of IVS, IBA and BR Act is required and any other situations where market value satisfying the criteria of **'willing buyers'** and **'willing sellers'** is required.

The principles of valuation as per Stamp Acts of Gujarat, Andhra Pradesh, Karnataka, Kerala and Tamil Nadu.

<table>
<tr><td colspan="2">These principles are without consideration of Valuation maxims like – physical, legal, social, economic, transferability, marketability, utility, demand, supply, value means present worth of future benefits and in valuation of land and building legal rights of individuals are valued and not land and building as such.

The principles are given below with the comment on each of them</td><td>Comments</td></tr>
<tr><td colspan="2">The collector of the district shall while determining the true market value of a property which is the subject matter of an instrument take into consideration primarily the capitalized value of the property i.e. the amount of money whose annual interest at the highest prevailing interest at any given time is its net annual income, and also the following factors, namely</td><td>The manual defines market value but does not define true market value.

There are three approaches to value
- Income, market and cost.

The income approach requires net rent from property and YP to estimate value. YP is to be computed from market-derived data from analysis of instances of sale of rented property.

The manual primarily recommends income approach with other factors.
Most of the property transactions are either with vacant possession (VP) or owner occupied (OO).

Tenants mainly fall under two categories.

- Protected under Rent Control Act.
- Not Protected under Rent Control Act.
The sale instances of rented property falling under above category are very rarely available. Hence, utility of income approach is very limited.

In view of facts mentioned above, it is not correct to recommend income approach only.</td></tr>
<tr><td>(a)</td><td>In the case of non-agricultural land-</td><td></td></tr>
<tr><td></td><td>i) the general value of non-agricultural land in the vicinity;</td><td>This is vague.</td></tr>
<tr><td></td><td>ii) facilities such as road, railway station, bus route, shops, market and the like available in the vicinity of the land;</td><td></td></tr>
</table>

	iii) amenities like public offices, hospitals and educational institutions available in the vicinity of land;	These are relevant factors; there are many other factors to be taken into consideration over and above these factors.
	iv) development activities including, development of industries in the vicinity of land;	
	v) any factors mentioned in the instrument which is relevant for the purpose of determination of true market value;	Factors under this category are neither outlined nor explained. The concerned authorities have hardly any time to read documents presented for registration. The Collector as well as his staff handling valuation are neither academically qualified in valuation nor properly trained and experienced in valuation and hence are not aware of ground reality of discipline of valuation of real estate. These underlined principles need to be exhaustive as they are to be used as guidelines in preparing a valuation. Therefore, all the factors need to be enumerated. Many vital factors to be considered for valuation are missing in these principles as outlined further below in the document.
	vi) any other factors which the Collector of the District thinks to have a bearing on the valuation of non-agricultural land;	As per (a) (v) above.
(b)	in the case of buildings- i) the area of construction; ii) the floor space index; iii) type of structure; iv) year of construction; v) kind of material used; vi) locality in which constructed; vii) rate of depreciation;	Factors mentioned under (b) (i) to (vii) forms part of one of the 10 valuation maxims-physical/technical factors. It will lead to brick mortar valuation and result will be different than the market value defined in the Stamp Manual if buildings are valued by taking into consideration these factors only.
	viii) any factors mentioned in the instrument which is relevant for the purpose of determination of true market value; ix) any other factors which the Collector of the District thinks	As per (a) (v) above.

	to have a bearing on the valuation of building;	
(c)	In case of any other property-	Principles for land and buildings have been given under (a) and (b) above. Now, question arises as to the meaning of the word ‘property’ given here. Does it mean lease-hold property? If yes, then principles underlined are not correct because they do not include issues to be taken into consideration for valuation of leasehold properties. Does it mean intangible property? It cannot be because the issues to be considered for valuation of intangible property are different than that for tangible property. None of them are outlined here. Does it mean personal property like plant & machinery? Obviously not. Then the question arises what is the meaning of any other property?
	i) the nature and condition of the property; ii) purpose for which the property is being put to use;	These are also vital for property falling under (a) and (b) above. But, these factors have not been mentioned exhaustively with illustrations.
	iii) any factors mentioned in the instrument which is relevant for the purpose of determination of true market value; iv) any other factors which the Collector of the District thinks to have a bearing on the valuation of property.	As per (a) (v) above.

MAHARASHTRA

	The Bombay Stamp Act – Determination of the Market Value of Property Rules, 1995 **Mantralaya Bombay-400 032 dtd.14th August 1995 (M.G., Part-IV-B, Page 646)**	
	The Principles as per Manual	**Comments**
	4. Annual Statement of Rates (ASR) of Immovable Property – (1) The Joint Director of Town Planning and Valuation, Maharashtra State, shall prepare annual statement of rates showing average rates of lands and buildings situated in every Tehsil, Municipal Corporation, or local body area with the help of such other officers as may be appointed by the Government from time to time and submit the same for approval to the Chief Controlling Revenue Authority, latest by 31st October of each year. (2) The data in respect of average rates of lands and buildings in every Tehsil, Municipal Corporation or local body area shall be arranged in the annual statement of rates as far as possible in ward wise / zone wise manner in respect of urban properties and in respect of rural properties, taluka, village-wise as the case may be. For the purpose of average annual rates, properties may be divided in groups, sub-groups or classes after taking into account the types of land, types of construction, location and situational advantages or dis-advantages of property. While working out the average rates, of lands and buildings, the	As academically qualified and trained valuers are not deployed at any level in Stamp Duty departments, there is a lot of scope for improvement in this area. The improvement suggested is explained later.

		concerned officers **shall take into account the established principles of the valuation** and any other details that they may deem necessary. (3) The Chief Controlling Revenue Authority shall by an order issue annual statement of rates showing average rates of lands and buildings situated in every Tehsil, Municipal Corporation and local body area (hereinafter called ‘annual statement of rates’) as soon as they are made for the first time, and thereafter, every year on 1st day of January, taking into account the average rates of lands and buildings prepared and submitted to him by the Joint Director of Town Planning and Valuation, Maharashtra State. (4) If the Chief Controlling Revenue Authority is not in a position to issue annual statement of rates as mentioned in sub-rule (3) above, on 1st day of January in any year due to any administrative difficulties, the rates mentioned in the annual statement of rates for the year immediately preceding may be incremented by the Chief Controlling Revenue Authority, in consultation with the Joint Director of Town Planning and Valuation, keeping in view the increase in market rates of immovable properties. (5) The Chief Controlling Revenue Authority shall annually supply to Sub-Registrar a copy of the above statement showing the average rates of lands and buildings situated within his jurisdiction. Every registering officer shall cause a copy of the above statement to be affixed outside the Registration Office.	

	(6) **Every registering officer shall, when the instrument is produced before him for registration, verify in each case the <u>market value</u> of land and buildings, etc., as the case may be, from the above statement and if he finds the market value as stated in the instrument, less than the minimum value, prescribed by the statement,** he shall refer the same to the Collector of the District for determination of the true market value of the property which is the subject matter of the instrument and the proper Duty payable thereon: **1**[Provided that, if a property is sold or allotted by Government or Semi-Government body or a Government Undertaking or a Local Authority on the basis of the pre-determined price, then value determined by said bodies, shall be the true market value of the subject property] : **1. Substituted by the Bombay Stamp (Determination of True Market Value of Property) (Amendment)Rules,2001 dtd.6th December 2001.** **2**. Provided further that, where the market value has been stated in accordance with or more than prescribed in the statement issued by the Chief Controlling Revenue Authority, but the Registering Officer has reason to believe that the true valuation of the immovable property cannot be arrived at without having recourse to the local inquiry or extraneous evidence, he may, before registering such instrument, refer the same to the Collector of the District for determination of true market	**Comments for 4**(6) Every registering officer shall .... the proper Duty payable thereon. **ASR indicates the average value of land and building as given in 4 (1).** The sub registrar is supplied with ASR. According to this provision i.e., 4(6), t**he sub registrar is supposed to verify in each case the market value of land from ASR.** Moreover, what is stated in the document presented for registration is the price at which the property is sold **and not the market value.** It is necessary to get clarity on these **basic terms 'market value' and 'price'.** Here the words used are **'market value'** which are not correct, the correct words are **'sale price'.** **Price is a fact, whereas market value is an estimate of what price ought to be.** **These words cannot be used interchangeably.** **In fact, the wordings of 4(6) should have been as under-** **'Sub registrar shall compare the price indicated in the document presented for registration with ASR and if price indicated in document presented is different, then appropriate action shall be taken as per the provisions of the Stamp Act.'** Due to this provision, one will rarely find apparent consideration mentioned in instrument of transfer exceeding annual statement of rates. Market value could be higher or lesser than the price paid. The price paid in a particular transaction is higher than that

		value of property and the proper Duty payable thereon. * This proviso was substituted by G.N., R & F.D., No. MUDRANK. 1099/2251/C.R. 676/M-1, dated 6-12-2001 (M. G. G., Pt. IVB, dated 13-12-2001, p. 837). **2. Inserted by G. N. Of 30.9.2013** **3**.Provided also that where the market value has been stated in accordance with or more than that prescribed in the statement issued by the Chief Controlling Revenue Authority, but the Registering Officer has reason to believe that the true **valuation of the immoveable property cannot be arrived at without having recourse to local inquiry or extraneous evidence** he may, before registering such instrument, refer the same to the Collector of the District for determination of true market value of property and proper duty payable thereon. **3. Substituted for the words "Provided further that" by G. N. Of 30.9.2013** (7) All the Registering Officers shall send to the Town Planning Valuation Officers appointed to assist the Joint Director of Town Planning and Valuation for preparation of annual statement of rates, the extract of the register in respect of the instruments presented for registration in which consideration for the subject property is stated to be more	prescribed in the statement is a not a proper basis to raise the rate in the statement. **Market value is to be always estimated as per the Principles of Valuation by considering Valuation Maxims coupled with proper local inquiry**

	than the annual statement of rates by 30th day of the following month. (8) All the Special Land Acquisition Officers appointed under the Land Acquisition Act, 1894, or any other Act for the time being in force in respect of acquisition of lands and properties for public purposes shall, whenever the amount of compensation awarded by them is higher than the one payable on the basis of annual statement of rates issued by the Chief Controlling Revenue Authority under sub-rule (3) and (4) above, send a copy of such award to the Town Planning and Valuation Officers appointed to assist the Joint Director of Town Planning and Valuation for preparation of annual statement of rates, referred to in sub-rule (7) above, within 30 days from the date of payment of compensation.	**Comments for 4**(8) All the Special Land Acquisition Officers .... date of payment of compensation. This needs an amendment as Land Acquisition Act, 1894 is replaced by The **Right to Fair Compensation and Transparency in Land Acquisition**, **Rehabilitation and Resettlement Act**, 2013. In earlier Land Acquisition Act,1894 the market value estimation was based on **'willing buyer'** and **'willing seller'** as defined by Law Commission of India 1958 under para.45 and solatium amount was 30% of market value. **As per revised 2013 Act, market value is not based on the concept of 'willing buyer' and 'willing seller' but as under:** The market value of the proposed land to be acquired, shall be set as the higher of: • the minimum land value, if any, specified in the Indian Stamp Act, 1899 for the registration of sale deeds in the area, where the land is situated; or • the average of the sale price for similar type of land being acquired, ascertained from the highest fifty per cent of the sale deeds registered during the preceding three years in the nearest village or nearest vicinity of the land being acquired.; or • the consented amount in case the land is acquired for private companies or public-private

		partnership projects. The solatium amount is 200% if property is in rural area and 100% if in urban area. **Therefore, the amount of compensation paid under revised Act is not based on market value** and it is much more than that was awarded in the earlier Act and **therefore amount of compensation under New Act cannot be the basis for estimation of market value under the Stamp Act.**

Reasons for Shortfalls

The principles of valuation laid down in various states as mentioned above are without consideration of valuation maxims as well as concept of willing buyer and willing seller, contrary to the principles of valuation, do not satisfy requirements under S.5(n) of Banking regulation Act,1949 and from the case laws cited earlier, it is clear that the market value for mortgage purpose cannot be determined on the basis of jantri rates / guideline values / circle rates or basic valuation register.

* * * * *

GUIDANCE NOTE 2 (GN 2)
GUIDELINES ON VALUATION OF REAL ESTATE PUBLISHED BY CVSRTA CONTAINING FOLLOWING TOPICS

1	**Various terms used in realm of real estate valuation**	
2	**Market Value and Role of Unaccounted Money in Property Transactions in India**	
	• *Market Value and related issues*	
	• *Importance of conceptual framework of 'market value' in actual practice*	
	• *Role of unaccounted money in property transactions in India*	
3	**Cost, Value, Market value, Special value,** **Value in use/Exchange/To the owner/To the occupier**	
4	**Property market & subject matter of valuation**	
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	• *Interest in a Property: Subject Matter of Valuation*	
	• *Illustration*	
5	**Income Generating Properties**	
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	• *Period – income flow*	
	• *Security and rate of Interest*	
	• *Dual rate of interest*	
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6	**Valuation Maxims**	
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	• *Value on Reversion: Reversionary Value*	
	• *Valuation of Lessor's Interest and Lessee's Interest*	
	• *Illustrations for computation of lessor's and lessee's interests under different terms and conditions*	
9	**Importance of Familiarity with the Provisions of Rent Acts by the Real Estate Valuers**	
	• *The valuer must be familiar with the rent act applicable to property under consideration.*	
	• *Two scenarios*	
	• *The provisions regarding exemptions from operation of Rent Control Act vary from state to state.*	

10	**Various Categories of Real Estate And Their Approach to Valuation**	
	• *Open land*	
	• *Built-up properties*	
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	• *Statement of object of GRUDA**	
	• *Section 10 of GRUDA provides for Circumstances in which unauthorized development may be regularized*	
12	Miscellaneous Topics	
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	• *Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013*	
	• *Land acquired for companies under the Land Acquisition Act, 1894 - Peculiar issues*	
	• *Vital issues to be taken into consideration in valuation for disinvestment, mergers and acquisitions*	
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	• *Buildings other than apartments in multi-storied buildings*	
	• *Other information*	
	• *Steps for valuation exercise for immovable property*	

GUIDELINES

ON

VALUATION OF REAL ESTATE

Prepared by

Centre for Valuation Studies, Research & Training Association, India

First Edition August, 2015

IMPORTANT NOTICE

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Preface

Centre for Valuation Studies, Research and Training Association (CVSRTA) considers itself lucky to do pioneering work in bringing out a document on the subject which will be beneficial to professionals in India.

I consider myself very lucky to have lectured on valuation of real estate throughout length and breadth of India. While interacting with participants, I discovered a dire need for guidelines in the subject area. This is very essential because most of the practitioners in our country are practicing without academic degree in valuation of real estate.

Standards/Guidelines available for real estate professionals across the globe are giving direction to the real estate valuers that he/she shall do this or that. This is because what to do is covered in the course curriculum.

Therefore, there is a basic difference in preparing the guidelines for the practitioners who practice with academic degree and those who practice without academic degree.

This material is titled as Guidelines. The format of the material is different as compared to available guidelines in the discipline of valuation of real estate. The purpose behind preparing this material is to equip the practitioners in the areas which are not covered in course curriculum of academic degrees possessed by them and vital for valuation of real estate and wrong knowledge is not spread. It is said for computation of obsolescence that it is important to consider the obsolescence in all forms in totality whatever may be the nomenclature is used – technological, functional and economic. In the same way, whatever may be the nomenclature used for the title, the idea is to fill the gap, and if that is achieved then the purpose is served.

Valuation really concerns itself with all species of legal interests arising out of land and building which are exchanged for money and therefore entails the phenomena of exchange, scarcity and choice that characterize a “market” in the economic sense of the term. Properties are purchased both for use and investment; but in both cases the purchaser measures the expected return or benefits to be received from the land and building against cost outlay.

The valuer’s task is to express these benefits in money terms and to interpret the relationship between cost and benefit as a rate of return, thus allowing a choice between alternatives.

Valuation of real estate is a multi-disciplinary subject involving following disciplines over and above valuation:

- Law
- Economics
- Finance
- Town Planning
- Insurance
- Building construction

- Environmental science

The major issues to be considered in RE valuation in actual practice are:

- Fundamentals of valuation
- Valuation maxims
- Valuation approaches and methods
- Urban land economics
- Real estate management
- Obsolescence
- Statistics, and
- Many others

The details of the above are given in Annexure – A.

The above issues are not covered in the course curriculum of civil engineering, architecture and town planning. They are only covered in the post graduate degree course in Valuation of Real Estate offered by ISTAR, Sardar Patel University, Gujarat, Shivaji University, Maharashtra, Annamalai University, Tamil Nadu and examination in the discipline of valuation of real estate conducted by Institution of Surveyors. The examination in valuation of real estate conducted by Institution of Surveyors is recognized by the Ministry of Human Resources, Govt. of India for recruitment for superior services and posts.

Central Board of Direct Taxes, Ministry of Finance, Government of India have reduced the experience criteria (10 years for engineers, architects etc.) to 2 years for holders of PG degrees in valuation of real estate as well as plant & machinery offered by ISTAR, Sardar Patel University and other recognized universities for registration as valuers of immovable property and plant & machinery u/s 34 AB of Wealth Tax Act, 1957.

Therefore, it is essential that an examination in the subjects which are vital for RE valuation and not covered in civil engineering, architecture, etc. courses be prescribed for RE valuers practicing with these qualifications. The course curriculum of such an examination is also part of this material (please refer to page number 174). The duration of such a course is one semester (6 months) and same can be offered in the distance learning so that practitioners are not caused inconvenience.

Shortcomings in the criteria for registration as valuers u/s 34 AB of Wealth Tax Act 1957 are highlighted under paragraph number 4.0 of the section – Need of the hour – Creation of separate cadre of valuers at page number 163 of this document.

The rules for registration as valuers for real estate need to be amended by putting a condition that after certain date only academically qualified valuers shall be registered. Those who are registered without academic degree in valuation of real estate must pass one semester examination referred earlier by certain period otherwise their registration shall be cancelled. This provision is similar to one provided in Section 13(3) of Valuer's Act, 1982 of South Africa.

It is also essential to have a grandfathering provision stipulating that the valuers who have attained certain age may be exempted from undergoing one semester course and for them a training programme be stipulated. The topics to be covered in such a training programme are also part of this document.

In view of above facts, for the benefit of practitioners, these Guidelines are framed.

These Guidelines will certainly serve useful purpose for practitioners as well as users of services of valuers of real estate.

The users of services of valuers will certainly expect service from valuers according to these Guidelines. Then in that case they will have to compensate valuers accordingly.

Date: 25th August, 2015
Mumbai

Kirit P. Budhbhatti
Chairman
Centre for Valuation Studies,
Research and Training Association

Annexure - A

The major issues to be considered in RE valuation in practice

Economics : Micro-Economics, Macro-Economics

Urban Land Economics: Urban renewal process: rehabilitation, redevelopment conservation; decay of core area.

Real Estate Management and Development: Concept of management in real-estate development and administration; aims, objects and practices.

Private development enterprises by developers and promoters; regulatory laws for construction of multi-storied buildings, transfers and administration.

Statistics: Regression and correlation, time series, index numbers, multiple correlation coefficients

Valuation:

Cost, price and value; types of value; value elements – ingredients – characteristics – highest and best use – value in use – value in exchange

Annuities – capitalisation – rate of capitalisation – sinking fund – redemption of capital - Construction and use of valuation tables

Income Approach to Value

- Rent
- Outgoings – income – yield – years' purchase

- Lease : lessor and lessee : covenants, terms and conditions
- Leasing; land and building; building/occupation lease
- lessor's interest and lessee's interest
- Investment comparisons : Yield from real estate and other forms of investment – sound investment

Market Approach to Value

- Market – real estate market – market value; bell type curve
- Comparison of sale instances – factors, methods and weightages

Cost Approach to Value

- Cost : ingredients – costing methods
- Accrued depreciation and methods of computation including norms in Income Tax Act and Companies Act : retirement of assets
- Age – effective age – economic life and remaining life
- Depreciated replacement cost
- Statistical and analytical methods in valuation

Investment methods: discounted cash flow technique, I.R.R., N.P.V., Layer approach, Ellwood approach, equitable yield and equated yield.

Valuation and levy of tax on property for municipal taxation in the Indian context.

Gross Value - annual letting value – reasonable letting value - hypothetical rent - principle of *communibus annis* and *rebus sic stantibus* –considerations for fixing rateable value - statutory deductions. Judicial decisions on rating.

Various purposes of valuation:

(A) Fiscal

(i) Stamp duty on transfer of property
(ii) Rating
(iii) Direct Tax Acts - Income Tax including capital gains, Wealth Tax
(iv) Court fees including probate and partition

(B) Non-Fiscal

(i) Mergers and acquisitions/disinvestment
(ii) Bank finance and securitisation
(iii) Auction reserve
(iv) Compulsory acquisition
(v) Insurance
(vi) Sale / Purchase
(vii) Betterment levy
(viii) Standard / fair rent under rent laws

Various forms of obsolescence including depreciation.

Effects of zoning and development control.

Real-estate market : investments in real estate

Factors affecting urban land value

Environment and valuation - measures to restore the damage; cost of cure. Stigma due to environmental factors.

Valuation of special types of properties: Hotels, Cinema, Petrol Pump, Hill station properties – Time shared property.

Valuation of easement rights.

Life interest.

Mass appraisal techniques: value contour maps.

Valuation for IFRS: accounting treatment of reserve created by revaluation of assets.

Effects of legislation on valuation: rent control law, town planning law etc.

Maintenance and repairs of buildings and dilapidations

Valuer as an expert witness in Court.

Valuation Standards published by –

- International Valuation Standards Council
- Royal Institution of Chartered Surveyors, U.K.

Case laws on valuation

Town and Regional Planning

- Physical, social and economic factors in relation to development.
- Land use planning and management
- Regional Planning

Laws

- Planning
- Contract and tort
- Conveyancing
- Land Acquisition
- Development control regulations
- Arbitration and conciliation : salient features
- Rent control.
- Transfer of Property Act, 1882

Salient features concerning valuation:

Indian Easement Act, 1882
Laws of evidence
Laws relating to inheritance/succession

Insurance

Principles of insurance and loss assessment

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It is practically impossible to prepare Guidelines on the subject dealing with diverse issues without the help of experts.

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- Kirit P. Budhbhatti
- Nelson J. Macwan
- Hitesh B. Borad
- Jighesh J.Mehta

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Nelson James Macwan
Secretary
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- Graduate in civil engineering from BVM Engineering College, Sardar Patel University, Vallabh Vidyanagar, Gujarat
- Awarded H.P. Gold Medal by Sardar Patel University for securing First rank in B.E.(Civil) examination
- Founder Member – Centre for Valuation Studies, Research and Training Association (CVSRTA)
- Fellow – Institution of Valuers
- Member – Institution of Engineers
- Former Council Member – Institution of Valuers
- Practicing civil engineer, architect and valuer since 1961.
- Designed all types of structures –residential, factories and colleges
- Government registered valuer of real estate with more than 50 years of experience of valuation of wide range of properties-residential, commercial and industrial for large corporate like Bajaj, Mafatlal, Pittie, GP Goenka, Britannia and many others
- Appeared as an Expert Witness in number of valuation assignments and clients derived benefits.
- Author of book-Elements of Valuation of Immovable Properties
- Former Editor, Indian Valuer and conducted popular Question/Answer column ‘In my opinion’
- Presented more than 50 papers/articles in conferences and lectured throughout India.
- Member of a team of valuers pioneer in introducing academic course in RE valuation in Sardar Patel University, Shivaji University
- Assisted the universities in preparing study material for real estate valuation

(b) Kirit P. Budhbhatti

- School education :
    - School no. 20, Rajkot
    - Kadvibai Virani Kanya Vidyalaya, Rajkot
    - Chaudhari High School, Rajkot
    - S.V. Virani High School, Rajkot
    - Vividhlakshi Vidya Mandir, Palanpur
- Pre University Science
    - H & H. B. Kotak Science College, Rajkot
- Graduate in electrical engineering from BVM Engineering College, Sardar Patel

University, Vallabh Vidyanagar, Gujarat and have passed an examination in valuation of real estate conducted by Institution of Surveyors (India).

- Former President – Institution of Surveyors
- Founder Chairman (1998-2007) International Plant and Machinery Valuation
- Conference Committee
- Founder Member – Centre for Valuation Studies, Research and Training Association (CVSRTA)
- Fellow – Institution of Surveyors
- Fellow – Institution of Valuers
- Member – Institution of Engineers
- Government registered valuer of real estate as well as plant & machinery with more than 40 years' experience. Valued wide spectrum of industries for various purposes for Hindustan Unilever, Murugappa, TATA, RPG, Arvind Mafatlal etc.
- Author of books on plant and machinery as well as real estate valuation
- Involved in preparing basic document for International Valuation Standards Committee (IVSC) on Plant, Machinery & Equipment Valuation in 1994-95
- Delivered lectures in Asia, Africa, America, Australia and Europe
- Pioneer in introducing academic course in PME valuation in Sardar Patel University, India which is unique in the whole world and real estate valuation in India and also organizing the first conference exclusively on PME valuation in India in 1998 subsequently in KL, Sydney, HK and London respectively in 2000, 2002, 2005 and 2007
- Assisted the universities in preparing study material both for real estate and plant & machinery valuation courses
- Recognized by BVM Engineering College as – **JEWEL OF BVM**
- Yoga Teacher and Sadhaka of Yoga Institute-Mumbai-400 055

(c) Nelson J. Macwan

- School education :
  - Kumarshala No.1, Navsari, Gujarat
  - Sheth P. H. Vidyalaya, Sanskar Bharti, Navsari, Gujarat
- Graduate in civil engineering from BVM Engineering College, Sardar Patel University (SPU), Vallabh Vidyanagar, Gujarat and law from SPU
- Post graduate in valuation of plant & machinery as well as real estate from BVM Engg. College and ISTAR, SPU respectively
- Founder Member – CVSRTA
- Member – Institution of Surveyors
- Fellow – Institution of Valuers
- Academician – Lecturer in Post Graduate courses in valuation of plant &

machinery as well as real estate offered by Sardar Patel University (1996-2008) and former visiting faculty for Master of Valuation (Real Estate), Shivaji University, Kolhapur

- Wide spectrum of industries valued for various purposes (2008 – till today) for Murugappa, Elecon, Hindustan Unilever, etc.
- Prepared study material for PM and RE valuation courses
- Presented papers in real estate valuation conferences
- Member – Multi Faculty Board for Master of Valuation (Real Estate), Shivaji University, Kolhapur

(d) Hitesh B. Borad

- School education : Shamji Velji Virani Vividhlakshi Vidyalaya, Rajkot
- Graduate in civil engineering
- Post graduate in valuation of plant & machinery as well as real estate recipient of Pragji Dharshi Budhbhatti Gold Medal awarded by Sardar Patel University for securing 1st rank in post graduate degree course in valuation of plant & machinery
- Fellow – CVSRTA
- Valuation Officer – real estate and plant & machinery in financial institution - Housing and Urban Development Corporation (HUDCO) since 2000
- Main speaker on valuation of real estate and plant & machinery for in-house training programmes in head office and regional offices of HUDCO
- Presented a paper on impairment in 4th International PME Conference in Hong Kong in 2005

(e) Jigesh J. Mehta

- School education : St. Xavier's High School, Surat
- Post-graduate in civil engineering and Graduate in law
- Post-graduate in valuation of plant & machinery
- Member – CVSRTA
- Fellow – Institution of Valuers
- Authored several articles in monthly journal of Institution of Valuers
- Valuation assignments executed for large corporate including Reliance Industries, Murugappa Group, ABG Shipyard Ltd., Hindustan Unilever Ltd., Breweries

Note: The above members have rendered the services to the committee in their individual capacities.

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* GRUDA - Gujarat Regularisation of Unauthorised Development Act, 2011

1 INTRODUCTION

1.1 Valuation of real estate is a multi-disciplinary subject involving following disciplines over and above the principles of valuation:

- Economics
- Law
- Town Planning
- Insurance
- Accounts and Finance
- Environmental Issues
- Building construction

Valuation of immovable property is a science and/or highly skilled art. This can be practised by those who understand the problems and also make specific preparations to work out solutions. The preparation includes particularly the organised study of the best available information on the subject of valuation, the recognition and observance of public interest in their activities, the acceptance of responsibility which would accompany the work of valuers and adherence to standards of excellence.

A scientist analyses a problem bit by bit and watchfully and then proceeds quickly with an answer. The common man is apt to struggle in disorganized attempts to get a quick answer.

The trained valuer addresses the problem posed by his client, who requires to know how much worth is his interest in a property.

While analysing a problem professionally, the following aspects emerge:

- There is no single definition of value. The basis of valuation will depend upon the purpose for which valuation is required.
- Values are dynamic and depend upon the supply and demand of the property under consideration in the market.
- The skill of a valuer is required in judging the legal rights in a property being valued and in selecting instances of sale and instances of rental in a process of comparison with known prices/rentals.

1.2 There are considerable facilities for organised study through academic courses in valuation offered by universities available in foreign countries like – Australia, Botswana, Canada, Fiji, Ghana, Jamaica, Kenya, Malaysia, Nigeria, Namibia, New Zealand, South Africa Sri Lanka, Tanzania, UK, USA, Zambia and Zimbabwe. This is mainly because valuation of real estate is regulated in these countries.

Whereas in India, the profession of valuation of real estate is not regulated.

1.3 Value means power of one good to command other goods in a transaction where no compulsion is present. If 5 kg of wheat can be exchanged with 7 kg of potatoes, we have measurement of value of these two commodities. But our problem starts when we find 5 kg of wheat can be exchanged with 4 kg of sugar and 4 kg of sugar command 8 kg of potatoes.

1.4 Valuation as an art and science is an exercise falling within the domain of economics as well as law. Valuation really concerns itself with all species of legal interests arising out of land and building, which are exchanged for money and therefore entails the phenomena of exchange, scarcity and choice that characterizes a 'market' in the economic sense of the term. Property is purchased both for use and investment; but in both cases, the purchaser measures the expected return or benefits to be received from the property against cost outlay. The valuer's task is to express these benefits in money terms and to interpret the relationship between cost and benefit as a rate of return, thus allowing the investor to make a choice between alternatives.

1.5 Value is an estimate, which can be quantified with a sound knowledge of law, economics, valuation principles and the application of logic. This is so, provided we can answer the question, value to whom.

Let us consider the case of a property having market value of ₹ 1.0 crore for sale. Now let us examine the value of same property to Wealth Tax Officer, Insurance Company and to a Bank.

(a) For Wealth Tax Officer, value of property is governed by Schedule III of Wealth Tax Act, 1957 which could be as low as ₹ 1,00,000/-.

(b) For Insurance Company, the insurable value based on type of policy taken-indemnity / RIV; so that the claim can be settled based on applicable insurance principle. Land is not insurable. Only building component is insured. Insurable Value of buildings on RIV basis is say ₹ 30,00,000/- and on indemnity basis i.e. after depreciation is say ₹ 25,00,000/-.

(c) For Bankers, the price it can fetch, if sold in the event of default by the borrower so that money realized out of sale of security is sufficient to recover the principal amount with interest thereon. This is governed by **S.5(n) of Banking Regulation Act, 1949,** i.e. market value for sale which is ₹ 1,00,00,000/-

Summary of valuation of <u>same property</u> to the various agencies referred above:

Value to Wealth Tax Officer – ₹ 1 lakh

Value to Insurer based on type of policy – ₹ 30 lakh and ₹ 25 lakh

Value to Banker – ₹ 100 lakh

1.6 Price is the value of a good measured in terms of a standard monetary unit, but we must never assume that the terms are synonymous for all purposes.

This is explained with following judicial pronouncements.

(a) In Rowan v. City of Vancouver (1963) (Supreme Court of B.C.):

> "A recent actual market price is not the best test of actual value within the meaning of the term as defined. The whole evidence surrounding the transaction, the condition of the market and other factors have to be weighed carefully".

Note by CVSRTA: This is explained by an illustration in Section - 2 under value to the buyer.

(b) In Bennett v. City of Dartmouth (Supreme Court of Nova Scotia, Canada):

> "Whatever the economic significance of the words, value and price are not to be confused".

(c) In Kitsul Bros. Gravel Sales Ltd. v. Barry Humbert and County Squire Realty Ltd. (Supreme Court of B.C. – 1982):

> "I doubt that this property could be said to have a "market value" in the conventional sense. There was no market which could be presumed to exist by reference to sales of comparable properties. There were no comparable properties.", and "The price a developer would pay for the property would depend entirely on the perception of the individual developer as to the economy of the enterprise. One developer might see the property as having no value; another might see a very large profit."

These three cases lead us to the realization that to assign a value to a good, we must first fully understand the purpose of the valuation; we must comprehend value; we must understand price and we must know the intention of the computation.

1.7 The sum total of the value of all the rights in a property can exceed, or be less than, the value of the whole that is intact. For detailed discussion, please refer to value of lessor's/lessee's interest under valuation of leasehold properties.

1.8 Valuer while reporting value, many times uses the phrase given below:

> The purpose of this valuation is to give opinion of the market value of the subject property as at a particular date.

There is no indication about the purpose whether is it for sale or rating or for compensation under Land Acquisition Act or loan security.

There are number of cases where third parties have based a decision upon valuation carried out for another person and have been successful in obtaining damages from a valuer.

In spite of a clause in a report reading, “This report may not be used for any purpose other than it was prepared for, and by the applicant only…” a third party used the report in purchasing a $ 50,000 fourth mortgage.

Hamilton, L.J.S.C. in Seeway Mortgage Investment Corporation v. First Citizens Financial Corporation, Realtex Appraisals Ltd., and Herman Von Doellm, Supreme Court of British Columbia, Canada 1983 (S.C.B.C. 1983) said: “In the case at bar there is nothing in the appraisal report to indicate the purpose for which it was prepared.” And later, “The plaintiff here did not see the disclaimer clause but that may not be sufficient to exempt its operation. However, if the plaintiff here had seen the disclaimer clause, it would not have been able to ascertain from the appraisal that the report was prepared for …”

Consider the case of a lease-hold property with balance period of lease of 10 years and there is no renewal clause. On expiry of lease period, the lessee to surrender property to lessor free of cost as per the terms of lease. Supreme Court of India have held that such a covenant is a valid covenant. Value of property (in April 2015) is ₹ 2,50,00,000/- had it been freehold. Lessee’s interest is a wasting interest. The buyer of lessee’s interest can enjoy the property only for 10 years and therefore the value of lessee’s interest will be say ₹ 25,00,000/- but the same is negligible compared to ₹ 2,50,00,000/-.

The lessor’s interest has following two components:

(a) Capitalized Value of rent for 10 years.

(b) Value of right of reversion.

In this case, after 10 years, lessor will get the property having current market value of ₹ 2,50,00,000/-.

Therefore, value of right of reversion is present value of ₹ 2.5 crore available after 10 years at appropriate rate of interest.

Let us assume the rate of interest at 8%. Present Value of ₹ 1/- at 8% available after 10 years = 0.46319. Therefore, value of right of reversion for lessor works out to ₹ 2,50,00,000 x 0.46319 = ₹ 1,15,79,750/-.

If lessor sells his rights in the property based on the valuation prepared for lessee’s interest, then he suffers a considerable loss.

1.9 A valuer must not only know the purpose of the report, but it must be stated in clear terms. “The purpose of this valuation is to render an opinion on ‘market value’ of lessee’s interest as on date of valuation for sale.”

Similar wording is necessary for each valuation report, stating the precise terms of the assignment undertaken. Valuers define value and quantify accordingly and must never leave the terms open to speculation or imagination. Without the exactness of purpose, the report is useless and dangerous.

2 VARIOUS TERMS USED IN REALM OF REAL ESTATE VALUATION

- **Actual age:**

  The number of years that have elapsed since construction of property - it is also known as historical or chronological age.

- **Agents in production:**

  Land, labour, capital and entrepreneurship which create wealth, goods, services and income.

- **Amortization:**

  A process by which a capital invested is recovered by a systematic schedule of repayment.

- **Amortization rate:**

  The ratio of periodic payment to the total capital.

- **Annuity:**

  An annual income; a program or contract of regular payments of agreed amount.

- **Annual Letting Value (Annual Ratable Value):**

  It is a rental value of the property assessed by the local authority for levy of property tax. Municipal/local authority adopting rental base, assesses rental value of all buildings within municipal limits for the purposes of levy of property tax. Rental value of the old buildings which have been assessed earlier are revised and reassessed periodically as per the provisions of the Act. The Annual Ratable Value of every property existing in different wards of the local authority are recorded in the register maintained by each local authority.

- **Appraisal:**

  It is a process of estimating value. It is an opinion of the nature, quality, monetary value or utility of specified interest in or with regard to aspects of identified asset.

- **Appreciation:**

  An increment in value.

- **Approaches to value:**

  A process to estimate value of assets, e.g., cost approach, income approach or market approach.

- **Arm’s length transaction:**

  A transaction by parties unknown to each other who are under no duress to undertake the transaction.

- **Before tax cash flow:**

  Income remaining from operating income after the payment of debt service but before payment of income tax.

- **Benefit/Cost ratio:**

  The ratio indicating present value of future benefits of an investment to the expenditure incurred for creating the asset in its existing state.

- **Book cost:**

  The cost of acquisition of an asset indicated in the company’s ledger inclusive of all taxes, erection, installation, foundation, pre-operative expenses and other related costs. Sometimes referred to as “gross book” / “gross block” i.e., original cost before deduction for depreciation.

- **Book depreciation:**

  Depreciation provided in the books of account as per policy of the company. It is the amount written off on capital accounts regularly during ownership of an asset.

- **Book value:**

  It is the original cost of an asset after providing the depreciation for the period of use (as per the policy adopted by the company – by straight line method or diminishing balance method or any other method) as shown in books of account of the owner of the asset. It is accountant’s method of indicating value of the asset after deducting depreciation in the books of account.

  In case of assets which is in use even after claiming 100% depreciation they are shown generally with book value of ₹ 1/-

- **Break-even point:**

  The level of operation of an enterprise at which gross income equals the sum of expenses incurred to keep the concern going.

- **Break-up Value:**

  When any running unit or an enterprise is closed down and sale of each individual asset is envisaged or planned separately, it is termed as break-up value of the property. Value of each asset is estimated separately in isolation of the other asset. Buildings may be sold separately and to different parties.

- **Bundle of rights in an asset:**

  The concept of comparing asset ownership to a bundle of sticks with each stick indicating a distinct right of the asset owner, e.g., right to use, to sell, to give it on leave and licence, to lease out, to mortgage, or to choose to exercise none of these rights or to execute all the rights. The loss of any one of these rights could alter the value.

- **Business cycle:**

  It is a trend of economic activity which passes through changing phases like prosperity, recession, depression, recovery, etc.

- **Buyer's market:**

  This is indicative of a condition of the market where the supply of goods and service is more than the demand and results in low prices by which buyers are benefited.

- **Capital:**

  Money available for investment or accumulated wealth having potential of generating income.

- **Capital assets:**

  Assets of permanent nature capable of generating income e.g., land, building, machinery, equipment, cash, receivables, inventories, current assets.

- **Capital expenditure:**

  Investment of cash to acquire fixed assets like land, building, machinery, additions to building and machinery.

- **Capital expense:**

  Capital charge or the amount necessary for interest on and amortization of an investment.

- **Capital gain:**

  The difference between net sale proceeds and book value of a fixed asset.

- **Capitalisation:**

  Method used to convert future benefits to present value by discounting such future benefit at an appropriate rate of return.

- **Capitalisation in perpetuity:**

  Capitalising the net future benefits assumed to last permanently or indefinitely.

- **Capitalisation rate:**

  A designated rate of return which converts net future benefits to capital value.

- **Capital market:**

  The interaction of sellers and purchasers trading through financial instruments.

- **Cash flow analysis:**

  An analysis of anticipated movement of cash in or out of a business.

- **Cost:**

  The term “Cost” admits of a wide variety of application and assumes different senses in different uses or contexts as hereinafter explained. It represents the actual expenditure to create/manufacture.

  In case of real estate, the cost of land, material, labour, entrepreneur etc. enter into cost of the product. In absolute terms it is a measurement of the expenditure necessitated to produce the product. This cost may not be the same that the prospective purchaser would be willing to pay. Thus “Cost” is a term used in relation to production and not exchange.

- **Cost of sales:**

  All the costs of a product sold including manufacturing cost and staff costs.

- **Costs decreed:**

  Expenses involved in court case as decreed by the court.

- **To cost a product:**

  To calculate how much money will be needed to make a product, and to work out a selling price.

- **Cost plus:**

  System of calculating price from actual cost of production including a per cent of that cost to cover overhead and profit.

- **Direct cost:**

  It means expenditure for the labour and materials necessary to construct a new improvement. Direct costs are also called the hard costs. A contractor’s overhead and profit are generally considered hard costs.

- **Indirect cost:**

  It means expenditure for items other than labour and material. Indirect costs include administrative costs; expenses incurred by the owner for professional fees, financing, taxes, interest and insurance during construction. Indirect costs are also called soft costs.

- **Cost approach:**

  It is one of the three valuation approaches. In this approach, the replacement cost is at first estimated and therefrom total depreciation for the age of the asset is deducted by giving due regard to physical deterioration, technological, functional & economic obsolescence. The difference of the replacement cost and cumulative depreciation and obsolescence gives a value.

- **Cost index:**

  A multiplier applied to historical cost which converts historical cost to estimated reproduction cost. In other words, by cost index one estimates trended cost. Trended cost reproduces the item and therefore the result is known as reproduction cost with all its bad and good qualities.

- **Current assets:**

  Assets not intended for use on a continuing basis in the activities of an enterprise. Examples include stocks, debentures, short-term investments, and cash in bank and in hand.

- **Current yield:**

  Current known periodic return on investment of capital.

- **Depreciation**

  Types of depreciation.

  - Depreciation due to wear and tear (physical depreciation).
  - Depreciation due to technological obsolescence.
  - Depreciation due to functional obsolescence.
  - Depreciation due to economic obsolescence.

  Physical depreciation: This is very common. This is due to normal wear and tear and usage of the asset. All similar objects do not observe similar depreciation. Quantum of this depreciation depends on several factors as given below:

  (i) **Manner of usage:** If the property is properly used, it will observe normal depreciation but if property is used ignoring basic principles for its usage, it results in higher depreciation. We find that well maintained building has longer life span than the building which is subjected to negligence in repairs and maintenance for years.

  (ii) **Environmental aspect:** A building on sea shore deteriorates faster than the building away from sea shore. Similarly a factory building in chemical zone would wear out faster than the factory in engineering zone.

(iii) **Natural force aspects:** Natural calamities like earthquakes, cyclone, tsunami or monsoon flooding, lead to sudden damage to property. Even otherwise these forces contribute to higher depreciation and higher wear and tear to the buildings.

(iv) **Accidental aspects:** Serious damage is caused to the buildings due to fire, defects in structural design, bad quality of construction, these even lead to collapse of the structure. Even due to war or riot or bombing on the structures, serious damage to buildings is caused.

- **Discounted cash flow analysis:**

  It is an analytical device or a programme in which the quantity, variability, timing, and duration of periodic income as well as the quantity and timing of reversions are specified and discounted to a present value at a specified rate.

- **Discounting:**

  The process which converts periodic income and reversions into present value, on the assumption that benefits available in the future are worth less than benefits received now.

- **Discount rate:**

  A rate of return to convert future receipts into present value.

- **Distress sale:**

  Seller selling the asset under compulsion for whatever reason.

- **Due-on-sale clause:**

  It is a clause generally found on mortgage contracts indicating as if there is an outstanding loan balance on a sale, it precludes loan assumption by a new buyer.

- **Earning power:**

  Capacity to raise income.

- **Economic base:**

  The quality of economic activity of a particular area/zone capable of attracting income from within its borders.

- **Economic feasibility:**

  Ability to produce sufficient income from investment to pay all expenses, charges and to provide a reasonable return on capital to enable the recapture of the sum invested.

- **Economic life:**

  The period of steady return after which it is uneconomical to use a particular asset.

- **Eminent domain:**

  The superior right that resides with the government enabling it to take over private property for public purpose on the payment of compensation as per legal provisions.

- **Encumbrance:**

  Mortgage, tax, dues, charges, restriction, easement, reservation or similar covenant whether arising out of legal or contractual obligations or judicial pronouncements but not lien as such.

- **Effective age:**

  Age indicative of the condition of utility of an asset. This is usually limited to physical life or can be a reference to age within an economic life.

- **Equity-debt ratio:**

  It is the ratio of capital invested to debt incurred in acquiring an asset.

- **Evaluation:**

  A study of nature, quality, or utility of an asset in which value estimate is not necessarily required.

- **Fee simple estate:**

  Freehold estate.

- **Fixed assets:**

  Assets of permanent nature like land, building, machinery, equipment, furniture which are not generally converted into cash or used up in production process once they are pressed into service. Some refers to this as capital assets.

- **Forced price:**

  The price realized in forced sale or purchase when sufficient time was not available to find a purchaser on reasonable terms. It assumes a result of a compelled seller.

- **Forced sale:**

  A sale under compulsion of circumstances or exigency of necessity including sale at a public auction under orders of the court of law.

- **Forecasting:**

  Predicting a future market condition on the basis of past or present trends.

- **Force majeure:**

  An unavoidable cause leading to the failure to fulfil obligation under the agreement within stipulated time.

- **Foreclosure:**

  Mortgagee exercising his right by due process of law and forcing sale of the mortgaged asset to recover loan which mortgagor has defaulted.

- **Fully amortizing mortgage loan:**

  A mortgage loan with repayment schedule in periodic or monthly instalments of equal nature which provides for return on investment/interest as well as return of the investment, or recovery of the principal over the period of the loan.

- **Functional utility:**

  It is the capacity of an asset to be useful and to execute activity for which it is built as per prevailing market tastes and standards.

- **Goodwill:**

  It is an intangible asset arising out of reputation, credibility and earning potential of a business or manufacturing concern.

- **Graduated payment mortgage:**

  A system of mortgage in which repayment increases with income; the periodic payment begins with low and increases gradually.

- **Gross National Product (GNP):**

  The total value of all final goods and services due to an economic activity in a country in any given time period, without taking into consideration, and allowances for the consumption of durable goods.

- **Gross Rent Multiplier (GRM):**

  It is the relationship between the value of the property and gross rental income. GRM is equal to value of the property divided by gross rent received from the property.

- **Gross rental basis:**

  This indicates all outgoings in respect of leased property are borne by the lessor.

- **Guaranteed mortgage:**

  It is a mortgage in which, in the event of default by the borrower, payment is guaranteed by a third party.

- **Highest and best use:**

  The utilisation of a property to its best and most profitable use. Highest and best use must satisfy four criteria viz., physical possibility, legal permissibility, financial affordability, and maximum profitability which result in highest property value.

Inherent factors in determination of highest and best use of real estate are:

- Time
- Location
- Market demand
- Legal right to develop
- Topography/resource quality of site
- Technological feasibility
- Financial or economic feasibility
- Public utilities

Time:

The time factor is probably the most significant, especially in this era of governmental controls and regulations, and is related to many of the other factors. It is the foundation factor in the study of the highest and best use of real estate.

The relative importance of the time factor can be illustrated by the following example:

In case of property development, the time when finance is available to buyers is the most appropriate time to develop the land.

Location:

The importance of the location factor is, generally, self-evident. If an industrial site is to be developed to its highest and best use, it must be located near a place of active labour supply where utilities must be available, and transportation facilities - both for manpower and goods - must be easily accessible. In many cases, truckage facilities are most important and necessary.

Market demand:

Analysis of market demand is necessary to determine whether the proposed use is “reasonably probable” given the supply and demand.

In order to come to the conclusion of demand potential, the following study is necessary:

- Market research for demand of product
- An inventory of the project under construction
- Population (workforce)
- Tax savings
- Industrial assistance
- Legal right to develop
- Public and private legal restrictions regulate the use of assets. This may be explained by the following categorization:

Public regulations	**Private regulations**
- Zoning regulation	- Deed restrictions
- Environmental law	- Easements
- Building code	
- Sub-division regulation	
- Compulsory acquisition for public purpose	
- Reservation for lower income group at subsidized rate	
- Rent control	

Legal right to develop:

There must be legal right to develop in the property.

Topography/resource quality of site:

The following factors are also relevant to be considered in the realm of highest and best use of assets:

Technological feasibility:

If the project takes too long a time to complete, its cost will overrun and it may not be within minimum quality requirement nor considered to be technologically feasible. There are following basic constraints that define why the project will not be feasible. These are:

- Physical,
- legal,
- safety,
- materials and supplies,
- financial,
- crew and
- management.

Note: These constraints, even if curable, may not be economically viable.

Financial or economic feasibility:

It is based on whether the proposed project will attain a cash flow of sufficient quantity, quality and duration to allow investors to recover the capital invested and expected rate of return.

Public utilities:

All properties must have water, sewage disposal facilities and abundant supply of power.

- **Historical cost:**

  The purchase price paid at the initial time of acquiring the asset plus additions made subsequent to purchase. Historical cost is without considering depreciation. Let us consider a case of a building constructed by a company for Rs.15,000/- in 1985 and additions made for Rs.5,000/-, Rs.10,000/- in 1989 and 1991 respectively, and if the same is sold in 1993 for Rs.50,000/- its historical cost remains Rs.30,000/-. It is sometimes referred to as first cost new.

- **Income capitalization approach:**

  It is an approach to value an income producing asset by converting future benefits, cash flows and reversions into asset value.

- **Index lease:**

  A lease in which change in rent is linked with change to a particular index e.g., cost of living index.

- **Inflation:**

  Rise in price causing erosion of purchasing power of currency.

- **Insurable value:**

  The value of assets at which they are considered to be insured. The value may be subject to provision in the policy.

- **Insurance:**

  It is a contract by which an insurer indemnifies the insured for damages or losses that may occur due to perils or events specified in the contract (insurance policy).

- **Insurance policy:**

  Insurance policy means contract of indemnity by which the insurer undertakes, in the event of loss, to replace insured article by payment or otherwise in the same position as it was before the loss, neither better nor worse, but subject to any limits or restrictions of the policy terms and conditions.

- **Indemnity value for insurance purpose:**

  Indemnity value for insurance purpose means value decided on the basis of depreciated replacement cost to take account of prior usage unless the second hand equivalent asset is available in the market.

- **Interest:**

  Return on capital and is not return of capital.

- **Internal rate of return:**

  It measures performance of an investment. It is the rate of return on capital that is generated or capable of being generated within an investment over a period of ownership. This is similar to yield rate.

- **Intrinsic value:**

  The inherent worth of an asset.

- **Investment analysis:**

  It is a study showing relation of price paid for purchase of assets with expected future benefits.

- **Investment property:**

  It constitutes business enterprise comprising all tangible and intangible assets acquired for earning profit by way of regular annual income and/or capital gain.

- **Investment value:**

  The value of property to a particular investor, or a class of investors, for identified investment objectives. This is a subjective concept that relates specific property to a specific investor or group of investors with identifiable investment objectives and/or criteria.

- **Investment yield:**

  It is a gain from investment made in any asset which is expressed as an annual percentage which includes all of the income and the capital gain or loss from sale. In other words, it is Internal Rate of Return.

- **Judicial sale:**

  The sale due to court action to satisfy the debt in mortgage foreclosure. The court supervises the sale and distribution of proceeds to the creditor.

- **“K” factor:**

  Stabilization factor used to convert a stream of unstable income at a constant ratio into its stable level.

- **Law of decreasing return:**

  The logic which indicates that any additional expenditure beyond a certain limit will not produce a return commensurate with the additional investment.

- **Law of increasing return:**

  The logic which indicates that larger amounts of factors of production produce more income to a certain point.

- **Lease:**

  A written document between owner of the property and lessee, (person who takes the property on lease) by which property is transferred for a specific period of time at certain rent and/or premium under agreed terms and conditions.

- **Lease back:**

  An arrangement under which seller of the asset takes the assets on lease from buyer under specific terms and conditions.

- **Lessee:**

  One who has right to occupy and/or use the property as per the terms and conditions of lease.

- **Lessor:**

  One who is owner of the property and conveys the right to use and/or occupy the property under a lease agreement.

- **Lessee's interest:**

  The right to use and/or occupy the property for certain period under certain terms and conditions as per the lease.

- **Letter of credit:**

  A letter issued by a financial institution certifying that the party named is entitled to draw on the institution and that institution will honour party's credit to a certain amount.

- **Leverage:**

  A technique used by investors to enhance the return on their equity. They buy the property by investing small portion of their own money and the balance is borrowed. They mortgage the property to secure the capital. In other words, it is the effect of borrowed capital upon the rate of return on equity investment.

- **Lien:**

  A claim or charge on an asset in which the property is the security for payment of debt.

- **Life**

  In determining total life of the building valuer should consider following aspects viz.

  - Materials used in construction
  - Workmanship
  - Usage of building
  - Soil strata/foundation depth

- Weather conditions etc.

Materials used in building may increase or decrease total life of the building. Building made out of stones lasts longer than building with steel or timber. Steel corrodes and reduces life. Wood is damaged by white ants. However, in earthquake prone zones, earthquake resistant R.C.C. framed structure has longer life than stone built structure.

Good workmanship enhances life of the structure. Poor workmanship and out of plumb structure reduces life of the building.

Proper maintenance and upkeep of the building and timely structural repairs of the building enhances life of building.

Excessive usage of building increases wear and tear. Excessive wear and tear reduces the life of the building.

Heavy vibrations within factory building reduces its life. Vibrations close to structure on account of heavy railway traffic or truck traffic also reduces life of the building.

Design and foundation criteria of building also would increase or decrease life. Building foundations at shallow depth and in poor soil strata may cause settlement of structure and reduce life of the building. High rise R.C.C. framed buildings which are not designed with earthquake resistant features like shear walls and special footings, may have reduced life in earthquake prone areas.

Weather conditions also affect life of the building. Building along seashore has high corrosion effect due to salty air and high humidity. Region having high rain fall also have reduced life of the building.

Poor soil like muddy or creek land or black cotton soil calls for specially designed foundation. If such foundations are not provided, building develops structural cracks due to uneven settlement and life of building is reduced.

There are following types of life of the building.

(i) Economic
(ii) Physical
(iii) Life due to legal constrains

Economic life is the actual service life of the building. Well maintained building has more or less same years of economic life. Nevertheless, bad or neglected maintenance and excessive wear and tear reduces economic life of the property. Economic life of an R.C.C. framed building is normally considered to be 60 years. Economic life of a building indicates life of a building which is economic to use; where cost of repairs is not prohibitive.

Physical life of the building is the actual survival life of the building before it collapses. It may be either more or in some cases even less than the planned life of the building.

In case of old buildings which are in good structural condition and which have already outlived their planned life (Say 60 years), yet, total physical life is adopted for the purpose of depreciation. If the building is 80 years old, its total physical life is adopted at 100 years, estimating 20 years as future life of such good building.

Bad workmanship, use of inferior materials, careless alterations and over loading of structures reduce physical life. In some cases accidents like fire, explosion, earthquake, flood damage causes total collapse of the structure much before its planned life. On the other hand it is not uncommon to see palaces having 200 years and temples made of stone having 400 years or even more physical life.

Life due to legal constrains

Life of building in some case depends on legal constrains. The building with 60 years life may be erected on a leasehold land which has only 30 years lease period. As per terms of lease on expiry of lease period the building is to be demolished and open land is to be handed over to the lessor. Income from building would cease after 30 years. Valuer in such a case has to adopt total life of building as 30 years only even though its economic and physical life may be 60 years.

- **Life interest/Life estate:**

  An interest in a property like occupancy or control limited to the life-time of a person other than owner and is terminated on the death of the designated person. It is also known as life tenancy.

- **Limited marketability:**

  The asset that has relatively few potential purchasers.

- **Liquid assets:**

  Assets that can be converted into cash very easily and are easily available for payment of debts.

- **Liquidated damages:**

  An amount liable to be paid as per the terms of contract in the event of breach of contract.

- **Liquidation:**

  Forced or voluntary cash realization by way of sale of fixed assets, bonds etc. to take profit in anticipation of decrease in prices.

  Termination of business by converting assets into cash, the proceeds being paid to creditors and remainder, if any, paid to owners as per their holdings.

- **Liquidity:**

  Cash position of an entity which is based on easy convertibility of assets into cash.

- **Loan to value ratio:**

  Ratio of mortgage loan amount to value of security offered e.g., 80% loan to 100% value.

- **Marginal cost:**

  In economic terms, it indicates price that barely, if at all, covers cost of production.

  In real estate terms, it indicates income derived from the property that just barely, if at all, covers operating cost.

- **Marginal revenue:**

  The required gross revenue by selling one additional unit to break even.

- **Marginal utility:**

  Utility gained by an additional dose of intake of any consumable commodity.

- **Margin of security:**

  The difference between market value and loan amount.

- **Market:**

  Place where free exchange of product takes place or buyers and sellers meet e.g., share market.

- **Market analysis:**

  The identification and study of a pertinent market.

- **Marketability:**

  Saleability of a particular commodity at a specific time and price.

- **Marketability study:**

  Micro-economic study to discover how a particular product can be marketed.

- **Market value:**

  Market value means the estimated amount for which an asset ought to 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 with full knowledge, prudently, and without compulsion.

- **Market value for the existing use:**

  The market value of an asset based on continuation of its existing use, assuming that the asset could be sold in the open market for its existing use, and other- wise, in keeping with the market value definition regardless of whether or not, the existing use represents the highest and best use of the asset.

- **Non-market value:**

  Non-market value is worked out in the field of valuation refers to estimating liquidation values, salvage and scrap values, insurance values. The valuer shall ensure that such value is duly estimated and reported though it may not reasonably be construed to represent the market value.

- **Market approach:**

  It is one of the three approaches to value. Value of the property in question is derived by the comparison of sales of similar property sold recently in the locality. The relative merits and demerits of sale instances are compared with the property in question. Sometimes it is referred to as “sales comparison approach”.

- **Mass appraisal:**

  The method of appraising an entire area or district at the same time by standard methodology using common data and allowing for statistical testing.

- **Merger:**

  The combining/absorption of two or more companies into one without dissolving the individual companies.

- **Money market:**

  The interaction of purchasers and sellers who trade short-term money instruments.

- **Net cash proceeds of sale:**

  Price realised after deducting all expenses related to complete the sale, like commission, outstanding debt, and tax claims on ownership interest.

- **Nuisance value:**

  Price paid to relieve an objectionable condition.

- **Obsolescence:**

  Decline in value due to new inventions, changes in design or demand, improved methods of production, change in legislation and taste and preference of consumers. It may be technological, functional or economic.

  Chawl with common toilet are best example of obsolescence. In modern time people like self-contained tenements and not premises with common toilet. Individual small shops design may become obsolete in Metropolitan towns having shopping malls. Residential buildings in Industrial Zone and factory building in Residential Zone become obsolete due to user restrictions though its economic life as well as physical life may be more.

- **Obsolescence - Economic:**

  A residential building existing on a plot in commercial zone is an excellent example of economic obsolescence. Highest and Best use of land and building is not made. As the building is put to inferior usage of residence instead of commercial user it results in an economic loss. Higher depreciation in such case is absolutely necessary.

  Due to legislative enactment and policies, property may remain underutilized. The policy of government to protect slums and not to permit removal of unauthorized structures in a plot without providing free alternate accommodation to dwellers is a classic example of economic obsolescence.

  Policy of government to permit 100% T.D.R. over and above permissible F.S.I. on certain types of lands, resulted in severe economic obsolescence of the buildings. Several developers demolished even 20 years old building in good and sound condition for optimum use of the plot.

  Dilapidation of a building or heavy structural repair cost for a building is also example of economic obsolescence. The structure becomes uneconomic to maintain. Due to dilapidation, repair cost becomes prohibitive. Similar situation arises when rental value of premises in a particular locality falls severely either due to bad neighborhood or due to migration of population to buildings in newly developed towns having better amenities.

- **Obsolescence - Functional:**

  The buildings which have become outdated mainly due to their planning and designing and being unsuitable for current requirements are good examples of functional obsolescence. An old palace becomes obsolete for usage as there is no demand for such palaces in the market though they are in good structural condition. Due to the functional obsolescence many of such palaces have been converted to hotel users for which there is a high demand and usage in the market.

  Old chawl buildings with common toilet blocks is yet another excellent example of functional obsolescence. Such buildings are outdated in planning and design. Now-a-days people require self-contained tenements and flats. Today’s trend of constructing new shopping Malls and Multiplexes is likely to make present shopping centers and single screen theatres obsolete in a few years’ time.

  A brand new computer suffers from functional obsolescence within one or two year’s period with more advanced technologies introducing superior product at much lesser cost. A new machine may become functionally obsolete; if product manufactured by the said machine does not have any demand in the market.

- **Obsolescence - Technological:**

  The load bearing buildings with thick walls are now-a-days usually not preferred in urban areas. Now there is a trend to live in high rise R.C.C. framed buildings having thin partition and external walls. This is now possible due to technological advancements. Timber structures are also now replaced by R.C.C. framed or steel framed constructions. Wooden windows are replaced by aluminum windows. Due to modern technologies, new building materials and planning concepts have made it possible to design and erect even intelligent buildings.

- **Original cost:**

  Actual cost of the asset to its present owner.

- **Payback period:**

  The length of time required for investors to recover their initial cash investment from any project, with reasonable or expected interest.

- **Perpetuity:**

  Everlasting.

- **Personality:**

  It includes tangible items which are not real estate. These are items not permanently affixed to real estate and are generally characterized by their moveability e.g., plant and machinery, furniture and fixtures.

- **Plant and machinery:**

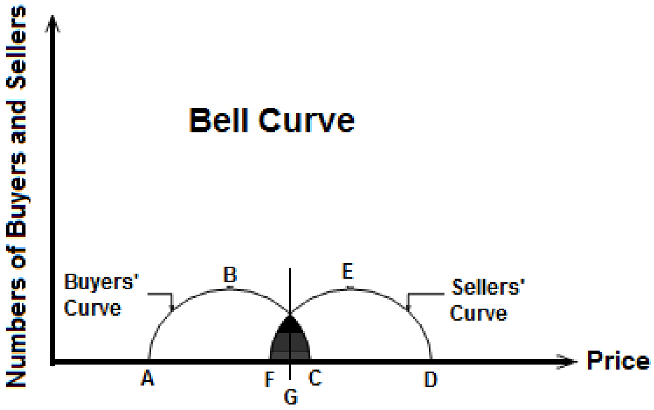
  Plant and machinery means installations and support facilities for manufacturing in an industry designed to perform a specific predetermined function, whether used singly or in combination with other items to enhance the productivity or operating facility; and includes all devices in fixed or movable form, other than real estate, deployed in manufacturing, processing or assembling of products from the stage of raw materials to finished goods.

- **Price:**

  Price is a fact while value is an estimate. Price can be the amount of money a purchaser actually pays or a seller receives. Price is what is asked to be paid whereas cost is what is primarily intended to be covered by price; they may or may not be the same.

  Price is the mechanism through which scarce resources are distributed in an open market over space and time. Different individuals may receive different measures of utility from the same goods. Depending on wealth and alternative purchase possibilities, each individual determines the highest price he is prepared to pay for the goods. This is investment value. The prices individuals are willing to pay or receive may never appear in the market place because they are too high or too low for a transaction to occur.

This concept is shown in a diagram below:



Everyone in the market place who owns or desires a particular good has a schedule of price indicating his mental offer to sell or purchase that good. The bell shaped curve above, from “A” to “C” represents the distribution of buyers, who at various prices would purchase some hypothetical goods. The curve, from “F” to “D”, represents the distribution of potential sellers. The buyer at “A” and seller at “D” would respectively offer or accept prices so far from the average that they would never become an actual participant in the market i.e., at price “A” no seller is prepared to sell and at price “D” no buyer is prepared to buy. The area where the curves intersect, from “F” to “C”, represents the range of prices where transactions might take place if right sellers and buyers make contact. This area represents the range of market prices which are possible. “G” represents the point of greatest probability where the most sellers and buyers will agree.

As the competition increases for this good, “F” and “C” move close together so that under perfect competition, all transactions take place at “G” which then is cost.

Economics define price as the monetary exchange value of a product or service. To a consumer the price is an expected agreement between seller and buyer concerning what each is to receive. Price is the mechanism or device for translating into quantitative terms (rupees) the perceived value of the product to the consumer at a point of time. The buyer’s interest lies in the “price” of the gamut of elements comprising the physical product together with the bundle of expectations or satisfactions. The consumer has numerous expectation such as accessories, after sale service, replacement of parts, technical guidance, repairing services, credit and many other benefits. Thus price must be equal to the total amount of benefits (physical, economic, social and psychological) in order to be acceptable.

Price means the money consideration for a sale of goods. [Sec. 2(10) of Indian Sale of Goods Act, 1930] Price is a fact and representation of market phenomenon. <u>Price is a term used for the amount asked, offered, or paid for goods or services.</u> **<u>It is a historical fact, whether it is publicly disclosed or retained in private.</u>** On account of differences in financial capabilities, motivations, or special interest of a given buyer and seller, the translated price for the goods or services may not always be an indication of relative value placed upon the goods or services by the particular buyer and/or seller under particular circumstances.

Price and cost do not mean the same thing either in an economic sense or in valuation procedure. Price is the phenomenon of the market place depending on what sellers choose to ask and buyers choose to pay under all the peculiar and often unknown conditions prevailing in the market place. Price variation depends on factors like supply and demand, trade barriers and restrictions, grey markets, the quantity of money in circulation, its velocity, etc.

- **Property:**

  The concept of property is fundamental to valuation. Value does not exist where there is no property in some form or other. Again property obtains its entire justification because it has a value. Now the question arises as to what property actually is? Is it basically something which is tangible? Or, is it conceivable apart from the tangible object? In exploring the concept of property, it can be said that a property simply defined is something which is owned. It can be either tangible or intangible and it can be solely owned or co-owned by a number of persons, individuals or juristic. Ownership includes the exclusive right to possess, use or dispose of the property owned. Short of full ownership, rights may be of lesser domain and of different varieties. For example, leased property have two sets of holders of rights - the lessor and the lessee. Ownership or the rights to use or derive benefit out of it constitute the property. It is these rights which are the subject matter of valuation. The bundle of rights attached to a property allows the holder to use, exploit, keep or dispose of the thing held; each of these rights is capable of being valued in accordance with the applicable methods.

- **Real estate:**

  Physical land and those human made items which are attached to the land. It is the physical tangible “thing” which can be seen and touched, together with all additions on, above, or below the ground.

- **Real property:**

  It refers to all the rights, interests, and benefits related to the ownership of real estate. Real property is normally represented by some evidence of ownership separate from the physical real estate. Therefore, real property is a non-physical concept.

- **Recession:**

  Decline in economic activity.

- **Recoverable amount:**

  It is the higher of an asset's net selling price and its market value in highest and best use.

- **Reproduction cost, Replacement cost, Reinstatement Value and Replacement Value**

  As these words are used interchangeably, it is necessary to thoroughly understand the meaning of each one.

  - **Reproduction cost** - the cost of construction, at current prices, of an exact duplicate or replica, using the same material, construction standards, design, layout and quality of workmanship, and embodying all of the deficiencies, super adequacies, and obsolescence of the subject building. When depreciation is deducted then the resultant amount is called Depreciated Reproduction Cost.

  - **Replacement cost** – the cost of construction, at current prices, of a building having utility equivalent to the building valued but built with modern materials and according to current standards, design and layout. This is Replacement Cost New (RCN). When depreciation is deducted from RCN the resultant amount is called depreciated replacement cost.

  - **Reinstatement Value is synonymous of Replacement Cost New.**

  - **Replacement Value- though called value, actually it is an estimate of cost.**

  Let us take an example of a 5 year old table. This can be replaced in following ways:

  (a) Replacing it by an identical 5 year old table

  (b) Replacing it by an identical new table.

  In the former case, the price at which 5 year old table is available is popularly termed as Replacement value.

  In the second instance, the cost of a new table duly discounted on account of depreciation for 5 years will constitute Depreciated Reproduction Cost which is also popularly known as Replacement Value.

- **Return of capital:**

  The recovery of the capital invested through income and/or reversion.

- **Return on capital:**

  A profit earned by the capital invested; the rate of interest on capital.

- **Rule of thumb:**

  A relationship between or among a number of variables based on experience, observation, hearsay or a combination of these.

- **Scrap Value (Junk Value):**

  It is the value of the property receivable for its usable material content in the market when it has become completely useless for any further use. In case of old buildings, to be demolished, it is the sale price of material content obtained from the building on demolition of the building less cost of labour for demolition.

- **Salvage value:**

  It is the price expected for a whole property, e.g. a house, or a part of a whole property e.g. a plumbing fixture that is removed from the premises, usually for use elsewhere.

- **Secured loan or advance**

  It has been precisely defined in clause (n) of Section 5 of Banking Regulation Act, 1949, as:

  > "a loan or advance made on the security of the assets the market value of which is not at any time less than the amount of such loan or advance".

- **Sinking fund:**

  It is an annual recurring amount required to be set aside every year, for a given period of time, at the given rate of interest, to recoup capital invested in a landed property.

- **Special purpose asset:**

  Asset with limited market having unique design; use for special purpose which restricts its utility to the only use for which it is made.

- **Straight line depreciation:**

  Method of providing depreciation by which assets are written off in equal annual amounts.

- **Surplus productivity:**

  Net income remaining after paying for labour, capital, organization and management; it is surplus and may represent the contribution of land.

- **Unique property:**

  It means rare articles like fine arts, antique, decorative, and luxury properties.

- **Useful life (sometimes referred to as normal useful life):**

  (a) the estimated period over which a depreciable asset is expected to be economically used, or the benefits represented by the asset are expected to be economically derived, in the business of the entity.

  or

(b) the estimated total service, expressed in terms of production units that is expected to be economically obtained from the asset when employed in the business of the entity.

- **Valuation:**

  Process of estimating various kinds of value e.g., insurable value, market value, investment value of an identified interest in a specific asset at any given point of time.

- **Valuation process:**

  A systematic approach to estimate value of asset.

- **Value:**

  The concept of value comprises many influences and the variety of such influences is so great that no one classification of them would be final. Thus, physical things may have an economic value or social value or aesthetical value or natural value. Similarly, a concept may have an intellectual value or moral value or religious value or recreational value. But to a valuer of real estate the term is used in a qualified sense. One is concerned here with the relationship of value to the thing owned in the mind of the owner. It is owner’s measurement of the anticipated sum of future services that the thing will procure. It is in the nature of an estimation that forms the owner’s decision to exercise his right with regard to the thing transacted. Since value is an estimate of the anticipated future utility of the thing owned, the concept of value is linked to a knowledge of the past that is projected into the future but measured in the present.

- **The essential elements of value are:**

  (a) Utility
  (b) Scarcity
  (c) Demand
  (d) Transferability

  An object can have value only if it has the four elements of value indicated above.

  Air, desert, sea water are useful for certain purposes; but they are not scarce, hence possess little value in commercial term. Modern new houses and office buildings are very useful objects, but if they are in over supply market price will be reduced. Utility and scarcity cannot create a market unless there is a demand and purchasing power to implement it; if there is no transferability the demand is ineffective.

- **Broad forces influencing value:**

  (a) Physical
  (b) Social
  (c) Economic
  (d) Legal

- **Distress Value:**

  Value of a property offered for immediate sale by its owner, who is under legal compulsion for immediate recovery of legal dues from him. The sale under this situation is called distress sale of the property. There is absolute urgency to liquidate assets. Owner may be in financial difficulty due to which he has been unable to meet legal or social liabilities. This value is quite often lower than market value of the property.

- **Forced Sale Value:**

  Forced sale value is an estimate of the gross amount that the tangible assets would fetch when the seller is forced to sell the assets compulsorily without proper marketing time / exposure time. There is an urgency to sell and the seller does not have control of sale process (generally sales by the banks/ courts/receivers, etc.).

  Note: So far as price obtainable in the forced sale condition is concerned, it is very difficult to predict because one is attempting to define a moving target. Is forced sale the one which is expected to take place within 3 months, 2 months, 1 month, 1 week or 1 day?

- **Going Concern Value:**

  It is an estimate of the price of the running business of an industrial or commercial establishment, in an open market, with its all tangible and intangible (including Goodwill) assets as well as all liabilities of the enterprise on the date of valuation. It is an estimate of the business assets as a whole block and the pre-condition is that the business unit must be profit- making and a running unit. It is also assumed that the unit will continue to operate in future i.e. continued use of all assets. Total break-up value of each individual asset of the enterprise plus goodwill value of the business may or may not be same as the Going Concern Value of the enterprise.

- **Hope Value:**

  Sometimes property owners expect some likely changes in Government or Municipal policies and such likely sellers, expect value of the property to rise in the near future. Relaxation in coastal regulations or scrapping of U.L.C. Act or likely increase in F.S.I. rules etc. are instances of Hope Value.

- **Intrinsic Value:**

  It is reflecting the intrinsic worth of the property as distinct from realized value or agreement value.

- **Liquidation Value - orderly:**

  It is an estimate of the price that would be realized by putting up the property for auction sale in the market. The sale under public auction is carried out after proper advertisement and due publicity. Such auction may be under an order of the Court. But it is generally a case of sale by unwilling seller and willing buyer. The enterprise may be a running unit or a closed unit. If adequate time (which is less than required as per market value definition) is given to liquidate the assets, it is known as Orderly Liquidation Value.

- **Monopoly Value:**

  Certain property may command an excellent situation in highly developed area or enjoying unique advantages not enjoyed by any other property. Due to prime location and absence of supply of any other similar property in the vicinity, the said property will be sold at premium i.e. at a fancy price. This is the monopoly value or a special value due to its unusual and peculiar advantages.

- **Mortgage Value:**

  It is an estimate of value of a property offered as a security by a borrower to the bank/financial institution for loan advanced. Each financial authority has its own regulations about safety margins etc. to arrive at the safe mortgage value of the property; in case of a bank having safety margin of 25%; mortgage value works out to 75% of market value.

- **Potential Value:**

  Property put to residential use in the commercial zone (where commercial use is lucrative) will generally have a high potential value of the property by putting it to commercial user.

  Again, a property which is fully developed with permissible F.S.I. of 1.00, will become an underutilized property due to additional permissible Transferable Development Right available on account of introduction of TDR policy.

  This extra benefit is potential value of the property.

- **Sentimental Value (Personal Value):**

  It is a value of the property, to the buyer or seller, as the case may be, who determines price on sentimental grounds rather than considering market forces. It may be a special or fancy price due to sentimental attachment to the property. A buyer may offer higher price for an old dilapidated house in a village only because he was born in the said house and sweet memories of the golden days of child hood are attached with it. An owner may refuse to part with his plot even at a higher price than what rules in the market only because he has cultivated an excellent rose garden in his property and he loves each plant as if his own child. Thus, "sentimental value" is the personal value to an individual and has no consideration whatsoever in the market value estimation.

- **Speculative Value:**

  It is the value of a property to a speculator who invests in the property with the sole motive of selling at a profit within a short period of time. If the speculator thinks that certain area is likely to command greater importance in near future, he may invest funds by acquiring properties in the said sector, even by paying a little higher price than that is prevailing in the said sector. A speculator may foresee, whether with or without reasons, that there is likelihood of change of zoning in certain area, from “No Development Zone” to “Residential Zone”. If such guess work materializes the speculator would earn enormous profit. The value presumed by him for the future is the speculative value.

- **Special Value:**

  This is also a personal value because it is a value to a particular buyer or seller. However, here sale or purchase is not governed by sentiments of individual but is governed by personal reasons of an individual. A purchaser may pay special price for a flat only because it is close to his work place as well as close to his children’s school. Other competing purchasers have no such criteria in mind. An entrepreneur may be willing to pay higher price than prevailing in market for an open plot of land next to his factory because said extra land would enable him to expand his rapidly developing industry in most profitable manner. Other buyers have no such consideration. In one of the cases a trust was prepared to pay higher price for purchasing shares of a private company yet the English Court adopted lower value by observing “The price which the trust would have paid, was not an element of the open market value of the shares, but was a fancy price, beyond the open market price, which such a trust would have paid for special reasons of its own”. Purchase price paid by a sitting tenant of a property to acquire full ownership rights in that property, is also the special price and not market price of such a property.

- **Statutory Value**:

  It is a value of the property estimated in accordance with the provisions of the concerned statute. Value for Wealth Tax worked out as per Schedule III of W.T. Act is the classic example of statutory value.

  Value estimated for wealth tax under Schedule III, has no consideration of “willing buyer” and “willing seller” but it has only legal base of various provisions of W.T. Act. Actual market value of a property may be say, Rs.60 lacs. However, as per Schedule III, of W.T. Act, its statutory value could be as low as Rs.1 Lac.

- **Stigma Value**:

  It is an estimate of the price of the property based on assumption of unwilling purchaser for such a property. Many a time, it is seen that some properties though in good physical condition do not get any buyers in the market because most of the prospective buyers have belief in stigma or disliking about the said property for certain reasons. House may be believed to be haunted by Ghosts. It may also be possible that a murder of a popular personality might have taken place in the said house or the property and hence the stigma. Stigma could be due to belief or suspicion that the plot was used as burial ground or cremation ground in the past or that land is affected by radio activity due to atomic reactor working on plot in the past.

Please refer to Section 4 for detailed discussion on following terms:

- Value in exchange
- Value in use
- Value to the buyer and seller
- Value in alternative use

3 MARKET VALUE AND ROLE OF UNACCOUNTED MONEY IN PROPERTY TRANSACTIONS IN INDIA

3.1 Market Value and related issues

Definition of Market Value:

The Law Commission of India, 1958 under principles of determining compensation under Land Acquisition Act, 1894, under Para 45, has defined **'market value'** as –

- the price, which a **willing vendor** might reasonably expect to obtain from a **willing purchaser**. The disinclination of the vendor to part with his land and the urgent necessity of the purchaser to buy must alike be disregarded and both must be treated as persons dealing in the matter at **arm's length** and **without compulsion.**

The Courts have held that market value is conditioned with **'willing buyer'** and **'willing purchaser'**.

The following case laws throw further light on determination of market value:

(a) Commissioner of Wealth-Tax vs. Purshottam N. Amersey and anr. (1969) 71 ITR 180 (Bom)

".....it would fetch **if sold in the open market**....." it must have regard to the actual facts and the actual circumstances and decide whether the asset could be sold or not in the open market. In that respect, it seems to us that the Tribunal was clearly wrong on a point of construction. When the statute uses the words "if sold in the open market", it does not contemplate any actual sale or the actual state of the market, but only enjoins that it should be assumed that there is an open market and the property can be sold in such a market and on that basis directs that the value should be found out. It is a hypothetical case, which is contemplated by those words of the sub-section. The tax officer must assume that there is an open market in which the asset can be sold and proceed to value it on that basis. The use of the words 'if sold' creates a fictional position, which the tax officer has to assume."

(b) Raghubans Narain Singh vs. The Uttar Pradesh Government (1967 AIR SC 465)

"Market value on the basis of which compensation is payable under s. 23 of the Act means the price that a willing purchaser would pay to a willing seller for a property having due regard to its existing condition, with all its existing advantages, and its potential possibilities when laid out in its most advantageous manner, excluding any advantage due to the carrying out of the scheme for the purposes for which the property is compulsorily acquired."

(c) **In case of R.C. Cooper vs. Union of India (AIR 1970 SC 564)** Supreme Court, has observed that -

"The market value may be determined from sales of comparable properties, proximate in time to the date of acquisition, similarly situated, and possessing the same or similar advantages or disadvantages. Market value is the price, the property may fetch in the open market if sold by a willing seller unaffected by the special needs of a particular purchaser."

(d) **Prithvi Raj Taneja vs. State of Madhya Pradesh and Others (1977) AIR SC 1560, (1977) SCR (2) 633**

"The market value means the price that a willing purchaser would pay to a willing seller for the property having due regard to its existing condition with all its existing advantages and its potential possibilities when laid out in the most advantageous manner excluding any advantage due to the carrying out of the scheme for which the property is compulsorily acquired. In considering market value the disinclination of the vendor to part with his land and the urgent necessity of the purchaser to buy should be disregarded."

(e) **Jawajee Nagnatham vs. Revenue Divisional Officer (1994) SCC (4) 595**

"Evidence of bona fide sales between willing and prudent vendor and prudent vendee of the lands acquired or situated near about that land possessing same or similar advantageous features would furnish basis to determine market value."

The above development from the year 1958 to 1994 provide us a conceptual framework of 'market value' definition as under:

- **if sold in the open market**
- **willing vendor**
- **willing purchaser**
- **arm's length transaction**
- **without compulsion.**

The above conceptual framework will also be found in the definition of Market Value given by International Valuation Standards Council (IVSC).

This is an excellent definition of 'market value' and valuer must consider all these aspects while estimating value.

We have to study this definition by understanding the proper meaning of each and every word used in the definition:

(i) As valuer has to estimate the amount, he should assume hypothetical buyer and hypothetical seller both willing to transact the deal in hypothetical market and no one being under any compulsion. This means that sentimental aspect and forced sale conditions are to be ignored in market value estimate.

(ii) Both the buyer and seller must be knowledgeable. If they are ignorant of ruling market trend, the transacted price cannot be fair. Deal should be in accordance with normal business practice.

(iii) Hypothetical market should be open market where all types of buyers and sellers compete with each other. It should not be a closed or restricted market.

(iv) Transaction has to be considered at arm's length. It means that transaction between related persons or between close friends should be ignored.

(v) The words "estimated amount for which an asset should exchange" means that valuer's estimate should be as close and near as possible to the asset's probable sale or exchange price in the actual market.

(vi) Words "after proper marketing" means after due advertisement, without time constrain at a fair price i.e. price determined after a process of higgle/haggle.

In addition to the various factors considered above, we can also add following two important considerations while valuing a property.

(i) The valuer while estimating market value of the property should ensure that assumptions and limiting conditions are minimum.

(ii) The valuer should give reasons for adoption of a particular approach to value, while undertaking valuation for market value.

3.2 Importance of conceptual framework of 'market value' in actual practice

This is explained by an illustration given below.

The client purchased a commercial office premises in New Marine Lines area, behind Income Tax Office, near Bombay Hospital and Churchgate Railway Station at ₹ 300/- per sq. ft. in 1981.

Valuation was required for Income Tax purpose. According to the Income Tax Officer (ITO), purchase price was too low.

The client requested a valuer to issue a certificate stating that the market value of the property was ₹ 300/- per sq. ft. It was explained to the client by the valuer that mere issuing a certificate will not be of any help, but a speaking report is required in justification of the same; as the transactions in nearby area were taking place at almost double the prices than the price at which the property was purchased.

In this case, to help and protect the client, it was necessary to carry out a detailed exercise in order to satisfy the ITO.

The client furnished the document by which the ownership of the commercial premises was acquired by him. While going through the document, following vital facts were noticed and the client's explanation was sought:

(a) The land, on which the multi-storeyed building was constructed, was a lease- hold land, and
(b) Whether the purchaser is aware of terms and conditions of lease by which land is given on lease in the year 1901.

The client replied that he was not aware of those details. He had signed the document without reading it. The client was a highly educated professional person.

The client was informed that it would not be possible to proceed further without going through the lease document.

The certified copy of lease deed was procured.

While going through the lease deed it was noted that the lease was to expire in the year 2000 giving an unexpired period of the lease as 19 years and there was no renewal clause. As per one of the covenants of lease, the entire property was to be delivered up to the lessor, free of cost on expiry of lease. In nearby area, properties were sold at more than double the price, because in case of those lease-hold properties, the unexpired period was more than 70 years and there was a clause for further renewal for 99 years. There was also no covenant to surrender the property free of cost. This was a strong justification for transaction, taken place at a lower price.

In order to substantiate the case, research on judicial pronouncements on such covenants was carried out. The Supreme Court case laws were identified, upholding that such covenants are valid covenants. The relevant Supreme Court decisions are:

- Dr. K.N. Dhayraman & Others vs. J.R. Thakur & Others (1958 AIR SC 789)

- Kanji Manji vs. The Trustees of the Port of Bombay – AIR 1963 SC 468

In the same building, other clients also had acquired the premises. As an abundant precaution, they were interviewed to find out whether they were aware of lease of land referred in the agreement by which they purchased the property. They also had signed the document without reading the contents of document. This is indicative that buyers were not falling under the category of **'willing, knowledgeable and prudent buyers'** as they had signed the document without knowing its contents.

This information was collected as an abundant precaution – as the transactions had taken place in the same building at the higher rate and if same are relied upon by the income-tax department, then it can be argued that these transactions are not by **'willing buyers'** and under the Income Tax Act - Fair Market Value to be computed must satisfy the criteria of **'willing buyers** and **'willing sellers'**.

The Income Tax Officer accepted the valuation prepared based on the covenants of lease and Supreme Court judgements.

3.3 Role of unaccounted money in property transactions in India.

History of various provisions, date right from 1972, under Income-Tax Act, 1961 on role of unaccounted money in property transactions.

It is a well-known fact that many a time apparent consideration is not truly stated in the instrument of transfer. This is evident from the report of the Wanchoo Committee appointed by the Government of India.

The committee submitted its final report in December, 1971, in which it made some significant observations. Dealing with the question of black money and tax evasion, the link between undervaluation of immovable properties and tax evasion was explained by the committee as follows:

> "Evasion of direct taxes in our country is closely linked with the practice of undervaluation of properties by the tax payers, whether in the transfer documents relating to immovable properties, or in their returns of wealth, or when explaining the source of cost of construction. The absence of proper valuation machinery in the income tax department helps the tax-dodgers in more than one way".

It facilitates utilization of unaccounted money in investments. It also provides scope for reduction of liability to direct taxes, whether on income, capital gains, wealth or gifts. Due to the opportunities available for understating the value of assets in the guise of honest difference of opinion, tax-dodgers are able to evade the penal consequence and merrily continue their game of tax evasion." (Para 2.194 of the report)

The Government of India introduced Chapter XXA w.e.f. 15-11-1972 in Income-Tax Act 1961, empowering the Government to acquire the property where apparent consideration is not truly stated in the instrument of transfer. Under this Chapter, the parties to the transaction were required to file the details of transaction in Form 37-EE before Competent Authority appointed for the purpose. If the Fair Market Value of property transacted exceeds 15% of apparent consideration indicated in instrument of transfer, then acquisition proceedings were required to be initiated within 9 months of filing Form 37-EE as stipulated in the Act. While initiating acquisition proceedings, the Competent Authority had to record the reasons for initiating proceedings. After stipulated period, it used to become time barred. In order to find out whether fair market value exceeds apparent consideration, the Competent Authority used to refer the valuation to Valuation Cell of the Income-Tax Department.

Chapter XXA was dropped w.e.f. 01-10-1986 as the Government could acquire only a few property because the Government was loosing the matter in the Court of Law.

Government of India introduced Chapter XXC w.e.f. 01-10-1986 in the Income-Tax Act, which gave pre-emptive right to purchase the property by the Central Government.

It was an excellent provision. The parties to the transactions were required to file the details of transaction in Form 37-I to the Competent Authority appointed for the purpose. The authority had to decide within 30 days of receipt of Form 37-I whether they want to acquire the property, and if they intend to acquire the property, and once a decision is taken to acquire the property then in that case they must make the payment to the seller as per apparent consideration mentioned in the instrument of transfer within 30 days. If no payment is received by the seller within 30 days indicates that the Government has accepted the transaction.

This Chapter was made applicable to properties located at Delhi, Mumbai, Chennai and Kolkata from 01-10-1986 in case of property where apparent consideration exceeded ₹ 10,00,000/-. From October 1987, and subsequently, it was made applicable to different cities and limit of ₹ 10,00,000/ was increased to ₹ 75,00,000/-, ₹ 50,00,000/ and ₹ 25,00,000/- as per the categories of cities.

This chapter worked very well. The Government auctioned the acquired property and realized higher price than the apparent consideration indicated in instrument of transfer. The ratio of accounted money/unaccounted money, which used to be 40/60 had gone up to 80/20 and in many cases up to 90/10.

This provision was dropped w.e.f. from 1.7.2002.

<u>If such a provision is introduced under the Stamp Acts of all the states then all the present problems arising due to unscientific stamp duty valuation relied by Income Tax authorities under S.50(c) of Income Tax Act would be almost solved.</u>

The above discussion throws light on the fact that in order to avoid the full payment of income tax and stamp duty, people indulge into transaction with partially recorded prices. **This again depends on the facts and circumstances of each case and therefore valuer has to make a study of the transaction to find out exact situation.**

The real property market is no doubt imperfect. The reasons for such imperfectness can mainly be attributed to the fact that the **data regarding price actually paid is suppressed or obscured due to the part played by unaccounted money,** non-standardization of the commodity and inelasticity of its supply. In addition, the price is negotiable.

The role of unaccounted money in property transactions is one of the major limiting conditions under which valuers in India are experiencing. The Indian real estate market operates in a peculiar manner, which a valuer cannot afford to ignore.

In India, under Direct Tax Acts, words used are **'Fair Market Value'** and not the **'market value'** and hence there is a general feeling that **'Fair Market Value'** indicates market value without unaccounted money. This is not correct at all. Because in USA and Canada where there is hardly any problem of unaccounted money; the term used is **'Fair Market Value'** which is same as **'Market Value'.**

Market Value / Fair Market Value / Open Market Value has same meaning as Market Value defined by Law commission of India unless a different definition is given in any statute.

Moreover, estimate of market value is based on price at which comparable properties are sold in the locality.

Rule 20 under Wealth Tax Act, 1957, states**:**

> The value of any asset, other than cash, being an asset, which is not covered by rule 3 to 19, for the purposes of this Act, **shall be estimated to be the price, which in the opinion of the Assessing Officer, it would fetch if sold in the open market on the valuation date**.

Price is an amount paid for a good or service. Sale price is a historical fact whether fully declared or kept private.

In India, there is a tendency that price is partly disclosed and partly kept off the record in property transactions.

Professional valuers must act with the special knowledge of property market and must understand the intricacy of dealings of participants in the market.

Market valuations are by and large based on data regarding sale of comparable assets. The process of estimation of value necessitates a valuer to conduct adequate and relevant research, to perform expert analyses, and to draw informed and supportable judgements. In this process, the valuers consider all pertinent market evidence, trends, and comparable transactions and also how real estate market operates. In Indian real estate market, unaccounted money plays a major role and valuer cannot ignore it.

<u>A valuer is bound to know how the property market operates and hence valuers in India cannot escape the responsibility of having knowledge of unaccounted money in property transactions.</u>

In a case before the Calcutta High Court for acquisition of property by the Income Tax Dept. under Chapter – XXC of Income Tax Act, 1961, one of the parties to the transaction was Life Insurance Corporation of India.

High Court held that the transaction in which one of the parties to the transactions is either Government, or Public Sector Undertaking then such transactions are genuine one and quashed the acquisition order. (Vide Competent Authority Vs. Shrimati Baniroy Choudhary, 131 ITR 578).

It is also worthwhile to mention here that if a public undertaking is in urgency or there are certain advantages of buying the property and seller of the property is aware of the compelling reasons of the buyer, then the transaction may take place at a price higher than the market value.

It is, therefore, essential for valuers to carry out proper research and have a data bank by interacting with parties to the transactions. **In our country, unaccounted money in property transactions is an open secret.**

Valuers must recognize that unaccounted money (cash payment) is one of the powerful market forces in real estate market in India; therefore must give appropriate weightage for the same depending upon market trend in converting cash money into accounted money by adjusting tax liability.

Let us consider a following case:

- The market where transactions take place at 60:40.This means 60% of total consideration is recorded and 40% is not recorded i.e. 40% payment is made in cash.
- The property is sold for Rs.1.0 Crore out of that 60 lacs is recorded and 40 lacs is not recorded.
- The parties to the transactions are in the tax bracket of 30%.

If someone has to buy this property with 100% payment by cheque, then the transaction generally does not take place at Rs.1.0 Cr but it would be less than 1 Cr, which depends on facts and circumstances of each case, mainly due tax liabilities. It may be in the range of Rs.80 to 90 lacs. It also depends on the parties to the transaction.

The following extracts from the decision of Supreme Court of India in case of Maj. Gen. Kapil Mehra & others Versus Union of India in Civil Appeal Nos. 2545-2546/2012 decided on Oct.17, 2014 will be helpful in reporting the value for auction purpose.

> "Where the auction sale is by banks or financial institutions, courts, etc. to recover dues, there is an element of distress, a cloud regarding title, and a chance of litigation, which have the effect of dampening the enthusiasm of bidders and making them cautious, thereby depressing the price.
>
> On the other hand when purchasers start bidding, an element of competition enters into the auction. Human ego, and desire to do better and excel other competitors, leads to competitive bidding, each trying to outbid the others. Thus in a well-advertised auction sale, where a large number of bidders participate, there is a tendency for the price of the auctioned property to go up."

When a valuation is required for the purpose of auction by the bank, it is recommended that the valuer to adopt the approach as out lined below:

- Giving explanation for role of unaccounted money in property transaction as explained earlier.
- Certifying range of values with reasons thereof.

4 COST, VALUE, MARKET VALUE, SPECIAL VALUE, VALUE IN USE/ EXCHANGE/TO THE OWNER/TO THE OCCUPIER

4.1 Value of a property could be more than its actual cost, may be equal to the cost or it may be even less than the cost; it all depends on demand for and supply of the property in the market at the relevant period of time.

Another important point for consideration for the valuers while estimating value of the property is -

- the rights held by the owner in the property or asset being valued.

It is rightly said that what the valuer values is not brick and mortar or land and building, but valuer values the rights of the owner in the property. We can, therefore, say that the value is the probable payment that a prospective buyer would be willing to make to acquire rights in the property, for anticipated future benefit.

Value of the property in following situations would vary to a great extent:

(i) Property may be fully owned with owner's possession.
(ii) Property could be owned but would be wholly in use and possession of tenant who is protected under applicable Rent Act paying rent for use of the property.

4.2 Let us study some practical cases to understand the difference between the words 'Cost' and 'Value'.

A dream resort was built on a hill of Khandala in the year 2000, by actually spending an amount of ₹ 500 Lakh (Fifty million). In the year 2001, said property was offered as a security for mortgage. Mortgagee's valuer, valued it at ₹ 300 Lakh only. The reason was that the certain area was found to be built in excess of permissible F.S.I. Here, ₹ 500 Lakh was actual 'cost' whereas ₹ 300 Lakh is to be termed as **'value'**.

A doctor constructed a four storied building in the year 1990 by purchasing the plot for ₹ 5 Lakh (500 thousand) and spending ₹ 15 Lakh on building construction. On completion of the building, it was fully let out to tenants protected under the applicable Rent Act for total rent of ₹ 15,000/- per month. For bank mortgage, in the next year, i.e. in the year 1991, the valuer valued this property at ₹ 7.50 Lakh. Here ₹ 20 (5+15) Lakh is 'cost' to the owner and ₹ 7.50 Lakh is 'value' of the property.

It is equally important to understand the proper meaning as well as the difference amongst the words '` market value', 'special value' and 'forced sale value'.

A flat (area 3,000 sq. ft.) at Colaba was sold for ₹ 450 Lakh. It was purchased in February, 1995 in public auction of Income Tax Department. The purchaser was staying in the flat next to the flat purchased by him in auction and he wanted to use the flat as an office. It was 80 years old load bearing structure. Similar flat in the same building was sold in November 1994 for ₹ 300 Lakh. There was hardly any price rise from November 1994 to February 1995. Both these transactions have taken place in open market. The price paid in both the cases is genuine. However, ₹ 450 Lakh is a 'special value' of the property to the purchaser. Special price was paid for adjoining flat with a special motive of using the flat for the office purpose.

In a building at Peddar Road, Mumbai, outside purchasers after making market survey offered a rate of ₹ 8,000/- per sq. ft. in the year 2001, for a flat. However, many residents of the building offered a rate of ₹ 12,000/- per sq. ft. for same flat as they wanted flat for their expanding family with whom they desired to stay close. Here ₹ 8,000/- per sq. ft. is ` market value whereas ₹ 12,000/- per sq. ft. represents special value. Special purpose calls for a special price. Other prospective buyers consider alternative flats available in the market, which is ignored by a special purpose buyer.

A flat (area 2,875 sq. ft.) in Nariman Point area fetched ₹ 4.60 Crore in March 2000 in public auction. In the same building, in April 2000, another flat of the same area was sold through a broker after proper marketing at a price of ₹ 6.04 Crore. We can say that ₹ 4.60 Crore is a 'forced sale value' (price paid under forced sale situation) and ₹ 6.04 Crore is the 'market value'. Here 24% less price was obtained in market, for similar flat, under forced sale condition.

4.3 There are number of factors, which affect value of real estate. Increase in F.S.I. can increase value of the land if there is a demand. Increased money supply also could increase sale price of properties in the market, which we are experiencing since 2007. On the other hand, construction of fly-over in front of the building could reduce the value of a flat. Flats on main road would normally fetch higher price than flats in by-lanes. Sea front properties generally fetch higher prices. Flats in new building built under Slum Redevelopment Scheme would generally fetch lower rate.

4.4 A well-known personality approached a bank for a loan and offered his large office premises (area 3,300 sq. ft. with 400 sq. ft. terrace) at Thakur Complex, Kandivali (East), as a security. Borrower's valuer reported value of office block at ₹ 90 Lakh. Bank's panel valuer valued at ₹ 65 Lakh. Bank's valuer mentioned that though society had not objected to change of user of premises from residential to office use, as per Development Control Rules, office use was not permissible and hence he had valued the premises as residential flats and not as commercial office premises. The valuer also deducted for the cost of restoration of single office premises back into five residential flats as before. Lesson to be learnt is that the commercial user do increase the value of premises provided the said use is legally permissible and there is a demand for commercial premises. **The sealing order of the Supreme Court in the year 2006, for properties situated in Delhi, is an eye opener in such cases. Those premises were approved as residential premises but were used as shops and offices, which were contrary to zoning regulations.**

4.5 A hotel was built in barren area 50 km away from a city. Water supply was by tanker – power supply was by generator- the hotel was linked with main city by a regular road. The hotel was next to the stadium.

The cost of the hotel was 50 million US dollars. The bank finance was 40 million dollars. The hotel occupancy was only 3% (10 days in a year) during car race in stadium. There were additional losses because of extra cost of providing water and power services in the said area. There were no buyers in market due to losses. An expert valuer advised bank to convert hotel cottages in to weekend villas by further investing 5 million dollars for conversion. Ultimately, the said property was sold for 200 million dollars to various city dwellers as a weekend house. This example shows us that **alternative and better use of the property is also one of the important criteria in valuation**.

4.6 A hotel having 100 rooms is built in the desert of Sahara at an investment of ₹ 100 Crore (one billion) 10 years back.

Its occupancy in each of last five years did not exceed 10%.

The owner of this hotel approaches bank for a loan. The bank appoints a valuer. The valuer first calculates the cost of replacing an identical hotel which works out to ₹ 200 Crore. Then he calculates the depreciation for age of the building as ₹20 Crore and reports the value at ₹ 180 Crore. Is it correct? It is not, simply because the valuer has not taken into consideration the earning potential. No prudent investor would invest in a property which does not generate sufficient return on investment. Though the Depreciated Replacement Cost (DRC) is ₹ 180 Crore, its value is much less in this particular case mainly due to factors external to the property itself - the economic obsolescence.

4.7 A building is constructed with bricks made out of 22 carat gold and the owner wants to let out the building. A prospective tenant is not aware of the fact that the building is constructed with golden bricks and he quotes the rent prevailing in the locality. On the owner informing him that the building is constructed with bricks made out of gold, the tenant poses a question - Can I take out the bricks? To this, the owner replies negatively. If rent is calculated on the basis of return on investment, then it will be very high as building is made out of golden bricks.

The tenant simply replies that even if the building was made out of platinum bricks, then also he would not pay more than the rent prevalent in the locality.

The prospective tenant will offer to pay rent based on utility and benefit to be derived by occupying the property and for that purpose he will be prepared to pay rent prevalent in the market.

In this case, if the property is fully developed and located in Mumbai and the tenant is protected under the Rent Act paying a net rent of ₹ 1.0 lakh per annum, will command a price of say, ₹ 15.0 Lakh. Vacant property is available in the locality for about ₹ 2.0 Crore. If alternative accommodation at a cost of ₹ 2.0 Crore is given to the tenant then the landlord will get the vacant possession of the property and if the property is demolished and golden bricks are recovered, it may fetch several Crore of rupees.

4.8 In the context of value, it is worthwhile to have an idea of two expressions 'value-in-exchange' and 'value-in-use'.

Value-in-exchange is the price that would tend to prevail in a free, open and competitive market on the basis of an equilibrium set by the forces of demand and supply.

Value-in-use is the worth of an asset to a specific user or set of users. As value-in-use is related to specific user's needs, it is often referred to as subjective value.

The following illustration throws light on various terms - cost, price, value and worth.

The management of a chemical plant 'A' wanted to acquire chemical plant 'B'. The management of plant 'B' who knew the dire need of the management of plant 'A', offered to sell at ₹ 200 Crore (rupees two hundred Crore). 'A' appointed valuers of immovable property and plant and machinery for valuation of plant 'B', who did an excellent job and estimated value at ₹ 1,25,00,00,000/- (Rupees one hundred and twenty five Crore). Keeping these figures in mind, 'A' started negotiations with 'B'; and ultimately transaction was settled for ₹ 1,75,00,00,000/- (Rupees one hundred and seventy five Crore), and there was a big hue and cry from the shareholders of plant 'A' for entering into transaction. Board of Directors of Plant 'A' convinced the shareholders that, what they are paying is ₹ 50 crore higher than the market value; but for the company that also will makes a sense. Because there are extremely good orders on hand with plant 'A' to be executed in next 2-3 years and if plant 'A' cannot execute these orders due to installed capacity not being sufficient and green field project would take minimum 2 years, the company will loose profit to a great extent and therefore it is desirable to buy the plant 'B'. Even by paying higher price, there will be excellent surplus profit on execution of the orders.

In the above case, ₹1,25,00,00,000/- (Rupees one hundred and twenty five Crore) is the market value, whereas ₹ 1,75,00,00,000/- (Rupees one hundred and seventy five Crore) is price paid and cost to 'A' and also worth to 'A'. While advancing loan, bank has to consider market value and not the cost to 'A'. If cost to 'A' is taken as market value, then assets offered as security will not fall under secured assets as defined under section 5(n) of Banking Regulation Act, 1949.

4.9 A landlord wanted to let his premises when rentals were considerably rising; he offered the premises to a prospective tenant (who was fully aware of the market that the rentals are going up) at a slightly lower rent for a long period with a condition that in the event of his vacating the premises before the expiry of agreed term/period, he will pay damages/compensation to the landlord. The tenant agreed to this condition because according to his calculations the rentals were to go up further. But, in reality it so happened that in a short span of one year, rentals went down to 50% i.e. the next door identical premises were available at 50% of rent paid by him; the tenant could not vacate the premises as the benefit of 50% rent was less than the damages required to be paid to land lord in the event of vacating the premises as per the terms of contract.

Here value to the owner, value to the occupier and market value are all different.

This is indicative that in valuation process, what we are valuing is the rights of the individuals in the property; and not the land and buildings as such, and for this, it is necessary to study the agreement amongst parties in order to understand the contractual obligations of various parties involved. For this purpose, it is the duty of the valuer to study the contract/agreement.

4.10 Bridges, roads, flyovers and other infrastructural assets are generally not exchanged and they have value-in-use and their value depends on the benefit derived by the society.

4.11 Value of a thing/commodity in terms of other thing/commodity i.e. power of one commodity to command over other commodities in transaction of exchanges, is known as exchange value. When however, an object/commodity is exchanged for and is measured in terms of standard monetary unit i.e. money, it is known as ‘Price’ of a commodity. Price is determined by the on-the-spot interaction of demand and supply. Price tends to restore the balance between supply and demand and is in fact a mechanism balancing demand (at a price) and supply (at a cost). Price thus takes into consideration both demand schedule and supply schedule.

5 PROPERTY MARKET & SUBJECT MATTER OF VALUATION

5.1 Market

The economic term 'market' refers to a group of buyers and a group of sellers who are in communication with each other for purpose of transaction and both of whom are willing and able to buy and sell at a price. Competition among buyers and sellers acts as a mechanism controlling the supply, demand and prices. Under conditions of perfect competition in an open market, neither buyers nor sellers are able to influence prices by their individual decisions as in the case of monopoly. Perfect competition is facilitated due to comparability and possibility of substitution among the products mainly resulting from standardization and possibility of increasing/adjusting supply and demand by various means.

Property market differs from market of other commodities in various characteristics due to which conditions of perfect competition are hard to obtain in a property market. These special characteristics are:

- **Heterogeneity and lack of standardization**

  No two properties are identical and differ from each other in many respects, which act as a constraint on comparison and substitution and hence conditions of perfect competition are almost absent.

- **Total supply of land is fixed**

  Total supply of land in all areas is fixed and land cannot be transported from one place to another as in the case of other commodities. Converting use of land say from agriculture to non-agriculture, from residential to commercial etc. may be possible, but it is time consuming.

- **Inelasticity of supply**

  Supply of land/property cannot be increased or decreased quickly to match demand.

- **Effect of various legislations**

  Various legislations like Rent Control Acts, Town Planning Acts and Development Control Rules, Land Ceiling Acts, etc. affect the use, quality and intensity of use, occupancy, transferability of landed properties constraining condition of perfect competition.

- **Imperfect and inadequate information**

  Lack of correct and adequate information about transactions contribute to imperfect competition.

Such inadequacy of information is mainly due to –

a) **Method of conducting transactions:** Most of the transactions in the real estate market, except open auctions, are conducted privately and adequate and correct information about transactions is not easily available.

b) **Various rights and interests:** Various rights and interests, ownerships, tenures, etc. such as freehold, leasehold etc. are being transacted which make comparison difficult.

c) **Non-availability of adequate and reliable information:** Information available from authentic sources like records of Registrar's and Sub-Registrar's Offices needs to be supplemented by conducting inquiries during site inspection for obtaining correct information.

5.2 Interest in a Property: Subject Matter of Valuation

5.2.1 The subject matter of valuation i.e. what is to be valued is the 'interest' in a property and **NOT** the physical asset comprising of land i.e. soil, morum etc., and building i.e. bricks, mortar, steel, cement etc. 'Interest' is defined as "Right to derive **benefits** by **legal use** of a property". A person interested is a person who has legal rights of deriving benefits by putting a property to legal use.

A person may have legal right as:

(a) An owner or lessor including legal heirs bearing right to derive benefits in perpetuity,

(b) Lessee having right to derive benefit of profit rent (difference between market rent and rent reserved (payable) under the lease/sublease or for a limited (short term or long term) period of lease, sublease, etc.,

(c) Monthly tenant, protected or unprotected tenant, holding property from month to month i.e. extremely limited period of 30 days and therefore virtually having no right to derive monetary right except as may be provided by law,

(d) Licensee occupying property by specific permission (usually from the owner) to do so at the pleasure of owner (i.e. so long as the owner pleases) and having no right to derive any benefit except of occupying the property on payment of license fee.

Use of land or property is subject to, or restricted by, existing land laws, such as –

- Transfer of Property Act relating to title and tenures, sale, lease, mortgage etc.,
- Town and Country Planning Acts including Development Control Regulations,
- Municipal Acts/Housing Acts,
- Rent Control Acts,

- Land Ceiling and Reforms Acts,
- Acts relating to Contract and Torts,
- Easement Act,
- Succession Laws,
- Any law regulating usage and transfer of property, e.g. environmental laws, Coastal Regulations, etc.

A valuer is therefore required to be familiar with provisions of these laws concerning valuation aspects.

5.2.2 If there are no rights in the property there is no value:

As stated earlier, in valuation of property, we are valuing the rights of individuals in the property and **there can even be a negative right of an individual in a property.**

An interesting case came up before the Supreme Court of India - Dr. K. A. Dhairawan and Others - The appellants, as trustees, of the Mankeshwar Temple Trust vs. J. R. Thakur and Others - The Respondents (AIR 1958 SC 789).

The lessor 'A' granted a lease to lessee 'B' for a period of 21 years on certain terms and conditions –

- Lease rent of ₹ 50/- per month.
- Under the terms of the lease, the lessees were to construct a double storied building on the land at a cost of not less than ₹ 10,000/-.
- On the termination of the lease, either at the end of 21 years or earlier, the lessees were to surrender and yield up the demised premises including the building with its fixtures and appurtenances to the lessors free of cost.

Accordingly, lessee constructed a building and sub leased to various parties on certain rent.

Lessors served a notice to quit before the expiry of lease and as lessee did not quit, the lessor filed a suit and Supreme Court held as under:

> Lessee has no right over the land after the expiry of lease period. The building constructed by the lessee shall vests with the lessors and rent received by the lessee shall be received by the lessor after the expiry of lease period.

The gist of the judgement is given below:

Facts of the case –

The lessors granted a lease of a parcel of land to the lessees for 21 years at a rent of ₹ 50/- per month. Under the terms of the lease, the lessees were to construct a double storied building on the land at a cost of not less than ₹ 10,000/-. The construction had to be to the satisfaction of the lessors' engineers, and the building had to be insured for at least ₹ 12,000/- in the joint names of the lessors and the lessees with an insurance firm approved by the lessors. In case of damage or destruction, the building was to be repaired out of the money received from the insurance company. On the termination of the lease, either at the end of 21 years or earlier, the lessees were to surrender and yield up the demised premises including the building with its fixtures and appurtenances to the lessors free of cost. After the expiry of 21 years, the lessors filed a suit for a declaration that they were entitled to the building, and were entitled to claim possession of the same and to recover the rents and profits thereof. The lessees pleaded that they were lessees of the building and were protected from eviction there from by the provisions of the Bombay Rents, Hotel and Lodging House Control Act, 1947 and that the covenant for delivery of possession of the building could not be enforced as the lease in respect of the land could not be terminated on account of the protection given by the Act.

Held,

That upon a proper construction of the lease there was a demise only of the land and not of the building and consequently the provisions of the Act did not apply to the contract for delivery of possession of the building. The ownership in the building was with the lessees and in which the lessors had no right while the lease subsisted.

The appellants are entitled to a declaration that the building constructed on the land demised under the lease, belongs to the Mankeshwar Temple Trust and the said trust is entitled to recover all the rents and profits from the same and the respondents have no right, title and interest therein since the expiration of the said lease. The first respondent is directed to render an account of the rents received by him from the tenants of the building from 23-5-48 and to pay to the appellants the amount found due, after accounting, with interest at 6% per annum from 23-5-48 until payment. There will be an order of injunction restraining the respondents, their agents and servants from interfering with the collection of rents and profits by the appellants from the tenants of the aforesaid building. **Appeal allowed.**

Comments

If the above property had been mortgaged by lessee to the bank one year prior to expiry of lease period and repayment period of loan is 10 years, in case lessee becomes a defaulter after 2 years and at the time of taking loan, valuer had valued as land and building without considering the fact that lessee had a right for one year only. Imagine the fate of the bank!

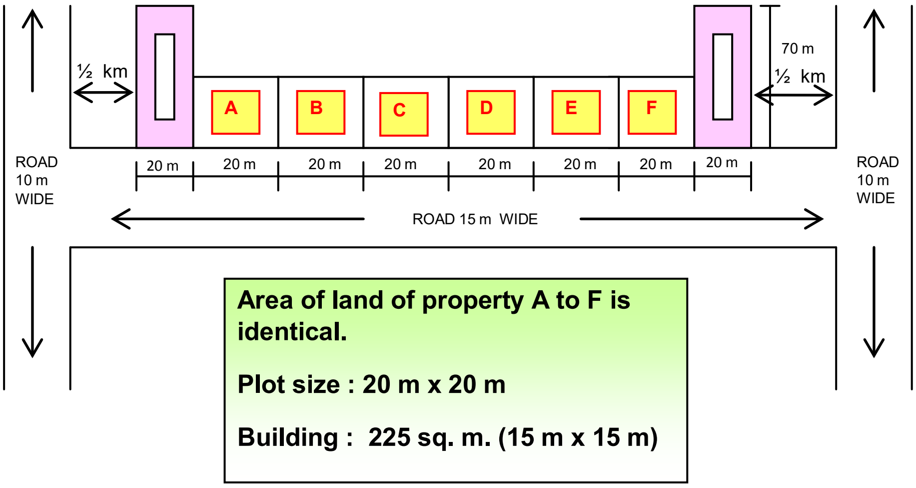
<u>The consideration of this legal aspect falls in the jurisdiction of a valuer.</u>

In fact, such a situation had arisen where a public sector company advanced loan on a property mortgaged by the lessee. After mortgaging the property, the lessee had handed over the possession of the property to the lessor as per the terms of lease agreement. Thereafter the lessee became the defaulter. The mortgagee wanted to recover the money by liquidating the security and for that served a notice to the lessor. **The lessor replied that he is the owner of the property, but he is**

not the party to mortgage transaction, and hence mortgagee has no right to recover money by liquidating his property. The mortgagee approached a senior valuer in the Government Department for the advice. He advised that mortgagee can only recover from their valuer and legal advisor. These consultants did not look into lease agreement and did not advise that mortgagor is not the owner of the property but possessing lease hold rights for the certain period only and therefore **mortgagee had to ensure that period of loan need to be less than the balance period of lease.**

5.3 Illustration

Let us consider the case of six properties mentioned below consisting of land with buildings located in Gujarat (having same area, size, maintenance, shape, design and age). There is no balance potential for further development for all buildings.



Purpose for which valuation is made : Bank finance

Date as on which valuation is made : 1st April 2015.

Prima-facie it appears that value of all the property will be the same. Actually, that is not the case on account of the following facts:

(a) **Property 'A'** is owner occupied.

(b) **Property 'B'** is rented at net rent of ₹ 15,000/- per month on 4th September, 2001.

(c) **Property 'C'** is also rented at net rent of ₹ 15,000/- per month on 6th September, 2001.

(d) **Property 'D'** is constructed on land taken on lease and there is a covenant for lessee to pay unearned increase to lessor at 50% in the event of sale or transfer. (Lessee is the borrower).

(e) **Property 'E'** is also constructed on land taken on lease. Unexpired period of lease is 10 years. There is no renewal clause. There is a covenant to surrender the building constructed by lessee to the lessor free of cost after expiry of the lease period. (Lessee is the borrower).

(f) **Property 'F'** is in the residential zone as per Development Plan in force and as per revised draft plan which will come into force as on 30 April 2016, it falls under commercial zone and commercial zone is lucrative than residential. Property is entirely owner occupied.

The value of each of the six properties will be different as out lined below:

(a) **Property 'A'** is owner occupied and purchaser can get the vacant possession and similar vacant property are sold for ₹ 75 Lakh; giving a market value of Property 'A' at ₹ **75 Lakh.**

(b) **Property 'B'** is fetching net rent of ₹ 15,000/- per month**.**

(c) **Property 'C'** is also fetching **net rent** at ₹ 15,000/- per month.

Prima facie it will appear that the value for both the property **'B' and 'C'** will be same as both property are fetching net rent of ₹ 15,000/- per month. But, that is not the case due to following reasons:

- Section 4(1A)(a) and (b) were introduced w.e.f. 5th September 2001 in the Gujarat Rent Control Act, 1963; due to this, Rent Act is not applicable to property let out for the first time on or after 5.9.2001.

Property 'B' was rented for the first time on 4th September 2001.

Tenant of property **'B'** paying a **net rent** of ₹ 15,000/- per month is protected under the Rent Control Act; as it was let out a day before the amendment to the Rent Control Act came into force. Therefore, landlord will not get the vacant possession of property, if tenant abides by the provisions of Rent Control Act. Due to this, value of right of reversion will be negligible. Its market value by rent capitalisation is say ₹ 22.00 Lakh.

Property 'C' was rented for the first time on 6th September 2001.

Due to amendment in the Rent Act from 5th September 2001, the tenant of this property falls under the category of a tenant **NOT** protected under the Rent Control Act.

Therefore, owner is entitled to recovery of possession of property after the tenancy period is over. He has a benefit of right of reversion. The value of property consists of capitalising the net rent for balance period of tenancy plus value of right of reversion. Property having market value of ₹ 75.0 Lakh will be available to landlord on expiry of tenancy period. Value of right of reversion will be present value of ₹ 75 Lakh available after expiry of tenancy period. Value of property C will be higher than the value of property B and lower than property A, say it is ₹ 45 Lakh.

(d) Value of lessee's interest (borrower) in property 'D'

In case of **Property 'D'**, lessee has taken a land on lease and in the event of sale or transfer by lessee 50% unearned increase is payable to lessor and it is a liability which requires to be deducted.

Let us assume that the land was acquired at ₹ 10 Lakh and current market value of land is ₹ 50 Lakh. This gives unearned increase of ₹ 40 Lakh and 50% of unearned increase = ₹ 20 Lakh. Value of lessee's interest without considering unearned increase is say ₹ 60 Lakh. Then after considering unearned increase it will be ₹ 40 Lakh.

(e) Value of lessee's interest (borrower) in property 'E'

In case of default by lessee of this property, if the lessee's interest is required to be sold then the purchaser of lessee's interest in this property can receive the benefit for unexpired period of lease i.e. for 10 years only. This will depress the value considerably. After 10 years, property is to be surrendered to lessor free of cost. Therefore, purchaser can expect rent / derive benefit for the next 10 years only.

The purchaser of lessee's interest can enjoy the property for 10 years. Let us assume that the property is capable of fetching net yearly income ₹ 3.0 Lakh as on 1^{st} April 2015 and YP is 10, then the value of the property is ₹ 30 Lakh.

(f) Value of property 'F'

In case of property 'F', existing use is residential but has a potential for commercial use and commercial use is lucrative. Due to this, it will command high value for commercial use. **Current land rate for commercial land in the locality is say ₹ 35,000/- per sq. m. which gives a value of land ₹ 140 Lakh**. This amount is required to be deferred for one year as D. P. will be implemented after one year. It works out to say, ₹ 127 Lakh.

Scrap value of structure is ₹ 3 Lakh and same will be available after one year as it will be necessary to demolish the building for commercial development. Present value of ₹ 3 Lakh available at 10% after one year is ₹ 2.7 Lakh.

Value of property F will be ₹ 127 + ₹ 2.7 = ₹ 129.7 Lakh.

Summary of value:

Property –A	₹ 75.0 Lakh	(Owner occupied)
Property - B	₹ 22.0 Lakh	(Occupied by tenant protected under rent act)
Property –C	₹ 45.0 Lakh	(- do - not protected under rent act)
Property - D	₹ 40.0 Lakh	(Lessee's interest)
Property - E	₹ 30.0 Lakh	(- do -)
Property – F	₹ 129.7 Lakh	(Owner occupied)

The land and building in all the six properties are having same area, location, size, maintenance, shape, design and age. But value varies from ₹ 22.0 Lakh to ₹ 129.7 Lakh depending upon occupancy and future potential. **This means, in valuation exercise what we are valuing is not the land and building but the rights derived in owning land and building.**

6 INCOME GENERATING PROPERTIES

In estimating market value of an interest in a property, following important aspects are required to be considered:

i. Net income
ii. Period – income flow
iii. Security and rate of interest
iv. Dual rate of interest
v. Rate of interest for capitalization
vi. Benefit
vii. Capital erosion and capital appreciation

6.1 Net Income:

It is the annual income that can be legitimately expected to be derived by a person interested by putting the property to highest and best use. In the case of freehold interest, the net income would be gross income at the market rent less all types of outgoings like annual taxes, annual repairs, etc. In the case of lessor, net income will be rent reserved under the lease for the unexpired period of lease and after such period, reversion to net annual income of market rent with deduction of all annual outgoings. In the case of lessee/ sub-lessee, net income would be annual profit rent i.e. market rent (or rent reserved under lease) less rent reserved under lease or sublease as the case may be. In the case of a tenant or licensee, he is permitted to occupy or enjoy use of the property only on payment of rent or license fee and normally he is not legally expected to derive any monetary benefits by transferring or assigning the property.

6.2 Period – income flow:

A free holder can enjoy the net income from a property, in general, in perpetuity. In case of land, net income would be perpetual. In case of building net income can be enjoyed for the future life of the building.

In the case of leasehold property, lessor is entitled to receive-

(i) Lease rent for the unexpired period of lease
(ii) Market rent after the expiry of lease i.e. reversion to net income (market rent less outgoings) in perpetuity, deferred for unexpired period of lease.
Or
Market value of property (as if vacant) deferred for unexpired period of lease.

In the case of lessee or sub lessee, the period for which he can enjoy profit rent is the income receivable during unexpired period of lease.

If such future life is sixty years or more, it is considered as perpetual and in case the future life is less than 60 years, net annual income can be capitalized for perpetuity allowing deduction of cost of reconstruction of the building deferred for future life of the building.

6.3 Security and Rate of Interest

The degree of security gets reflected in the rate of interest for capitalization of net annual income. Higher the security (i.e. lower the risk factor) lower is the rate of interest for capitalization (i.e. higher the Y.P. multiplier) and vice-versa. In other words, the rate of interest is inversely proportional to the degree of security. For estimating the appropriate rate of interest for capitalization of net income, it is necessary to ascertain the degree of security of investment by asking questions regarding the safety and liquidity of capital as well as regularity and ease of collection of net annual income. The estimation of market value of a property depends on correct estimation of the rate of interest for capitalization.

In the case of all types of investments, including that in real estate, there are certain criteria which go on to decide the level of safety of investment (or conversely the risk factor) or characteristics of sound investment .

The following factors determine the soundness of investment which has a direct or indirect bearing on the valuation of real estate:

- Security of capital
- Liquidity of capital
- Security of income
- Regularity of income
- Ease of purchase and sale
- Least costs of purchase and sale
- Divisibility of holdings
- Security in real terms
- Capital appreciation prospects

Security of capital is a vital feature, as only imprudent investors will invest their money in an investment in which the risk of losing money is high. The vast majority of investors will only wish to place their money in an investment if there is a strong probability that they will be able to recoup their capital at any point in time should the need arise. The greater the chances of their being able to get their original money back at any point in time (or the greater the security of their capital), the greater will be their willingness to invest.

Security of income is another vital consideration, and it must be borne in mind that, in investing money, an investor is giving up the immediate use of that money and is allowing its use to pass to some other party. In return for giving the use of his money to someone else, he requires payment, and this payment will be the interest his money earns. It is his reward for foregoing the use of his own money, and before he is prepared to give it up he will wish to be reasonably certain that he will get adequate payment for such use, and that there is a high degree of certainty that the payment will, in fact, be made.

Regularity of payment of interest is naturally coupled with certainty of interest. If regular payments are made, the borrower is less likely to get into arrears, whilst the receipt of interest at regular intervals enables the lender to phase such receipts to meet regular expenditure which he may be incurring, and this will assist his own budgetary control.

Investments which are easy to exchange at market place by buyer and seller will be particularly attractive to an investor who may be likely to require his capital in relatively short notice.

Cost incurred in investing and withdrawing is as vital as the speed with which capital invested can be realised. Some investments have little or no cost incurred in depositing money and subsequently withdrawing it, but with others there may be considerable expenses to be met, such as the payment of professional fees, stamp duty, and sometimes even a certain amount of interest as penalty if the withdrawal of capital is premature. Obviously, the cheaper it is to invest and withdraw money, the more attractive will be an investment.

Many a time an investor is interested in withdrawing part of his money. In such cases he will be at a great advantage if he is able to sell part of the holdings, but this is not always possible. For instance, if he has invested in a piece of real property it may be difficult for him to sub-divide and sell a portion of it.

During inflation, when the purchasing power of money is rapidly decreasing, it is not only important that the capital which was originally invested should be capable of recoupment at any point in time, but also that the investment in which the money has been placed appreciates at a sufficiently rapid rate to keep pace with the changing value of money. Such an investment is known as investment secured in real terms and it is also often referred to as being a good hedge against inflation, or as being inflation proof. In recent years, this quality perhaps bears the most desirable quality of an investment, and the fact that property has generally satisfied this requirement has tended to make it a very attractive investment for those who require security in real terms. A cautionary word should be added at this stage to point out that not all types of property fall into this category (e.g., rented property occupied by the tenants protected under applicable Rent Act) and undoubtedly there will be some types of property in the future which may not be secured in real terms. Nevertheless, it is generally true to say that sound investments ought to ensure hedging against inflation compared to other alternatives.

An investment where all the above criteria are 100% satisfied is called a ‘Gilt Edged Security’ as found in investment in long term Government bonds and these are generally considered as gilt-edged security.

6.4 Dual Rate of Interest

Another important basic principle is in respect of use of dual rate of interest for capitalization of net income. The two rates of interest are - The **'remunerative'** rate of interest which is the remuneration on capital invested and the other is **'accumulative'** rate of interest at which the annual sinking fund accumulates, at the end of certain period, to the original capital invested.

The appropriate remunerative rate of interest which depends on the degree of security offered by investment should be estimated by conducting study of real estate market in the area concerned. The remunerative rate of interest should **never** be adopted on ad hoc or thumb rule basis.

Property having terminable income may be short term leases or building having life span of 60 to 80 years not affected by the Rent Act. As income is terminable, capital invested in building and/or premium paid to acquire leasehold interest must be accumulated within income termination period. This accumulation, therefore, requires highest and assured security with no risk whatsoever. Therefore, rate of accumulation has to be lowest possible (i.e. at minimum rate) below which it is not likely to fall during entire period of accumulation of capital. The accumulative rate of interest should, therefore, be minimum i.e. 2½% to 3½%.

The use of dual rate table (valuation table) automatically takes care of sinking fund element of net income and hence the amount of sinking fund to be kept aside need not be worked out separately when dual rate is used.

The Rate of Reversion i.e. the rate at which income or capital receivable in future should be deferred.

Then the question arises, what should be the rate of revision?

It depends on the terms and conditions of lease, mainly on reversion of the property after the expiry of the lease period. If terms and conditions are such that the lessor is assured of reversion then it should be same as rate of capitalisation. If terms and conditions are such that on expiry of lease period, lessor is not assured of reversion on account of uncertainty, in such cases rate of reversion should be 1% to 2% more than the rate of capitalisation.

6.5 Rate of Interest for Capitalization:

The rate of interest for capitalization of net annual income for the appropriate period should be estimated by the study of the real estate market in the area concerned. Temptation to adopt ad hoc rate of interest should always be resisted.

6.6 Benefit

Expecting or anticipating a benefit is one of the natural instincts of all living creatures. No one acts or takes any action unless there is some benefit existing or anticipated.

Benefits can be tangible or/and intangible and are ultimately measured/counted in terms of saving of time and saving of money or conserving or recouping energy.

Gross Rent - In the case of real estate benefit arise out of –

(a) Safety, design or hygienic conditions including light and ventilation, etc. of structure
(b) Provision of utility services like water supply, sewerage, electricity, etc.
(c) Locational advantages like nearness to facilities, amenities, shops and markets, work places, etc. which are reflected in market rent and net annual income.

Net Annual Income - The benefit accruing due to ownership and occupation is in the form of net annual income and is estimated by deducting all annual outgoings from the gross annual income from a property. In income approach to valuation, such net annual income is considered as annual interest on capital invested in buying a property.

6.7 Capital Appreciation and Capital Erosion

(a) Capital Appreciation

It is extremely necessary for a Valuer to be aware of trends in various investment markets including real estate market. A Valuer must also be aware of returns expected by the investors in real estate market at different period of time. A Valuer must also appreciate effects of additional money supply in money market as well as effects of crisis in money market. It is common knowledge that funds normally flow from one investment market to the other market depending upon possibilities of better short term and long term returns as well as security.

In the case of investment by investors in the form of Govt. bonds, saving certificates, fixed deposits, etc. the depositor either gets interest regularly with return of capital at the end of the term or gets back original investment together with interest payments accumulated at the compound rate of interest over the fixed period. In both the cases, what an investor gets back is essentially the original capital invested by him; but capital invested does not appreciate.

In case of investment in real estate, due to development of urban areas both in densification and spread over the area, a landed property which was once on the outskirts becomes almost centrally located or improves its locational aspects. Moreover, with the growth of an urban area, development & improvement of infrastructure, amenities & facilities may take place. Moreover, due to surge in population, demand for properties also increases. All these factors accordingly result in increase in prices of properties without owner doing anything for or contributing in any way to such increase in values and hence such increase is termed as ‘Unearned’ increase. Such an increase in capital value of a landed property is known as 'Capital Appreciation'. In view of possibility of Capital Appreciation, owners/investors usually accept interest at lower rates than those offered by Govt. Securities.

(b) Capital Erosion:

As in contradiction of the aspect of 'Capital Appreciation', a valuer must also understand and appreciate another aspect or eventuality wherein the capital invested loses value in real terms. One of the main reasons of such decrease is 'Inflation' i.e. rupee value going down. Due to increase in rate of inflation with time, purchasing power of a rupee gets reduced. In case of investment made in Govt. bonds, fixed deposits, etc. i.e. in pecuniary form for certain term, there is increase in the inflation rate during that term, the investor will get back the same amount he has invested but the purchasing power of that capital amount gets reduced. In other words, value of the capital amount will reduce in real terms and thus will get eroded, i.e. wear away or get reduced. Such reduction in value of capital is known as 'Capital Erosion'.

In the case of investment in real estate/property, as inflation increases, rent levels and capital values of properties also correspondingly increase. Capital invested in a property does not get eroded or reduced in value. In view of this, the investor often determines his willingness to accept interest at rates lower than those yielded by Govt. Securities.

This phenomenon is explained by an example.

In Mumbai, in Vile Parle (E) area on Nariman Road in a good building, 1BHK apartments were available at ₹ 5,000/- per sq.ft. of carpet area on outright purchase in the first quarter of the year 2003. These premises were fetching a gross rent of ₹ 25/- per sq.ft. of carpet area per month on leave and licence basis (the tenant is not protected under Rent Control Act). The same premises in May 2008 were available at ₹ 10,000/- per sq.ft. of carpet area and gross rent was ₹ 40/- per sq. ft. of the carpet area per month in the year 2008. All the outgoings are borne by landlord. In year 2015, the premises are available at ₹30,000/-per sq.ft. of carpet area and the gross rent is at ₹ 75/-per sq.ft. of carpet area per month. The net rent roughly works out to 75% of gross rent.

These figures are tabulated as under:

Year	Rate at which premises were available per sq. ft. of carpet area (in ₹)	Gross rent per sq. ft. of carpet area per annum (in ₹)	Net rent per sq. ft. of carpet area per annum (in ₹)	Rate of yield per annum (%)	Bank deposit rate on long term fixed deposits (%)	Return from Gilt edged security (%)
2003	5,000/-	300	225	4.5	5 - 6	6 - 9
2008	10,000/-	480	360	3.6	8 - 9	8
2015	30,000	900	675	2.25	8 – 9	8.5

The above table shows that there is an increase in capital value by 600% from 2003 to 2015. During the same period rental yield has increased by 300%. This has resulted in to the reduction of rate of yield by 50%. **The acceptance of lower yield is mainly due to anticipation of rise in capital value. Rise in capital value is much more than reduction in yield.**

But in case of property in urban areas covered by rent control laws in which the tenants are protected under the rent control act, the problem arises in a peculiar manner; capital invested in real estate gets eroded, on account of protection granted to tenants under Rent Control Act. The reduction in value is not due to actions on the part of the investor. **Rent controlled rented properties are the classic example of capital erosion of the invested capital sum. This capital erosion is due to frozen rents coupled with inflation in the country over a period of several years.** As the inflation grows, the rate of return expected by the investors in the real estate market also increases. As rents are frozen, investor tied up with tenanted property where tenant is a protected tenant, gets lesser return than that is anticipated by other investors in the market and thus he suffers erosion of capital originally invested in the property. Therefore rent act affected tenanted properties are also known as “Depreciating assets”.

7 VALUATION MAXIMS

Value of Real Estate is conditioned by following factors:

- Physical
- Legal
- Social
- Economic
- Utility
- Marketability
- Transferability
- Scarcity
- Present worth of future benefits, and
- Intangible rights

7.1 Physical aspects:

(a) Size/area, shape, access, etc.
(b) Location with reference to amenities, facilities available in locality.
(c) Buildings/Development which include engineering aspects, architectural aspects and facilities within property itself.
(d) Utilities and other services in the property.

7.2 Legal aspects:

The various government actions can be classified as legal forces. They have a far-reaching effect on the value of real estate.

A partial list of legal aspects affecting value which a valuer must know includes:

(a) Zoning and land-use regulation.
(b) Central and State Govt. Legislations
(c) Building and safety regulations.
(d) Environmental protection laws.
(e) Government – sponsored urban redevelopment and housing finance programmes.
(f) Regulation of industries.

Town Planning Laws

Draft or Final Development Plans or Master Plans prepared by Local Planning Authorities i.e. Municipal Corporations/Councils or Planning and Development Authorities, include proposals for –

(a) Allocation of land uses or Land Use Zoning,
(b) Proposals for new roads, road widening and designation or reservation of lands for various public purposes providing civic amenities, social facilities and Utility Services etc.
(c) Development Control Rules for regulating development.

All these proposals have their effect on market values of properties in different ways. Land use zoning restricts type and quality of use of properties while Development Control Rules to prescribe restrictions on intensity of use.

(a) Land Use Zoning

Development Plans allocate lands for various uses such as residential, commercial, industrial, etc. (Land Use Zoning). Depending upon permitted land use, the value of land varies.

(b) Land Designated for Acquisition:

Land earmarked for public reservations are not permitted to be developed by the owner and it will be acquired by local authority for public purpose. Such reserved sites, if acquired under the Land Acquisition Act, compensation is paid for it.

(c) Development Control Rules:

Every local authority and municipal corporation prescribe rules and bye-laws for development and construction on the land under its jurisdiction. These building bye-laws and development control rules (D.C.Rs) also affect value of land. Important provisions of these bye-laws affecting value of lands are F.S.I. (Floor Space Index) or density control provision, open space rules and height restrictions.

For certain narrow plots, only ground floor or ground and first floor are allowed to be built on plot as per provision of Development Control Rules. Many a time, such restriction results in lesser utilization of F.S.I. thereby limiting intensity of use as compared to the permissible limits for the locality. This restriction, therefore, reduces the property values. Minimum open space required to be provided all round the building, also sometimes results in less intensity of development in the plot and hence reduces value.

Central and State Govt. Legislations:

There are some Central and State Govt. legislations which restrict or regulate development on land and sometimes even regulate holding of land. These restrictions in turn, reduce value of properties in the open market.

(i) **Rent Control Act** is another Act which in effect reduces value of properties to a very low level. As per provisions of Rent Control Act of Maharashtra, rent of buildings occupied by tenants protected under the Rent Control Act is frozen at its standard rent level and the permissible increase in rent is very less compared to inflation. Under this Act, tenants who are protected under the Act cannot normally be evicted from premises and thereby protected tenants are virtually getting permanent protection against eviction. Tenancy rights do not extinguish even after the collapse of the building. Tenant can even claim tenancy in the rebuilt building constructed on the plot. Thus, landlord does not virtually get back land, once building on land is let out.

Different states have enacted different Rent Control Acts to suit to the conditions prevalent in the respective states. However, provisions of freezing of rent and protection against eviction are almost common in all States.

(ii) **National Highway Act and Railway Act** regulates development in the plot adjacent to Highway and Railway lines by prescribing restrictions of no construction zone or set back lines/building lines for a certain distance inside the plot from Highway center/Highway boundary. For a small plot, this restriction may result into an unbuildable plot and in turn its value will reduce drastically.

(iii) **Civil Aviation Authority** regulates and restricts height of **buildings** on plots in the vicinity of Airports. These height restrictions will result in low consumption of F.S.I. on plot and ultimately reduces value of the land.

(iv) **Coastal Regulations** restrict and regulate development on all lands falling within 500 m. distance from high tide line along the sea coasts. The Act adversely affects the value of sea front property, falling within 500 m. distance from high tide line.

Sometimes clearance is required from irrigation canals and also 'nallah' passing through the plot. This reduces buildability in the plot. If optimum use of land is not possible because of these restrictions, value of land falls substantially.

(v) **Indian Electricity Act** regulates development on land falling under power transmission lines. If high tension power transmission line passes through the plot, no construction is permitted in certain distance on either sides of such a line and also no development is permitted for certain prescribed safety distance. This affects land value.

(vi) **Ancient Monument Protection Act** which restricts and regulates construction activities.

Or

any other Acts having bearing on value of landed property like Tribal Act, Land Reform Act, etc. of various States/Central Governments.

7.3 Social aspects:

The social forces affecting value include all the characteristics and customs of the people that make up the community. Here is the partial list:

(a) In certain parts of southern India, plots on **'T' junction** have very limited marketability as hardly anybody comes forward to buy such plots. In western India, such plots are sold like hot cake. This is indicative of the effect of the social forces having effect on market value.

(b) Family sizes and age-group distribution in the neighbourhoods and communities.

(c) Neighbourhood stability and attitudes about property.
(d) Population growth, decline or shifts at the community, regional and national levels.
(e) Life-style and living standards

7.4 Economic aspects:

The major economic forces affecting real estate include:

(a) Income level of neighbourhood and community residence.
(b) Employment opportunity and rents.
(c) Level of wages.
(d) Availability of money and credit, and interest rate levels.
(e) Price levels and property tax burdens.
(f) Personal saving levels and investment returns.
(g) General business activity.

7.5 Utility

Utility is the power of goods to render a service. In order to possess value an asset ought to have utility.

In other words, real estate have some use and therefore have a value.

Utility can also be termed as the power of a good or service to satisfy needs of human beings. Value is dependent on the degree of satisfaction derived, which varies from person to person and hence it is subjective.

The main criterion in the valuation of any property is its utility. The method used in the valuation exercise must have the main objective of quantifying usefulness of the property valued.

Utility is not an absolute condition but a relative or comparative term. As per example, the utility of an agricultural land is conditioned by its productivity. Its value is dependent on the quantity and quality of produce.

If the land has potential for development, then its productivity is measured by how it will support potential use as a residential, commercial, industrial, or mixed use.

Utility is measured over the normal useful life of a particular asset. At times, a particular asset may become temporarily redundant or otherwise removed from production or put to alternative use. It may also be kept idle for some time due to market forces. Valuation in such a situation requires a special skill.

The main effect of political or economic uncertainty is a variation in utility; it could be in terms of capacity or efficiency. It is the Valuer's responsibility to assess the market. The property or asset valued need to be viewed in the light of all factors, internal and external, having a bearing on its operating performance.

The utility is explained in the following illustration.

Let us consider a case of manufacturing facility established five years back as per technology available then. The buildings and plant & machinery required for the process are shown in photographs marked ‘A’ and ‘B’. Photograph ‘A’ shows specially designed building with walls having abnormally high thickness (1000 mm) and height (15000 mm) and a large built-up area.

Photograph ‘B’ shows rows of aluminium trays used for manufacturing process. These aluminium trays are housed in the building shown in photograph ‘A’. The total investment in building and equipment was approximately ₹ 15 Crores.

Now, the technology has changed and current process is carried out in a white coloured reactor (shown in Photograph ‘C’) which requires building area less than 80% of the old process.

The latest process has following advantages:

- Improved quality
- Improved yield
- Less capital cost
- Less running cost / operating cost

The current cost of brand new reactor and building required for the same capacity (as of old process) for latest process is ₹ 7.5 Crores

This gives an idea that buildings and equipment used in old process are functionally obsolete and utility of these assets is also adversely affected.

Photograph - A shows the building in which aluminium trays are installed. The building is specially designed with walls having abnormally high thickness (1000 mm) with height of about 15000 mm and a large built-up area.

Photograph - B shows rows of aluminium trays used for manufacture, housed in building mentioned in photograph - A

Photograph - C shows the white coloured reactor for manufacturing

7.6 Scarcity

The properties which are available in limited quantity and are not in abundance command high value.

7.7 Demand & Supply

Demand and supply have direct bearing on value. This is the most important factor, because a dilapidated building (which has out lived its economic life years back) in a main business area of metropolitan city commands high price due to its demand on account of its location as well as demand for property in the area far exceeds its supply.

7.8 Transferability/Marketability

The ownership and possession of the property can be transferred by way of sale, gift, lease, mortgage, will etc. and hence it has a value.

7.9 Present worth of future benefits

The decision of making any investment is based on the current value of the future benefits to be earned by that investment, and the value of a particular asset is represented by the present value of its projected future benefits.

7.10 Intangible rights

In the process of valuation of tangible assets, the subject matter of valuation is the value of rights derived from ownership of tangible assets. This is explained in detail in examples given under subject matter of valuation.

8 METHODS OF VALUATION

8.1 Background

Valuation of immovable property utilizes logical processes which are dictated by and justified by the generally established findings of land economics. In order to carry out sound valuation, it is necessary to have economic background of immovable property. This is so because valuation is concerned with the consequence of interaction of economic forces.

The valuation process takes into account uses of land, productivity of land, land policies, geography, transportation, natural resources and alike value phenomenon. In the valuation of immovable property one values “properties”. Property refers to certain rights which an individual enjoys by virtue of ownership of wealth. Wealth consists of useful things owned by man. Wealth and property differ. The former is the material thing; the latter is the right to use the material things. The valuation technique is concerned with the valuation of the rights of ownership. One who owns wealth possesses certain rights, which are simply the rights to enjoy the benefits of wealth. It is the possession of these rights which constitutes property. These property rights are not material things but are merely abstract relationships and may be included under the term ‘ownership’. Since past benefits expire with time, the property consists only of rights to future benefits. Property may be defined as rights to future benefits arising from ownership.

Immovable properties may consist merely of land or of land and improvements. Improvements may be on the land or to the land. Construction of a building on the land is an improvement on the land. Improvements like providing means of access, drainage, services etc. are improvements to the land.

Land has productive capacity, but not without the application of labour and capital on it. In the case of agricultural land, labour for cultivating it and the working capital in the form of seeds, fertilizers and water have to be provided before it becomes productive. Similarly, labour and capital have to be applied to the urban land before it can become productive.

In the combination of these factors (land, labour and capital), an economist distinguishes rent, wages and interest. The services of labour are reckoned as wages, and the services of land as economic rent. In this system the product of land, viz., rent, was considered residual quantity remaining only after sufficient portion of the product had been allocated to wages and interest to satisfy the demands of labour and capital.

In the development of valuation technique there is a practical identity between the elements of the product, except that the return to land is residual in character and the value of land is an appropriate proportion of the joint product which remains after adequate returns to labour and capital.

Land has value because on the application of capital and labour the joint product produces rents or services which are sufficient not only to meet the interest charges on the cost of labour and material, but also leave residual income attributable to land.

Immovable properties have value because they serve mankind and are capable of satisfying their wants. The differences in the quality and advantages of immovable properties are the difference in the utility. These differences of various kinds of properties have brought about competition between individuals in the possession of particular property and recognition of relative worth. Sales, exchange and renting of immovable properties have given them values. The differences in exchange values or prices will be found to be a reflection of difference in potential productivity that is future benefits. These future benefits may be in terms of money income or in terms of amenities.

It is the failure to recognize these economic principles that produces disagreement between **valuers. On the one hand there are those who see in a property a physical thing or an area of land limited by boundaries, a pile of bricks, mortar, steel, cement, timber and with a street address. These men say "there is the thing"; that is what we are going to value. On the other hand, there are those who see in a property not only its physical features, but its legal and economic characteristics.**

A purchaser of immovable property, purchases the right there in with the expectation of future productivity. The price he would pay, i.e. the capital value of the property is proportional to the character, importance and the extent of the future productivity anticipated by him. The degree of certainty attached by him to the future productivity, the period of time for which it will continue, the amount of it, and the tendency to increase or decrease of productivity over the years - all reflect into the capital value of the property to him. He first estimates the quantity, quality and duration of anticipated future productivity into a capital sum which is known as capitalization. It will be seen that the anticipated productivity is the primary consideration in the purchase. The capital value is secondary in character and derived from it.

It is now a well-established fact that immovable property market is an integral part of the investment market and therefore, the same factors which influence the investment market will influence the immovable property market.

Properties / Real Estate can be classified under three basic groups, keeping marketability in view:

(i) Income fetching marketable properties: Rented properties whether residential, commercial or industrial. Hotels, Cinemas or industrial properties fall under this group.

(ii) Non income fetching, marketable properties: Owner occupied bungalows, apartments/flats, shops, offices, factories fall under this category.

(iii) Non income fetching, non-marketable properties: Religious and public buildings like temple, church, school, college, public buildings, museum, town hall, fire station and Govt. buildings which are neither sold nor let out, fall in this category.

Note: In the above classification, income fetching properties are those which are fetching income at the time of valuation and not the property, which are capable of fetching income but not fetching at the time of valuation.

Based upon different characteristics of above referred three types of properties, three different approaches of estimating value of the property are evolved.

Income Approach: This approach is generally useful to value income fetching marketable properties.

Market Approach: This approach is generally recommended for all marketable properties, whether income-yielding or not.

Cost Approach: This approach is generally adopted for non-income fetching and non-marketable property.

All the three approaches to valuation involve comparison of various legal, physical, social and economic factors/aspects, as also of advantages/merits and disadvantages/demerits arising out of these various factors. In order to ensure that none of those factors and their advantages and disadvantages are over looked or lost sight of, it is advisable that a valuer should first step in the shoes of the client and think about the problem i.e. of property, its advantages and disadvantages and market value of the same from the other angle also. Thinking from points of view of both (or all) sides will ensure better and fairer estimation of market value of a property.

All these three approaches are not exclusive of each other. In income approach, market rent i.e. income is estimated by comparison. In market approach, sales analysis is carried out. While in cost approach, value of land is estimated by sale comparison and that of building by contractor's method as explained later.

8.2 **The** selection **of a method of valuation is the prerogative of the valuer.** Based on the facts and circumstances of each case, the valuer shall select appropriate method of valuation. <u>It is not necessary to estimate market value of a property by adopting all the three approaches to valuation, unless the valuer himself desires to cross-check with alternative approach.</u> **In any case, however, temptation to arrive at an average value should always be scrupulously or strictly avoided because in reality, average never exists. This is explained by an illustration below.**

Let us consider a case of a rented property having land area of 400 sq.m. and building area of 200 sq.m. located in a developed city entirely occupied by a very old tenant protected under Rent Control Act. There is no further potential for development as FSI is fully consumed. The net income from the property is say ₹ 1 lakh. Let us assume that Y.P. is 8. This gives value of property ₹ 8 lakh. As the tenant is protected under the Rent Control Act value of right of reversion is negligible. If we carry out valuation by cost approach by considering current market value of land plus depreciated replacement cost of building value works out to say ₹ 1 crore. **The average value of property works out to ₹ 54 lakh.** <u>No prudent buyer will buy the property at the average value. The average value worked out does not satisfy the concept of willing buyer and willing seller.</u>

As explained above, valuation of tangible assets involves three basic approaches:

- Market approach
- Income approach
- Cost approach

8.3 Market approach

8.3.1 There are several educative stories of Akbar and Birbal. One of the stories is related to 'Three Dolls'. An artisan produced three identical looking dolls in Akbar's Darbar and requested the King to get each doll valued. As usual, this difficult task of valuation was assigned to Birbal. Looking to the apparent paradox, Birbal asked for 24 hours' time for valuation. Next day he declared the result as under:

- First doll was declared worthless or having Nil value.
- Second doll valued at 1,000 gold coins, and
- Third doll valued at 1,00,000 gold coins.

The King asked for justification.

Birbal gave a practical demonstration. He put a thin wire in the ear of the first doll. It came out of the mouth of the doll. Birbal said that this doll symbolises a person who listens to the secret of his friend and tells everyone about it and hence such person has no value in the society.

The wire was put in the ear of the second doll. It came out of the second ear. Birbal said such people are less harmful as they neither help the friend nor cause any harm to the friend. Hence he valued the second doll more than the first doll.

When he put the wire in the third doll's ear, it did not come out but remained inside the doll. Birbal explained that such persons are invaluable because they not only keep the secret with themselves but they also try to solve problems of their friends. For this reason, he valued the third doll more than the second doll.

There are three important lessons to be learnt from this story by valuers:

(i) The similarity of property may be deceptive. We must thoroughly investigate to find out differences of attributes even between similar looking properties.

(ii) The valuer should not immediately jump to conclusion. The case must be thoroughly studied by asking some time for valuation and then only a considered opinion about valuation should be given.

(iii) End user of report (Client or Court) should ask for reasons for giving such a valuation and the valuer should support and prove his valuation by giving reasoning and supporting evidence.

8.3.2 For standardized goods and services, the prices paid at 'arms' length', after bargaining in an open and normal market provide a reliable evidence of value. As a rule, little difficulty is encountered in obtaining reasonably accurate estimates of market price quotations for commodities such as wheat, coffee, sugar, and corn or for bonds and stocks, which are freely traded. The greater the dissimilarity of the product and lesser the frequency of trading, greater is the required skill necessary to adjust for product differences in order to attain the price comparability and the greater the chances for error in the final estimate of value through the market approach.

With properties such as land and buildings which are heterogeneous in character, exact comparability can never be obtained due to differences in the fixed geographical location of the property. Nevertheless, it is possible through study and analysis of market operations to adjust for price effects caused by differences in 'physical' characteristics in order to obtain 'economic' equality essential to an accurate estimate of market value.

The greater the number and more recent the sales of comparable properties, greater is the accuracy and, more convincing are the results obtained through the market approach to the value estimate. Ready access to market transaction source data is, therefore, of primary importance. Most active valuers maintain a market sales data / record in their file as part of their valuation plan at least for the geographic area in which the majority of their assignments originate.

Any market sale transaction should never be used as a value source data unless the valuer has personally or through a responsible assistant, taken steps to confirm the sale and to inquire into circumstances causing the sale or affecting the transaction price. Comparable sales selected for price analysis under a market approach to value must be adjusted if necessary to compensate for the effect of economic forces that influence the real estate market during the time interval elapsed between the date of the comparable sale and the date of valuation of subject property.

A detailed comparison and logical adjustments for building differences caused by size, age, quality, legal issues and quantity of construction should also be made to estimate the proper value.

8.3.3 Primary Considerations

In Real Estate Market, valuer first considers the four basic qualities of the property, while estimating its value. Valuer should ask following questions about the property to be valued.

(i) What is the utility of the property? **Utility** means existing and anticipated **benefits** due to ownership, possession and use of property. In case of real estate such benefits are reflected in **rent.**
(ii) Is it scarcely available or abundant in supply?
(iii) How much is its ‘demand’ in the market?
(iv) Is it ‘transferable’?

Market approach is basically operating on the **“Principle of substitution”.** Valuer has to find out from the market about the availability of identical property or nearly similar property to the property which is under valuation. He should also find out actual sale price or asking price of such similar property. Then valuer has to compare both properties and estimate market value of subject property after making appropriate adjustments, based on available evidence.

This principle of substitute product and comparison with the required products is already operating in the consumer product market. Same principle with a little change is operating in Real Estate Market. This is true for sale or purchase of the open plot of land or land with buildings as well as for sale or purchase of flats, shops, offices and industrial galas (units), etc.

One may perhaps find two exactly similar consumer products in the market. But there are no two exactly identical properties in this world. They may differ in size, shape, area, location and situation (placement), improvements, ownership, usage, topography, legal or in many other respects. These variations or the differences call for adjustment in values while comparing properties.

The subject property is compared with similar/substitute properties recently sold in the market. Some factors which may be positive factors may tend to increase price of the property to be valued while other factors which may be negative factors may tend to reduce the price of the property.

To estimate fair and reasonable price for a real property in a real estate market and its condition, as defined under “market value” definition of real estate transaction as stated hereunder are required to be considered.

Instances of sale satisfying all the following criteria are considered as genuine sale transactions:

(i) Buyer should be a willing buyer and he should not be compelled or forced buyer in urgent or immediate need of the premises. He should not be a forced purchaser as we find in case of purchase of undivided share of co-owner in a property jointly held with the other co-owners.

(ii) Seller should also be a willing seller and not a seller forced to sale property by extraneous/external circumstances. Internal circumstances or circumstances under one’s control like daughter’s marriage or meeting medical expenses cannot be considered as compelling circumstances unless those are unavoidable emergency cases. Negotiated or auction sales by Banks for recovery of mortgage debt are forced sale by unwilling sellers (mortgagors). Sales by a person in distress are also examples of unwilling and forced seller.

(iii) In order to find out whether such sales in reality are distress sale or not, personal enquiries during site inspection are necessary. Mere mention in sale deed may not be proof of a forced sale.

(iv) Buyers as well as sellers are fully knowledgeable about prevalent market rates and market conditions. This is an ideal situation. Sometimes it is found that one or both transacting parties are unaware or ignorant about actual or true price of the property. They also do not know factors that affect the value of the property under sale. In number of cases it is found that the party who is stronger in bargaining succeeds in getting the price fixed in his favour.

(v) Transaction has to be at arm's length. This is also not always possible. Many a time the transacting parties are related. Sometimes they are influenced due to political, social or financial powers of one of the transacting party.

In market approach, while comparing properties, generally "Highest and Best use" of the property potentials has to be considered to estimate Market Value on the relevant date. Many a time we come across property which is put to inferior use (e.g. property falling in commercial zone but being put to residential use). Such an inferior use is required to be valued considering the best permissible use, ignoring actual use or continued subsisting use of the property. Value of a property put to continued inferior use is bound to give lower value as compared to the market value on the basis of Highest and Best use.

There are no common market place for sale or purchase of real estate like market place for sale and purchase of other commodities and consumer goods. Open market for real estate can, therefore, be defined as a notional forum or platform, where group of buyers and group of sellers are competing with each other to buy or to sell and where substitute properties are also available for sale and purchase in perfect competition and monopoly conditions are absent. While understanding this open market concept, we must also keep in view that the "market is supreme" for all marketable properties. Market takes into account all market forces which may be economic, technical, legal, social, political, or any such other factor. Market considers them all and prevalent exchange values or prices in the market are obtained after considering impact of all these forces on supply and demand and interaction thereof.

Market does not care for any one including government. A person in distress and in urgent need to sell his property, may accept 20% to 30% lesser price in market because buyers in the market will come to know that a particular seller is in distress and they will offer low price. Another glaring example of this supremacy of market is the case of Rent Control legislations enacted by most of the State Governments throughout India. Though government tried to regulate rental market by levying artificial control by freezing of rent which is grossly contrary to market forces operating in the real estate market, the market invented a scheme of payment of *pugree*, premium, salami or key money, under which the landlord was financially rewarded in advance, in lieu of loss of rental income due to freezing of rent.

In case the information about prevailing recent prices in locality is not available in the government records, inquiries with estate brokers, property owners, etc. is essential.

Now-a-days there are num**ber of websites offer platform to sellers to advertise their property. Valuers need to be careful to use such data available on the internet. Valuer must ensure that the prices available on internet are reliable.**

8.3.4 Process of valuation in market approach - Steps Involved

The process of valuation in the market approach involves following steps:

- Collect data in respect of recent instances of sale of similar land/properties in the vicinity from different sources and weed out non genuine sales.
- Select comparable and genuine instances of sales which are proximate in time as well as proximate in situation with the property under valuation.
- Visit physically, site and location of all the properties involved in the genuine instances of sale and record all favourable and unfavourable aspects of these properties. Formula for success in any valuation assessment is “Inspect before you value”. Inspection of the subject property and properties involved in the instances of sale is a MUST.
- For the purpose of deciding genuineness of sales, obtain sale documents or copies of these documents and examine for any unusual covenants or precarious conditions. During inspection of site/properties, contact and enquire with sellers or purchasers to find out whether the sale was genuine and was not a forced sale or distress sale though it has been executed in normal business like circumstances. This will help in proving the valuation in the Court of law if necessary.
- Analyse and work out rate of sale in each of the genuine instances of sale.
- Compare each of the properties involved in instances of sale with the subject property and give appropriate weightages to the rates of sale for favourable and unfavourable factors. Also assign appropriate weightages for major attributes like time factor, size or area of property, situation and location aspects, specification or age factor for building, utility and infrastructure services, etc. Care should be taken by the valuer to assign weightages according to the importance and the priorities attached by the local people in the locality in which the subject property and properties sold are situated.

Priorities for size of flat or the specifications would be quite different in poor class localities and in posh areas.

- Freehold properties is to be compared with freehold properties.
- Leasehold properties is to be compared with leasehold properties.
- Properties occupied by the tenants protected under the Rent Control Act to be compared with properties occupied by the tenants protected under the Rent Control Act.
- Properties occupied by the tenants not protected under the Rent Control Act to be compared with properties occupied by the tenants not protected under the Rent Control Act.
- Work out final estimate by comparison techniques or by weightage score system and form final opinion for the market value of the subject property.
- Deduct the cost of immediate repairs, unpaid taxes and other liabilities (e.g. mortgaged dues) from market value.

8.3.5 Sources of Data

There are several sources from which sale instances of a particular locality can be collected.

(i) Sales recorded at the Registrar's Office of the concerned district.
(ii) Information from local brokers/residents (local enquiry).
(iii) Advertisements in newspapers/websites.
(iv) Land Acquisition cases data.
(v) Auction sale information of different authorities.
(vi) Valuers own Data Bank.

Each State Government at their District Registrar's Office, maintains a register of property transactions which is called Index II Register. In this register, Registrar records all sale transactions that have taken place during the year in the entire district under his jurisdiction. Each of these entries of sales in the register shows name of the seller (Transferor), name of the purchaser (Transferee), identification of property i.e. plot No., survey No. or City Survey No. etc., name of village in which said property falls, the date of execution of document and the date of registration of document in Registrar's Office. This register also shows sale price or transfer consideration, area of the property sold, serial number of registration of the sale in register. Register further shows the type of transfer document viz. sale transaction, lease assignment, mortgage deed, release deed, gift deed, rectification deed etc. These sales are recorded in village wise lists which are compiled in alphabetical order. All sales in a particular village in a particular year are recorded in the register in chronological order of dates and months of the said year. Registrar maintains separate register for each year. Old records of past 100 years are preserved and maintained by the Registrar. These are made available to the public on payment of fixed inspection and search fees. Hence a valuer can obtain detailed information about land or property transactions of all sales in any locality, for current and any previous years from the Registrar's Office of the concerned District of the State.

The Registrar's Office, apart from issuing certified Extract of Index II Entries, also issues certified true photo copies (on requisition) of any sale documents of any year that is registered in the Index II Register. Study of the copy of a document will enable valuer to understand background and the conditions, if any, of sale transaction as well as whether the property sold with entirely under owner occupation/wholly or partly occupied by tenant, sale to sitting tenants etc. This document copy will normally indicate the date of agreement to sale, the date when earnest money has been paid, the date when balance consideration was paid and date of registration with Registrar as endorsed on the conveyance or lease deed. The rate of consideration per unit area should be considered as on the date when earnest money was paid and if earnest money is not paid then the date of agreement to sale because that is the first date when sale price has been agreed between the seller and the purchaser.

Many states have made on line availability of property transactions.

Another source of data regarding sale transactions in a locality is the local inquiry. Information from local estate brokers dealing in such real estate transactions is quite useful. Information from local residents and the property owners will also be helpful. Particularly owners who have purchased or sold properties in a locality can give information about the transactions.

Advertisements in local Newspaper/web sites and business papers also give information on sale prices offered and the unit rates of various types of properties in the locality.

Information available about the land acquisition cases and the detailed land acquisition Awards in respect of the properties acquired in the locality can also be considered as valid data indicating prevalent rate as on the material date.

Auction sales by Income Tax Department by Govt. or Semi Govt. undertakings, by Banks custodian, Improvement Trusts, Court Receiver or Court Registrar also give information about the price at which properties are auctioned. These prices are required to be checked whether they represent the market value or not.

Past experience of valuer himself, his own data bank can also indicate prevailing trend in the real estate market in the locality concerned.

A residential flat (subject flat) in 4 years old building is required to be valued as on 31-03-2001. The building has good aesthetics and good specifications. Flat has marble flooring. Area of flat is 85 sq.m. It is in middle class locality and in a lane parallel to main road. Three sales are available for comparison in the locality.

Sale - A: Flat area 120 sq.m. abutting main road. Good specification with marble floor. Building with garden and swimming pool. Sold on 25-08-2001 at Rs. 8,000/- sq.mt. Building is 22 years old.

Sale - B: Flat area 80 sq.m. abuts cross lane but it is closer to market and school. Average specification is provided with mosaic tiles flooring. Age of building is 18 years. Flat was sold at Rs. 5,600/- sq.mt. in 20-01-2001.

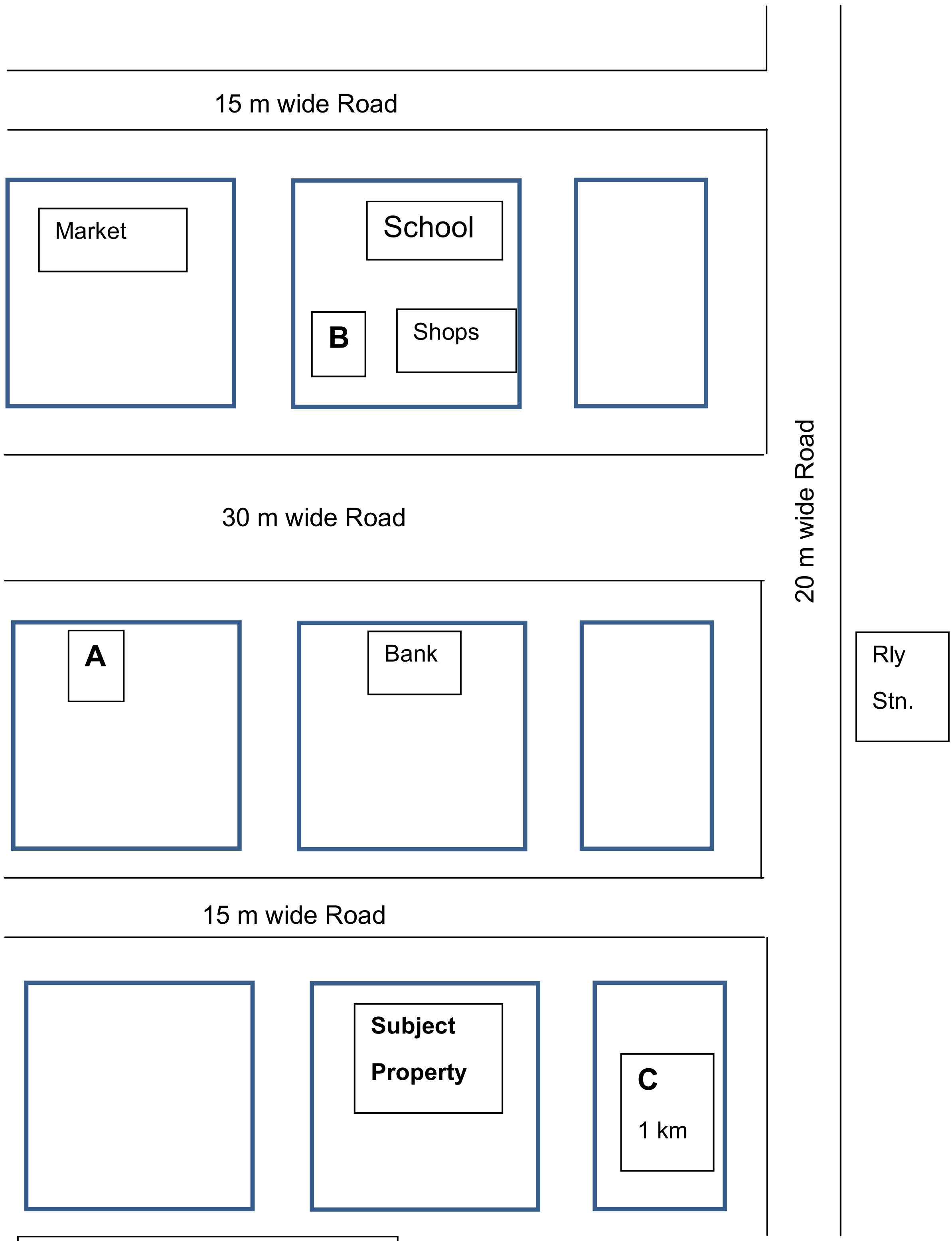
Sale – C: Flat area is 45 sq.m. abuts on small lane 1 KM away from station and market. Poor specification. Age of building 30 years. Sold in October 2000 at Rs. 4,000/- sq.mt.

The relative locations and placement of all four properties are as per given sketch. **(Refer Sketch - A)**.

The fundamental rule for making adjustment in values is to compare and bring (notionally) sale instance premises in level with qualities of subject premises. Positive weightage is to be given on sale instance rate for inferior quality of sale premises whereas negative weightage is to be adopted if sale instance premises is superior to subject premises.

Sketch – A

(Not to Scale)



- Subject flat 85 sq.mt.
- Sale 'A' flat 120 sq.mt.
- Sale 'B' flat 80 sq.mt.
- Sale 'C' flat 45 sq.mt.

ADJUSTMENT GRID : (Balance Sheet of Weighted Values)

GRID TABLE

Sr. No.	Details of Factors	Subject Flat 85 SM.	Sale -A 120 SM.	Sale - B 80 SM	Sale - C 45 SM	Remarks
1.	Sale rate per sq.mt	To find	8000	5600	4000	12 % per year price rise as per market inquiry.
	Months difference from 31-03-2001		- 5 Months	+ 2 months	+ 5 months	12 % per year price rise.
	Adjustment for time at 1% per month		- 400	+ 112	+ 200	
2.	Adjusted Value Rs/SM		7600	5712	4200	
3.	Locational factor Ranks Percentage Weightage	3	5 - 15%	3 - 5%	1 + 25%	
4.	Size Factor Ranks Percentage Weightage	3	1 + 5%	3 Nil	5 - 5%	
5.	Age factor Ranks Percentage Weightage	5	1 + 9%	3 + 7%	1 + 13%	1% for 2 years age.
6.	Quality factor Ranks Percentage Weightage	3	5 - 10%	3 + 15%	1 + 25%	
7.	Overall % variation over rate in Sr. 2		- 11%	+ 17%	+ 58%	
8.	Adjusted values.	Adopted 6700 per sq.mt	6764 per sq.mt	6683 per sq.mt.	6636 per sq.mt.	

* Rate adopted by valuer for subject flat is Rs. 6700/- sq.mt.

Following observations are obvious.

(i) Originally, before adjustments, difference between highest and lowest rate was 100%. After adjustments, this difference was hardly 2% which makes selection of rate for subject flat pretty easy.

(ii) Average of rates of 3 sales before adjustment was Rs. 5866 per sq.mt. Final rate adopted at Rs. 6700 per sq.m. is in no way closer to this average rate.

(iii) It is not the average rate but closer resemblance to any one of the sale which is deciding criteria. In present study, sale 'B' is more similar to the subject flat and hence it can be selected as base.

8.4 Income approach

8.4.1 The term 'Income Approach to Valuation' itself suggests that the income from a property forms the basis for estimating value of the property. To explain the income approach to valuation in a very simplistic manner, it can be stated that the net income from a property is considered as interest yielded (at a certain rate of interest) by the amount or capital invested in purchasing that property, i.e. value or price paid for purchasing that property. In mathematical form, it is stated as under:

Capital Value		Net Income		Multiplier which depends on the rate of Interest expected to be yielded by the investment in the property
of a Property	=	from Property	x	
(C.V.)		(N.I.)		(Year's Purchase -Y.P.)

C.V. = N.I. x Y.P.

The multiplier of Y.P. is the summation of the present worth of series of income of ₹ 1/- receivable every year, at the end of 1st year, 2nd year, 3rd year ……………… up to …n^{th} year, for a period of 'n' years at a compound interest at a certain rate of interest and the same is given in Valuation Tables. It is however not intended to deal with mathematics of valuation here. It is an attempt to explain the basic logical thinking behind estimation of value of a property by income approach.

The real problems arising in such a simplistic solution to estimation of value are:

(i) Proper estimate of the net income, which is due to tangible as well as intangible aspects,

(ii) Estimation of the appropriate rate of interest, which can reasonably be expected to be yielded by a particular type of property. Income from a property and appropriate rate of interest depend respectively on the concepts of benefits and security, both of which are basic human instincts.

8.4.2 Estimation of income

Once it is accepted that the rents actually paid by tenants to landlords are true and correct indicators of fair rents, then the income from the property can be estimated by collecting data regarding instances of rentals in respect of other comparable properties in the vicinity by comparing the accommodations of properties let out with the accommodation of property to be valued.

While relying on any rental instances it is to be assured that they are genuine one.

The fair rent in respect of the property can thus be estimated by comparing property under valuation with the properties involved in instances of rentals.

Illustration on estimation of gross rent:

The following three rental instances of premises on ground floor on the eastern side of Vile-Parle occupied by the banks for their banking operation have been taken into consideration.

- ABC Bank has taken a premises admeasuring carpet area of 1,400 sq. ft. by an agreement dated 17th August, 2001 at a monthly gross rent of ₹ 150/- per sq. ft. of carpet area.
- DEF Bank has taken a premises admeasuring carpet area of 3,000 sq. ft by an agreement dated 10th September, 2002 at a monthly gross rent of ₹ 120/- per sq. ft. of carpet area.
- GHI Bank has taken a premises admeasuring carpet area of 1,300 sq. ft. by an agreement dated 17th July, 2002 at a monthly gross rent of ₹ 90/- per sq. ft. of carpet area.

The comparison of above rental instances with property in question had been made with regards to following factors:

- Location
- Size
- Age
- Type of construction
- Time factor
- Special factor

and the result is tabulated below:

	Property in Question	**ABC Bank (R1)**	**DEF Bank (R2)**	**GHI Bank (R3)**
Floor	Ground Floor (G.F.)	Ground Floor (G.F.)	Ground Floor (G.F.)	Ground Floor (G.F.)
Carpet area in sq. ft.	1,200	1,400	3,000	1,300
Month of transaction		August – 2001	September – 2002	July – 2002
Gross rent per sq. ft. per carpet area per month	To be estimated	150	120	90
Factors of comparison (%)				
Location		- 10	- 20	+ 25
Size		Nil	+ 05	Nil
Age		- 05	- 15	- 10

Type of construction		- 10	+ 10	- 10
Time factor		+ 05	Nil	Nil
Special factor		- 15	Nil	Nil
Total		**- 35**	**- 20**	**+ 05**
Net rent (₹) per sq. ft. of carpet area per month		97.5	96.0	94.5
Therefore, gross rent per sq. ft. of carpet area per month for premises in question at ₹ 95/- is considered to be fair and reasonable.				

It is observed from the computation table that the above factors like location etc. have been assigned plus and minus weightages and same have been explained below.

Let us consider the rental instance of ABC Bank. This rental instance is assigned weightages as under:

Location	- 10
Size	Nil
Age	- 05
Type of construction	- 10
Time factor	+ 05
Special factor	- 15

Overall effect = (-10 -5 -10 -15 +5) = (-40 +5) = - 35%

When comparison of property in question is made with rental premises of ABC Bank with regard to the above factors leads us to following conclusion:

Location of rental instance is better than the property in question to the tune of 10%.

Size of rental instance is almost same as the property in question and hence no adjustment is required for this factor.

Age of rental instance is less than the property in question and therefore property in question is considered to be inferior by 10%.

Type of construction of rental instance is better than property in question and therefore the property in question is considered to be inferior to the tune of 10%.

Time Factor the rental instance is for the year August 2001 whereas market rent is to be estimated for the year October 2002, the increase in the rent in the intervening period is considered to be 5%.

Special Factor ABC Bank was already in the occupation of adjoining premises at the time of taking the premises referred in the rental instance, they were in need of the other premises, and hence paid a special rent, and in view of this 15% decrease is considered for this special factor.

The factors considered above are relevant for the case under consideration. These factors vary from case to case depending upon facts of each case. Now, let us consider a case of a rental instance having type of construction poor than the referred above, then instead of (-10) there would have been plus factor depending up on the type of construction and condition.

The gross rent paid by ABC Bank is at ₹ 150/-. Overall reduction factor computed for deriving the gross rent for property in question from rental instance of ABC Bank is minus 35%.

The gross rent per sq. ft. of carpet area per month for property in question from rental instance of ABC Bank works out to

150 x 0.65 = ₹ 97.5/-

Similarly, from other two properties it works out to 96 and 94.5 respectively per sq. ft. per month of carpet area.

The gross rent for premises in question per sq. ft. per month at ₹ 95/- is considered to be fair and reasonable.

Carpet area of premises	=	1,200 sq. ft.
Therefore the gross rent	=	1,200 x 95
	=	₹ 1,14,000/-

8.4.3 Analysis of sales

The process of analyzing a sale transaction is a simple one and involves finding out the rate of interest (or degree of security) yielded by the capital invested or price paid for purchasing a property. The ratio of net income from the property purchased and price paid for purchasing that property multiplied by 100 gives the rate of interest yielded by that property (yield rate). This is true only in cases where income is receivable in perpetuity.

$$\text{Rate of Interest for perpetual income} = \frac{\text{Net Income}}{\text{Capital Value or Price}} \times 100$$

In order to estimate appropriate rate of interest expected to be yielded by the property under valuation, it is necessary, in the first instance, to analyze number of sale transactions, which have taken place in the vicinity, preferably recent transactions. For this purpose, firstly data regarding sufficient number of sale transactions which have recently taken place in respect of comparable properties in the surrounding areas is required to be collected along with the data regarding the recent instances of rentals. The properties involved in the instances of sales and rentals are then required to be inspected carefully. The rates of gross rent for the properties involved in sale instances are then estimated by comparison with properties let out on rent and gross annual income and net annual income from each of the properties involved in sales is then estimated. In case of perpetual income, e.g. where future life of building is more than 60 years, the rate of interest yielded by properties sold can be worked out by finding out ratio of net income to purchase price and multiplying it by 100 as stated above.

It is essential to prepare a separate list of sale instances of property sold under following categories:

(a) Property sold with vacant possession/owner's occupation.

(b) Property sold with tenants protected under the applicable Rent Control Laws.

(c) Property sold with tenants not protected under the applicable Rent Control Laws.

8.4.4 Terminable income

The real estate properties can be very broadly divided into two categories viz.-

1) Properties yielding income in perpetuity.

2) Properties yielding income only for a limited period of time i.e. yielding income which terminates after certain period.

Freehold properties with buildings having estimated future life of 60 years or more are considered as properties yielding income in perpetuity, while leasehold properties with shorter unexpired period of lease are properties yielding income only for unexpired period of lease. In case of leasehold properties, income terminates on expiry of lease period.

The value of property varies with not only the quantity or amount of rupees but also with income quality and its duration. The quality of income generally is dependent on the kind and character of tenants, the type of long or short term leases, the degree and extent of space competition (both current and anticipated) over the economic life of the property and the stability of economic conditions in the subject market territory. Quality differentials should be a matter of analytical considerations in the selection of the applicable interest rate at which the net income flow is to be capitalized.

The income approach requires the preparation of income statements and thereafter deductions are required to be made towards operating expenditures, repairs, vacancy, insurance, bad debt/rent arrears, property tax and other outgoings, if any, thereby to get estimated net future income from the property. The most important phase of property valuation revolves around the procedure for the determination of the market rate of capitalization through which estimated net future income can be converted into a sum of present value. It is necessary for the valuer to recognize and differentiate between the interest rate and rate of capitalization.

The interest rate is in effect a major cost of money and represents 'wages' paid for the use of capital. It is a return on investment and must be high enough to attract an investor to a particular kind of investment. The rate of capitalization in percentage forms the relationship between the net income of a property and the value or price at which the property can be sold.

8.4.5 Steps involved in the Income Approach

Estimation of market value of a property by Income Approach, involves the following steps:

1. Collection of data regarding transactions of sale and rentals which have recently taken place in the locality.
2. (a) Inspection of site, local inquiries and collecting information regarding recent instances;

   (b) Inspection of properties involved in genuine instances of sale and rentals and the property to be valued and collecting all the information in respect of factors of comparison.
3. Estimation of rent of the property to be valued.
4. Estimation of appropriate remunerative rate of interest (i.e. security) by analysis of instances of sale and by comparison with economic indices.
5. Estimating fair market value of the property to be valued by capitalizing net income by single or dual rate of interest depending on whether the income is perpetual or terminable.
6. Deduct cost of immediate repairs, unpaid taxes and other liabilities (e.g. mortgage dues) from capitalized value.

8.4.6 Special Care to be Taken While Using Rental Method

Rental Method greatly depends on selection of proper and accurate rate of capitalisation. Even 1% variation in the selected rate of return, may change values by 8 to 10%. Again there are two sets of rate of return operating in the actual real estate market, based on legal aspects. There is one rate of expected return by the landlords of the rent controlled properties. There is also another rate of return that simultaneously operates in the market, and this rate is as per expectations of the landlords whose properties are falling outside the purview of Rent Control Act. This situation makes the task of the valuer, in selecting proper rate of capitalisation, very difficult.

In case of rent controlled premises, rental method gives too low market value as compared to the intrinsic value of the land and buildings. **In some cases outgoing expenses are so high that they outweigh the actual income derived from the property.**

In case of owner occupied or vacant premises applicability of rental method is questionable. Rental method may or may not give its true market worth. It could be lower or may be higher than the price at which such premises are likely to be exchanged in the open market. In such cases sales comparison method would be a more appropriate method of valuation.

When the land is underutilised (full permissible F.S.I. not consumed), rental method alone cannot give market value of the whole property. Help of other methods is required to value the balance development potential available in the plot.

Assessment of maintainable rent requires verification from point of view of Standard Rent, for the properties falling in areas where Rent Control Act is applicable. If actual rent is higher than Standard Rent, its adoption under rental method will not give true market value of the rented property because actual rent may not be maintainable and future flow of income may drop. **Moreover, willing buyer will certainly take into consideration the risk involved in buying the property where rent charged is in excess of standard rent, and in the event of tenant moving the court for fixation of standard rent, the contractual rent would be reduced to the level of standard rent.**

When the property is purchased by sitting tenants in Rent-Controlled areas, value worked out by rental method may give much lower value than the actual purchase price paid by the sitting tenants. **This is because it is the tendency of sitting tenant while buying the property to compare the price to be paid with property which are sold without tenants.** Due to Rent Control Act, a trend was developed in the market, where many landlords started fixing rental value of the premises at much lower rate than the standard rent of such premises. To compensate for the loss in rental income, such landlords started charging a very high amount in the form of non-refundable one-time premium (*Pugree* or *salami*) while creating tenancy. This resulted in artificially low market rentals and value of such properties under rental method also came down substantially. This evil of premium suppresses market trend of true rentals and it also artificially reduces the value under rental method vis-à-vis intrinsic value of the property.

In rent - controlled areas where tenants are protected under the Rent Act, reversionary value of land (value of right of reversion of property) is taken at nil value as it is negligible and land/property never reverts back to the landlord due to protection granted to tenants under the Rent Act. <u>However, for the properties not affected by Rent Act, rental method does give fair value because reversion of land/property has to be considered in such cases as there is a revesion of proeprty.</u>

8.4.7 Limitation of Rental Method

Every method of valuation has got its own limitation. No single method of valuation is perfect or complete having universal application for all types of the properties. Rental Method has a limitation that- it is not suitable for non-investment type of properties like schools, temples, museum and such other public buildings.

8.5 Cost approach

8.5.1 Valuation is a process of estimating the value of rights of various parties in a property as per the terms of agreement. Moreover, it is necessary to see that result does not turn out to be a brick mortar valuation.

In our country, cost approach is widely used for valuation of property even in case of property which can be valued by market and income approaches. Moreover, the cost approach is a contractor's method of valuation, but in our country it is traditionally known as land and building method, thereby it gives an impression that in valuation exercise land and buildings are valued separately which is not correct.

Let us consider three properties (A,B and C) consisting of piece of land with structure constructed by three different owners located side by side and identical in following aspects:

(a) Square plot of land having a size of 20m x 20m (400 sq.m.) purchased for ₹1.0 cr. two years back
(b) Zoning is residential
(c) FAR is 1.0
(d) Age is 1 year
(e) RCC construction on ground floor only having built up area 160 sq.m. with an investment of ₹40 lakh in structure.
(f) Total investment in each property is ₹1.4 cr.

If current land rate and cost of construction per sq.m. are ₹30,000/-and 26,500/-per sq.m., respectively then the value of these three properties as per the traditional land and building method will be reported as under:

Value of land 400 x 30,000 = ₹1.2 crore

Current cost of construction 160 x 26,500 = ₹ 42,40,000/-

Building is 1 year old.

Total economic life structure is considered to be 60 years.

Scrap value is considered to be NIL.

Depreciation on straight line method for a building one year old

= 100/60 = 1.66 %

Therefore, depreciation 42,40,000 x 1.66/100 = ₹ 70,384/-

Value of structure = 42,40,000 – 70,384 = ₹41,69,616/-

Value of property

Value of land	₹1,40,00,000/-
Value of structure	₹ 41,69,616/-
Total	₹1,81,69,616/- Say,1.82 cr.

Now let us examine whether these three properties if sold in the open market can fetch above price.

The investment in each of the three properties is same i.e.1.4 cr. They are also identical with respects to the parameters given above but each owner has constructed the structures as under:

Owner A has invested ₹ 40 lakh in carrying out RCC construction of 160 sq.m. But he has constructed RCC pillar having 160 sq.m area with a height so that total expenditure incurred is ₹40 lakh.

Owner B also has invested ₹ 40 lakh in residential building with RCC construction having an area of 160 sq.m. but the arrangement within the building for rooms, bathrooms, kitchen etc. is not as per current market trend.

Owner C also has invested ₹ 40 lakh in residential building with RCC construction having an area of 160 sq.m. but the planning is absolutely as per current market trend.

Though these three properties are identical from the point of view of size and rectangular piece of land, same area of construction, age and investment but marketability is very much affected.

Therefore, when cost approach is used it is essential for valuer to consider whether the property is marketable at the value worked out for land and depreciated replacement cost (where depreciation is considered on account of wear and tear only). If not, then in order to make it marketable, the additional factors out of following, whichever applicable, are required to be considered:

(i) Physical Depreciation – curable:

- Damaged roof top.
- Poor maintenance of external walls.
- Damaged trim.
- Damaged floors.
- Damaged wall finish.
- Damaged trim finish.
- Damaged bath fixtures.
- Damaged kitchen fixtures.
- Damaged plumbing and water supplies.
- Damaged electrical switches and fixtures.
- General wear and tear that is economically curable.

(ii) Physical Depreciation – incurable:

- Loss in value resulting from the wearing out of irreplaceable items.
- Damage to concealed foundations, exterior walls, load-bearing members of roof, structural defects.

(iii) Functional obsolescence – curable:

- Crack or failure in foundations caused by other than poor structural design or workmanship.
- Undersized and weak roof members.
- Inadequacy or absence of baths.
- Obsolete bath fixtures.
- Fixtures or finish below neighbourhood standards.
- Poor kitchen layout.
- Inadequate kitchen cabinets.
- Obsolete kitchen fixtures.
- Obsolete plumbing and water supply system.
- Inadequate ventilating.
- Obsolete ventilating.
- Inadequate electrical wiring.
- Single pane windows.
- Outdated electrical fixtures.
- Insufficient electrical service.

(iv) Functional obsolescence – incurable:

- Oversized foundations.
- Cracked foundations.
- Oversized roof members.
- Column spaces too narrow for efficient parking layout.
- Poor workmanship in walls.
- Poor workmanship in structural framing, oversized or undersized structural framing.
- Oversized, undersized, or poor workmanship in floor and roof slabs.
- Poor quality in workmanship in finished floor.
- Poor quality and workmanship in walls.
- Bath fixtures above neighbourhood standard.
- Super-adequacy in electrical wiring.
- Garage too small or super-adequate.
- Architecture poor, unusual, bad floor plan, excessive ceiling height, poor plot plan.
- Excessive wall thickness.
- Any functional characteristic of a building that has become non-functional by reason of new materials, new techniques, or decreased costs.

(v) External obsolescence:

- Architectural over improvement or under improvement for neighbourhood.
- Nuisances such as smoke, dirt, noise, odor, traffic, zoning, change in use, rent control, excessive taxes, inadequate transportation, shopping, schools, and parks.
- Local, regional, and national legislation.
- Changes in economic conditions.
- Potential profitability

The drawback in calculating the depreciation is that only depreciation for wear and tear is considered and it does not take into consideration the cost of cure to make the property marketable. **Therefore, depreciated replacement cost worked out is subject to demand and supply/potential profitability.**

In certain instances, recourse may have to be taken to the cost as an evidence of value, particularly in cases where type of the properties under valuation seldom change hands in the market.

This method involves the following four steps in estimating value of a property:

(1) To estimate fair market value of open land under valuation by comparison with the open lands in the neighbourhood which have been recently sold or purchased. (a)

(2) To estimate either cost of reproduction or cost of replacement of development i.e. building, as new, at the present day scheduled rates of construction at the site where building is located. (b)

(3) To estimate fair allowance for depreciation for wear and tear and to deduct the same from cost of reproduction/replacement cost of building. (c)

(4) Allowance for obsolescence as out lined earlier. (d)

(5) Market value of property = (a + b) – (c + d)

8.5.2 Limitations of Cost Approach

Valuation by Cost Approach has the following limitations:

(1) The Cost Approach considers only the supply side and neglects demand side. It is therefore advisable to adopt Cost Approach as a last resort.

(2) This method is not helpful in estimating values of premises which are rented. Particularly in India as majority of rented premises have frozen rent i.e. controlled Standard Rent. Value of such property by this method would be many times more than its saleable value. In such a case help of rental method of valuation is required to be taken to estimate its market value.

(3) Value by land and building method in certain areas is found to be much higher than its actual realisable value in the open market even if it is not tenanted but vacant or owner occupied. Particularly in the less populated deserted region or in area where paying capacity of people in the region is very low, value fetched in market is much lower than its actual cost. In such cases also help, of rental method has to be resorted to by the valuer, by estimating probable rental value of such premises.

(4) Land with building will need adjustment in estimated total value because land married with structure does not fetch same price in market as an open plot of land or virgin land.

(5) In some cases building valuation is required to be done by quantity survey method which is very time consuming and involves very cumbersome and long procedure.

(6) The modern design, planning, specification and aesthetics of the building many a time out-weighs age factor or depreciation aspect. This is the reason why good old buildings fetch much less price in the market than its value worked out by cost approach. Even if appropriate depreciation for age of the building is allowed market worth does not correspond to worked out value.

(7) If the property is not put to highest and best use (full F.S.I. not consumed) sometimes existing building in plot has to be valued at scrap cost instead of depreciated cost, even though its physical and economic life is more.

(8) Building cost estimated by Cost Index Method is controversial. There are too many adjustments and additions. Again adoption of Delhi based cost index for all India towns is illogical and improper. The value estimated will be thus quite different than its actual market worth.

(9) Let us consider a case of RCC building having same specification constructed in Mumbai city, Mumbai suburbs, Thane and Navi Mumbai.

If a building with same specifications is constructed in Sion, Kalbadevi and Girgaon, the cost of construction will not be same on account of following reasons:

a. In Kalbadevi and Girgaon area heavy vehicles are not permitted during day time.
b. Arrangement for storage of building material is to be made near to the site.
c. Labours have to come from long distance for work.

All these factors add to the cost of construction but not more than 30% than the cost of construction in Sion.

The cost of construction of a building with same specification in Sion shall not exceed 10% than the cost of construction in Mumbai suburbs, Thane and Navi Mumbai.

The cost of construction under cost approach to be adopted based on the cost of building material and labour at the site where property is located. Adopting the cost of construction based on cost of construction at Delhi and modifying with cost index for various parts of the country is not a reliable indicator.

9 Valuation of lease – hold properties

9.1 Lease-hold Interest

A lease-hold interest is usually subject to the payment of annual rent and to observe terms and conditions i.e. covenants contained in the lease agreement. The person who grants lease is called "lessor" and the person who takes property on lease is called "lessee". The covenants of lease usually include three main conditions amongst other conditions, regarding payment of rent reserved under the lease, regarding regularly carrying out annual repairs and maintenance and manner in which the property reverts to lessor on expiry of lease period. A lease where lessee undertakes to carry out all the repairs and to bear all outgoings is known as "**Full repairing lease**".

9.2 Types of leases

There are four principal types of leases in practice.

i. Building lease

These leases are in respect of **lands** ripe for construction of buildings. In such a lease, lessee undertakes –

(i) to pay annual ground rent,

(ii) to construct building or buildings on the land,

(iii) to keep the buildings in good state of repairs and maintenance during the period of lease and pay all outgoings, and

(iv) on expiry of lease term either pull down buildings and revert the land to its original state or to handover possession of land with buildings thereon to the lessor.

These leases are usually for long term **e.g.** 99 years.

ii. Occupation lease

These are leases where **land and buildings** are leased out for occupation by the lessee. The term of lease normally varies according to type of property and leases are usually for short-term or for medium term. In the case of medium or long term leases, there is usually a condition regarding periodic revision or review of lease rent.

Where the rent reserved under this type of lease is the full rental value of land and buildings, it is known as 'market rent' or 'rack rent' and where it is less than the full rental value it is known as a 'head rent'. The difference between the rack/full rental value and the head rent (such difference is known as '**Profit rent**') when capitalized represents the value of lessees interest.

iii. Sublease

Subject to the terms and conditions of head lease, a lessee may sub-lease the property for any term less (at least by a day) than his own lease term. Sub-lease may be building sub-lease or occupation sub-lease.

iv. Lease for life

It is the lease granted for the duration of the life of the lessee or some other person. The period of such a lease is uncertain and can be considered as may be indicated by mortality tables or life expectancy tables.

State Government, local authorities and Semi Government agencies many a time give land for development to individuals or to entrepreneurs or to a company by creating long lease and by charging initial full premium representing full market value of land at a nominal lease rent of Re.1/- per year. Keeping in view long term public interest, and in view of desire for development of under developed area, such lands are sometimes given on long lease charging premium at less than the market value of land. Such leases invariably consist of a clause of payment of unearned increase, in case of sale or transfer of lease-hold interest in land. If lessee earns profit on land value, by way of such sale, the lessor (Government) or leasing agency would have a share in profit (say 50% of unearned increase in value of the property over initial premium payments, as per Government Policy). This charge by the lessor, in case of sale or assignment of the lease, is called payment for unearned increase. It is a charge on the property. In such leases, the premium charged represents market value of land with or without concession and the lease rent is nominal. Such leases are **virtually** grant of land but leases for names' sake for observing polity of disposal of land by Government or by Planning and Development authorities.

9.3 Lessor's Interest

a. Lessor or freeholder has right

   (i) to receive lease rent fixed under the lease deed for the unexpired period of lease and

   (ii) to receive the property **after** expiry of lease period when the property reverts to lessor. This second component of lessor's interest when the property reverts back to the lessor is known as **Reversionary Value** as the property reverts to lessor after the expiry of lease period.

b. The lessor has right to receive rent reserved under lease deed for the unexpired period of lease. Where the rent reserved under the lease is well below the fair market rent, it is **most** secured and hence remunerative rate for capitalizing rent reserved is estimated at ½% to 1% lower than the normal rate of interest corresponding to security offered by property. If the difference between the market rent and rent reserved is less, still the rent reserved is

more secured than the market rent and the remunerative rate for capitalizing such reserved rent is capitalized at about ½% lower than the normal rate of interest corresponding to security offered by the property.

c. The value of the lessor's interest will therefore be the sum of –

(i) Capitalized Value of rent reserved under the lease, at appropriate single rate of interest for unexpired period of lease and

(ii) Right of reversion of property after expiry of lease period.

The presumption is often made that the lessor's interest plus lessee's interest add to the fair market value of freehold property and that the fair market value of freehold property can be apportioned into lessor's and lessee's interest in some fixed proportion. This proposition is totally incorrect and wrong.

9.4 Lessee's interest

In the case of lease-hold properties, the lessee has a right to enjoy the difference between the market rent and the rent reserved under the lease which is known as profit rent, for the unexpired period of lease. The market value of lessee's interest is therefore estimated by capitalizing profit rent for the unexpired period of lease. The accumulative rate of interest is usually, taken at 2½% to 3½%. The remunerative rate of interest for capitalizing lessees profit rent is usually taken at ½% to 1% higher than the remunerative rate considered for capitalizing freeholder's (lessor's) net income corresponding to security offered by the property since the lessee's interest in a property is considered to be less secured than the lessor's interest/right.

9.5 Value on Reversion: Reversionary Value

In the case of lease-hold properties held on building lease or occupancy lease, the lessee's interest being limited to enjoy the benefits from the land/property only during the period fixed under the lease, ceases on expiry of the lease period and the property with or without improvements or buildings reverts back to the lessor as per terms of lease.

Once the property reverts to lessor he has option to give it on further lease, keep vacant or to use for self-occupation. Thus, lessor has right to derive benefits in perpetuity as the owner of the property.

The market value of this right of the lessor (to get back the property) is estimated by deferring market value of property as freehold for unexpired period of lease.

Let's consider a case of a property having unexpired period of lease as 15 years. Market value of property in vacant possession to a freeholder on the date of valuation is say ₹ 1 cr. The lessor will get back the property after the expiry of lease period of 15 years. Therefore, value of right of reversion will be ₹ 1 cr. deferred for 15 years.

The value of such reversion of the property depends on the unexpired period of lease and in case the unexpired period is too long i.e.50 years or more the capital value on reversion being deferred for longer period becomes almost negligible, but still it is not zero.

9.6 Valuation of Lessor's Interest and Lessee's Interest

The simple case of valuation of the interests of lessor and lessee is where lease has been granted at certain lease rent without charging any premium and has some unexpired period of lease. It has been already stated earlier that the Lessor's interest comprises of two parts viz. (i) to receive the rent reserved under the lease for unexpired period of lease and (ii) reversion to land or land and building, as per terms and conditions of lease, after expiry of lease. The lessee's interest is to receive profit rent (i.e. market rent – lease rent) for the unexpired period of lease. The following examples will show how the values of lessor's and lessee's interests can be estimated.

Example - I

A Lessor leased 1,500 sq. m. land in 1970 to Lessee for 99 years period by charging full repairing lease rent of ₹1,000/- per month. Lessee constructed the commercial building yielding total rent of ₹5,500/- per month. Lease is renewable for further period of 99 years on same terms. Calculate value of the Lessee's interest in the property and also value the Lessor's interest in property, as on March, 2015. Property taxes and other outgoings are 40% of the Gross Rent. Adopt expected rate of return on the property at 7%.

Solution

(a) Value of Lessor's Interest

Net Ground Rent (₹ 1,000 x 12 = ₹ 12,000/-)		₹ 12,000
Y.P. in perpetuity at 5% (Ground Rent is 5.5 times secured) (₹ 5500 ÷ ₹ 1,000/- = 5.5) (Market rent / Ground Rent)		20 -----------------
Net rent x Y.P. = 12000 x 20		₹ 2,40,000

(b) Value of Lessee's Interest

Gross Rent (₹ 5,500 x 12 = ₹ 66,000/-)		₹ 66,000
Less: Outgoings		
Lease Rent	₹ 12,000	
Other outgoings (at 40% of ₹66,000)	₹ 26,400	₹ 38,400 -----------------
		₹ 27,600

Y.P. in perpetuity at 7%	14.3
Net Income Capitalized in perpetuity (Unexpired period of existing lease is 52 years and renewable for further 99 years.)	₹ 3,94,700
	Say ₹ 3,95,000/-

In this example ground rent is ₹1,000/- per month and rental income from building is ₹5,500/- per month. Hence **ground rent** is 5 ½ times secured. Rate for capitalization of **ground** rent could therefore be considered as 5% or even less than 5%.

Example - II

A freeholder (owner of property) leased his land with commercial building to Lessee for 15 years period, by charging net rent of ₹ 15,000/- per year. Rental income from the building is ₹ 70,000/- per year of which ₹25,000/- per year are required to be spent for outgoings, like property taxes, repairs etc. The unexpired period of lease is 10 years. An investor desires to purchase Lessee's right and expects 9% yield on investment. What price should he offer to acquire Lessee's right in the property?

Solution

The rental income from property received by the lessee would cease after 10 years as unexpired period of lease is 10 years. Hence, recoupment of capital invested has also to be provided for, by adopting dual rate of interest.

Gross Annual Rental Income				₹ 70,000
Less: Outgoings				
	Lease rent	=	₹ 15,000	
	Taxes, repairs, etc.	=	₹ 25,000	₹ 40,000

			Net annual income	₹ 30,000
Capitalizing net income for 10 years at 9% and 3%				
i.e. Y.P. 10 years at 9% and 3%				5.642

			Value of Lessee's Interest	₹1,69,200
				Say ₹ 1,69,000/-

Example - III

A Lessor leased his land (Area 2500 sq. m.) for 40 years period for a rent of ₹10,000/- per month. Lessee constructed house yielding rent of ₹40,000/- per month. Lease condition states that on maturity of lease, Lessee shall **remove** the structure and return open land to Lessor. Unexpired period of lease as on today is 10 years.

Expected yield on investment on building is 8%. Land rate prevalent in locality as on today is ₹ 3,500/- per sq. m. Rent Control Act is not applicable. Advice on fair price for purchasing Lessor's interest.

Solution

Lessor holds two rights -

(i) To receive ground rent for 10 years

(ii) Reversionary value of land receivable after 10 years

(a) Ground Rent = 10,000 x 12 = ₹ 1,20,000/-

The ground rent is 4 times secured (₹ 40,000 ÷ ₹ 10,000)

∴ Capitalized at 5%

Ground Rent	₹ 1,20,000		
Y.P. 10 years at 5%	7.722		

Capitalized value of Ground Rent	₹ 9,26,640	₹ 9,26,640	(a)

(b) Value of land as if freehold = 2,500 x 3,500

= ₹ 87,50,000

The value of land as freehold is not receivable today but after 10 years.

∴ Present value of Re.1/- deferred 10 years at 5%	0.614		

∴ Reversionary value of land	₹ 53,72,500	₹ 53,72,500	(b)

Total value of Lessors interest (a + b)		₹ 62,99,140	(c)

Say ₹ 63,00,000/-

A valuer can advice investor to offer a price of ₹ 63 lakhs to acquire the Lessor's interest in the above property as on today.

Example - IV

A lease-hold property is acquired by Planning Authority in 2015. Estimate the market value of Lessor's and Lessee's interest for claiming compensation. The data regarding the property is as under: (Do not consider solatium at 30% and other claims).

Land area = 2100 sq. m.

Area of commercial building = 750 sq. m. ground floor and 750 sq. m. 1^{st} floor

(FSI is fully consumed)

Ground rent = ₹ 5,000/- per month from 1985 for 60 years period.

Unexpired lease period = 30 years.

Rental income from building = ₹ 50,000/- per month.

Outgoing including taxes = 30% of Gross Rent

Prevailing land rate = ₹ 2,000/- per sq. m.

Expected yield rate for commercial building is 8%. Lease provides that on maturity of lease, Lessee will handover open land back to Lessor.

<u>Solution</u>

(a)	Value of Lessor's Interest		
	Ground Rent (5,000 x 12)	₹ 60,000	
	Y.P. Capitalized for 30 years @ 8%	11.258	

		₹ 6,75,480	Say ₹ 6,75,500
	Reversionary value of land		
	Land value = 2100 sq. m. x ₹ 2,000	₹ 42,00,000	
	P.V. Re.1/- in 30 years at 9%	0.07537	

		₹ 3,16,554	Say ₹ 3,16,500

		Value of Lessor's Interest	₹ 9,92,000
(b)	Value of Lessee's Interest		
	Gross Annual Income (5,000 x 12)		₹ 6,00,000
	Less: Lease rent ₹ 5,000 x 12	₹ 60,000	
	Taxes/Repairs 30%	₹ 1,80,000	
		-----------------	₹ 2,40,000

	Net annual income		₹ 3,60,000
	Y.P. 30 years at 8% and 3%		9.899

		Value of Lessee's Interest	₹ 35,63,640

Say ₹ 35,64,000/-

9.7 Illustrations for computation of lessor's and lessee's interests under different terms and conditions

<u>Illustration no. I</u>

A commercial land is given on lease.

Particulars of property as on date of valuation, 31 December 2014:

Area of land	:	500 sq. m.
Permissible FSI/FAR	:	1.0
Total built-up area of existing buildings	:	500 sq. m.
Balance FSI/FAR	:	Nil
Premium paid at the time of grant of lease	:	₹ 50,000/-
Date of agreement of lease	:	31st December, 1965
Date of commencement of lease	:	1st January, 1966
Period of lease	:	60 years i.e. up to 31.12.2025
Current ground rent per annum payable to lessor by lessee	:	₹ 3,00,000/-

Lessee constructed a building by investing ₹ 1,00,000/- in 1966 and let out to various parties for a period, one day less than the period of lease of sixty years:

Gross rent received by the lessee per annum		=	₹ 20,00,000/-	(a)
Outgoings				
Ground rent	= ₹ 3,00,000/-			
Property tax, etc.	= ₹ 3,00,000/-	=	₹ 6,00,000/-	(b)
Net rent per annum (a) – (b)		=	**₹ 14,00,000/-**	

Scenario – 1

Terms and conditions of lease:

(a) There is no renewal clause.

(b) The unexpired period of lease is 11 years.

(c) After the expiry of lease period, lessee to surrender the property free of cost to lessor.

(d) Value of property as on 31st December, 2014

(Had it been vacant) = ₹ 3,00,00,000/-

Value of lessor's interest as on 31-12-2014

(a) Capitalized value of ground rent for un-expired period of lease.

Ground rent per annum	=	₹ 3,00,000/-	

The ground rent is secured almost 7 times, as gross rent received by the lessee per annum is ₹ 20,00,000/-.

That means the ground rent is well secured. Therefore, rate of interest for capitalization is adopted at 5.0 %.

Y.P. at 5 % for un-expired period of			
11 years	=	8.306	
Capitalized value of ground rent	=	3,00,000 x 8.306	
	=	₹ 24,91,800/-	(i)

(b) Value of right of reversion

The lessor will receive the property (land and building) worth ₹ 3,00,00,000/- on expiry of lease period of 11 years free of cost.

Present value of ₹ 1/- receivable after 11 years at 10% = 0.35049

Due to uncertainty, higher rate of capitalization i.e. 10% is adopted.

Value of right of reversion	=	3,00,00,000 x 0.35049	
	=	₹ 1,05,14,700/-	(ii)
Value of lessor's interest	=	(i) + (ii)	
	=	24,91,800+ 1,05,14,700	
	=	**₹ 1,30,06,500/-**	

Value of lessee's interest

Capitalized value of net rent for un-expired period of lease of 11 years:

Net rent received by lessee	=	₹ 14,00,000/-
Y.P. at say 11% for 11 years and		
redemption of capital at 3%	=	5.317
∴ Value of lessee's interest	=	14,00,000 x 5.317
	=	**₹ 74,43,800/-**

<u>Scenario – 2</u>

Instead of lessee surrendering at free of cost to lessor, the lessor will buy the property at ₹ 5,00,00,000/- along with improvement made by the lessee after the expiry of lease period.

Other conditions remaining the same.

Value of lessor's interest as on 31-12-2014

(a) Capitalized value of ground rent for un-expired

period of lease as estimated

under Scenario – 1 = ₹ 24,91,800/- (a)

(b) The lessor will buy the property at ₹ 5,00,00,000/- after the expiry of lease period.

Present value (PV) of ₹ 1/- at 10% for

11 years at = 0.35049

PV of amount payable by the lessor

after 11 years = 5,00,00,000 x 0.35049

= ₹ 1,75,24,500/- (b)

(c) The lessor will start getting the gross rent of ₹ 20,00,000 after 11 years.

Net Rent = 20,00,000 – 3,00,000

= ₹ 17,00,000

The above net rent is to be capitalized in perpetuity at 10 % and differed for 11 year at 10 %.

YP in perpetuity, differed for 11 year at 10% = $17,00,000 \times \frac{100}{10} \times 0.35049$

= ₹ 59,58,330/- (c)

Value of lessor's interest = (a) – (b) + (c)

= 24,91,800 - 1,75,24,500 + 59,58,330

= (- ₹ 90,74,370/-)

Value of lessee's interest as on 31-12-2014

(a) Capitalized value of net rent for

un-expired period of lease of

11 years as estimated under Scenario – 1 = ₹ 74,43,800/- (a)

(b) PV of ₹ 5,00,00,000 receivable

after 11 years at 11% = 5,00,00,000 x 0.31728

= 1,58,64,000/- (b)

Value of lessee's interest as on 31.12.2014 = (a) + (b)

= 74,43,800 + 1,58,64,000

= ₹ 2,33,07,800/-

Scenario – 3

Lease will be renewed for a further period of 99 years after the expiry of existing lease i.e. after 11 years at revised ground rent of ₹ 6,00,000/-

Revised gross rent receivable by lessee after 11 years is ₹ 25,00,000/-

Lessee will demolish the building and surrender the land after 110 years to the lessor.

Other conditions remaining the same.

Value of lessor's interest as on 31-12-2014

(a) Capitalized value of current ground rent for

un-expired period of lease as estimated

under Scenario – 1 = ₹ 24,91,800/- (a)

(b) Capitalized value of ground rent of ₹ 6,00,000/- in perpetuity differed for 11 years at 5%

Capitalized value of ground rent in Perpetuity = $6{,}00{,}000 \times \frac{100}{5}$

= ₹ 1,20,00,000/-

The above amount is to be differed at 10% for 11 years

PV of ₹ 1/- receivable after 11 years at 10% = 0.35049

Capitalized value of differed ground rent = 1,20,00,000 x 0.35049

= ₹ 42,05,880/- (b)

Value of lessor's interest	=	(a) + (b)
	=	24,91,800 + 42,05,880
	=	**₹ 66,97,680/-**

Present Value of land available to lessor after 110 year will be negligible and therefore same is not considered.

Value of lessee's interest as on 31-12-2014

(a) Capitalized value of net rent for un-expired period of lease of 11 years.

Net rent received by lessee	=	₹ 14,00,000/-	
Y.P. at say 11% for 11 years and redemption of capital at 3%	=	5.317	
∴ Value of lessee's interest	=	14,00,000 x 5.317	
	=	₹ 74,43,800/-	(a)

(b) Capitalized value of net rent for extended period of lease of 99 years to be differed for 11 years.

Net rent to be received by lessee	=	25,00,000 - 6,00,000	
	=	₹ 19,00,000/-	
Capitalizing net profit rent at 11 % in perpetuity and differing the same at 11% for 11 years	=	$19{,}00{,}000 \times \frac{100}{11} \times 0.31728$	
	=	₹ 54,80,290/-	(b)
Value of lessee's interest	=	(a) + (b)	
	=	74,43,800 + 54,80,290	
	=	**₹ 1,29,24,090/-**	

Summary

Date as on which valuation is made: 31st December, 2014

Scenario	Value of lessor's interest	Value of lessee's interest
1	₹ 1,30,06,500/-	₹ 74,43,800/-
2	- ₹ 90,74,370/-	₹ 2,33,07,800/-
3	₹ 66,97,680/-	₹ 1,29,24,090/-

Note: It is observed from the above that value of lessor's and lessee's interest in the same property varies considerably on account of terms and conditions of the lease.

<u>Illustration no. II</u>

Let us consider the case with following data:

Date as on which valuation is made: 01-12-2015

(a) Area of land: 15,000 sq. m.

(b) Date of commencement of lease: 01-01-1919

(c) Period of lease: 999 years

(d) Premium paid by lessee at the time of entering into lease: ₹ 20,000/-

(e) Ground rent payable per annum : ₹ 1,000/-

(f) Covenants of lease:

   (i) Lessee has a right to develop the land any time during pendency of lease.

   (ii) In the event of sale or transfer 50% unearned increase is payable by lessee to the lessor.

   (iii) Lessor cannot increase the ground rent.

(g) Lessee is in possession of land and it is lying vacant.

From terms of lease, one can conclude that lessor has surrendered almost all the rights of development in lieu of premium charged at the time of granting lease except benefit of unearned increase.

Period of lease is 999 years from 01-01-1919.

Unexpired period of lease = 999 – 98

= 901years i.e. perpetuity

Value of lessor's interest

(i) Capitalized value of ground rent in perpetuity.

(ii) Value of right of reversion, which in this case will be negligible as property shall revert to lessor after 901 years.

Capitalized value of ground rent in perpetuity at 5%.

$$= 1{,}000 \times \frac{100}{5}$$

$$= ₹\ 20{,}000/- \qquad \text{(i)}$$

Value of right of reversion is negligible as mentioned above.

Value of unearned increase at 50%:

Current land rates is say, ₹ 10,000/- per sq. m.

Area of land	=	15,000 sq. m.	
Premium paid	=	₹ 20,000	
Unearned increase	=	(15,000 x 10,000) – 20,000	
	=	₹ 14,99,80,000/-	
50% unearned increase	=	₹ 7,49,90,000/-	(ii)
Value of lessor's interest.	=	(i) + (ii)	
	=	20,000 + 7,49,90,000	
	=	**₹ 7,50,10,000/-**	

Value of lessee's interest

This is an open plot of land.

Lessee has right to develop as well as sell and in the event of sale or transfer 50% unearned increase is payable.

Current land rates is say, ₹ 10,000/- per sq. m.

Area of land	=	15,000 sq. m.
Value of lessee's interest	=	₹ 15,00,00,000/- (15,000 x 10,000) minus 50% unearned increase minus capitalized value of ground rent
	=	15,00,00,000 – 7,49,90,000 – $(1{,}000 \times \frac{100}{6})$
	=	₹ 7,49,93,333/-

Value of lessor's interest	=	₹ 7,50,10,000/-
Value of lessee's interest	=	₹ 7,49,93,333/-

Note: In above case if no earned increase is payable by the lessee, then almost 100% value would be to lessee.

It is observed from above two illustrations that following points ought to be considered in order to estimate value of lessor's and lessee's interest in a property:

(i) What is the lease rent for land?

(ii) What is total lease period and unexpired period of lease?

(iii) Whether lease is renewable or not?

(iv) In case of renewal of lease, will lease rent remain same, as old or new rent will be fixed?

(v) What amount will be payable to lessor as premium or capital investment in case of sale/assignment of property or extension of lease?

(vi) On maturity of lease, if land reverts to the lessor then what will happen to building constructed by the lessee on the leased land? Will building vest free of cost with the lessor or the lessor has to buy from the lessee?

Generally, covenant provides that lessee will have to demolish the building before surrender of land to lessor and / or possession of land and building either free of cost or on certain payment.

All these alternatives need to be properly examined.

10 IMPORTANCE OF FAMILIARITY WITH THE PROVISIONS OF RENT ACTS BY THE REAL ESTATE VALUERS

10.1 The valuer must be familiar with the rent act applicable to property under consideration.

- The approach to valuation of rented properties depend on the category of tenants i.e. whether the building is occupied by a tenant falling under the category of tenant protected or not protected under the rent act.
- If the tenant falls under the category of protected tenant, then value of right of reversion is negligible and can be ignored. But if it falls under the category of a tenant not protected under the rent control act then value of right of reversion cannot be ignored and its value depends on the balance period of tenancy.
- For this purpose, valuer has to find out the section relating to exemption in the rent control act. In our country, each state has got its own rent control act and provisions vary from state to state.
- The following illustration will be of help in understanding the matter.

Let us consider the case of a residential apartment having carpet area 3000 sq. ft. located on Peddar Road, near Jaslok Hospital, Mumbai. In the year 1970, landlord gave this apartment on leave and licence basis at a monthly compensation of Rs.2500/- as per provisions of The Bombay Rent, Hotels, and Lodging House Rates Control Act, 1947 applicable then. The occupier (i.e. licensee) was not granted protection under the rent control act then prevalent in the year 1970. In the year 1973, the rent act applicable to Mumbai was amended and the licensees occupying the premises under the leave and licence were granted a status of protected tenant. So the licensee became a statutory tenant. On becoming a statutory tenant, he filed an application in the court for fixation of standard rent. The petition was decided in the favour of tenant sometime in the year 1999 and the court fixed the standard rent at Rs.1050/-per month.

The tenant was a multi-national company.

The Bombay Rent, Hotels, and Lodging House Rates Control Act, 1947 was replaced by the Maharashtra Rent Control Act, 1999 with effect from 1st April 2000 and as per the amended Act the tenant being a multi-national company was falling under the category of a tenant not protected under the Act. Under the changed circumstances the landlord can recover the market rent. The market rent for the premises in the year 2001 worked out to ₹ 3,00,000/- per month against standard rent of ₹ 1050/- per month.

Market value of above property on the basis of vacant possession as on 30th April 2015 is say, Rs 15 crores.

10.2 Let us consider following two scenario:

Scenario 1: Property is occupied by a tenant not protected under the Rent Control Act and balance period of tenancy is 5 years.

Scenario 2: Property is occupied by a tenant protected under the Rent Control Act. If tenant abides by the provisions of the Rent Control Act, landlord will not be able to recover the possession of the property.

Under scenario 1 landlord will get the possession of the property after 5 years as tenant is not protected under the Rent Control Act which entitles the landlord to recover the property having current market value of Rs. 15 crores indicating landlord having the right of reversion which is valued as under:

> Computation of present value of ₹ 15 crores at appropriate rate of interest available after 5 years.

Let us assume that rate of interest is 10%. Present value of Rs. 1 after 5 years is equal to 0.62092 that means value of right of reversion = 0.62092 x ₹ 15,00,00,000 = say, ₹ 9,31,00,000/-

Under scenario 2 the tenant is protected under the Rent Control Act and let us assume that the landlord will recover the possession after infinite years; this is as good as landlord will not get the possession. Let us also assume that the infinite years is equal to 100 years. Now the present value of ₹ 1 at 10% available after 100 years is 0.000073 which gives the value of right of reversion = 0.000073 x ₹ 15,00,00,000 = say, ₹ 10,950/- which is negligible compared to ₹ 15 crores and therefore value of right of reversion is ignored for the property occupied by the tenant protected under the Rent Control Act.

10.3 Any '**willing buyer**' will take in to consideration above facts while purchasing the property falling under above two scenario because the **'willing buyer'** is a person who would pay a price to a **'willing seller'** for the property by taking into consideration its existing condition with all its existing advantages and disadvantages.

10.4 The provisions regarding exemptions from operation of Rent Control Act vary from state to state.

The exemptions are generally based on rent/ownership/date of construction.

According to Section 3.0 of Model Residential Tenancy Act, 2011 published by Ministry of Housing & Poverty Alleviation, Govt. of India exemptions recommended are given below –

(http://mhupa.gov.in/W_new/MODEL_RESIDENTIAL_TENANCY_ACT_2011-24-5-11.pdf):

Exemptions:

Nothing in this Act shall apply to –

(a) Any rental unit owned by the Central or State Government or Local Authority or a Government undertaking or enterprise or a statutory body or cantonment board.
(b) Any rental unit let out before the commencement of this Act where rent paid on the date of commencement of this Act exceeds ₹ ______ and where such units had been exempt under the existing State Rent Control Acts.
(c) Rental unit[s] owned by a company, university or organization given on rent to its employees as part of service contract.
(d) Any rental unit owned by religious or charitable institutions as may be specified by the State Government.
(e) Any rental unit owned by Wakfs registered under the Wakf Act, 1995 (No.L3 of 1995) or to any trust registered under the Public Trust Act.

Some of the provisions related to premises/tenants are outside the preview of Rent Control Acts are given below to give an idea.

For further study please refer to Rent Control Acts.

Gujarat Rent Act

- Premises let out for the first time on or after 5.9.2001

Maharashtra Rent Act, 1999

- Multinational companies
- Public sector banks
- Companies having share capital exceeding ₹ 1 cr.
- Foreign Missions
- International agencies

Delhi Rent Act

- Premises fetching rent exceeding ₹ 3,500/- per month
- Tenants of residential premises of landlords (who are retired from armed forces) who require the premises for his own residence.
- Tenants of the premises of the landlords having age exceeding 70 years.

Tamil Nadu Rent Act

- Any building for a period of 5 years from the date on which the construction is completed.

For further information for various states please refer to Working Paper no. 158, Summer Research Internship Programme 2006, Centre for Civil Society (www.ccs.in)

For paper please visit the site;

http://www.ccs.in/internship_papers/2006/Rent%20Control%20Act%20-%20Satvik.pdf

11 VARIOUS CATEGORIES OF REAL ESTATE AND APPROACH TO THEIR VALUATION

11.1 The valuers of real estate have to encounter properties falling under following categories in actual practice.

Open land

Residential, Commercial and Industrial

- Free hold
- Lease hold

Built-up properties

Residential property (other than apartments)/ Commercial property office building (other than office apartments)/ Industrial property (other than industrial unit in a multi-storeyed industrial building:

- Entire building occupied by owner
- Entire building occupied by the tenant protected under rent act
- Entire building occupied by the tenant not protected under rent act
- Entire building occupied by lessee
- Partly occupied by owner and partly by the tenant protected under the rent act.
- Partly occupied by owner and partly by the tenant not protected under the rent act.
- Partly occupied by owner, partly by the tenant protected under the rent act and partly by the tenant not protected under the rent act
- Partly occupied by owner and partly by the lessee
- Partly occupied by owner, partly occupied by the lessee, partly occupied by tenant protected under the rent act and partly by the tenant not protected under the rent act.
- Buildings falling under above categories where FSI is fully utilised/partially utilised.

Residential ownership apartments in a multi-storied building, Office premises in a multi-storied commercial building, Industrial premises in a multi-storied industrial building and Shops on ground floor in a multi-storied commercial building

- Occupied by owner
- Occupied by the tenant protected under rent act
- Occupied by the tenant not protected under rent act
- Occupied by lessee

Hotel buildings

Cinemas

Nursing homes

Petrol pumps

Properties under development

Any other type of the property not covered above

11.2 The above properties can be broadly classified in following categories:

(a) Open Land
(b) Buildings other than apartments in the multi-storied buildings and apartments in the multi-storied buildings – let us call these properties as built-up properties

The following approaches to value shall be applied depending upon the nature of the property.

(a)	Income capitalization approach	-	Income producing property like rented/leased properties
(b)	Sales comparison approach	-	Owner-occupied/marketable properties
(c)	Cost approach	-	Specialised properties like school, Jail etc.

The interest in the real estate to be valued may include ownership right, lease-hold, tenancies, leave and license, etc.

The real estate like land and building yielding periodical income by way of rent will be valued by income capitalization approach. The other items of real estate which are commonly transacted in the market will abide by the market approach. At this stage the consideration of location, occupational use, size, amenities, state of construction, age and other relevant parameters will arise.

Specialised real estate which are neither income yielding nor marketable shall be valued by cost approach comprising market value for land and depreciated replacement cost for buildings which will take into account all forms of obsolescence.

11.3 The information required to carry out the valuation of above property is outlined as under:

Open land:

Area and shape of land

- Dimension of each side of the plot
- Frontage on roads and widths of roads

- Demarcation of land
- Soil bearing capacity, foundation conditions, level of land and cost of leveling if any
- Tenure of land
- Is it Freehold or Lease-hold land
- In case of lease-hold –
    - Name of Lessor
    - Name of Lessee
    - Date of commencement of lease
    - Period of lease
    - Date of termination of lease
    - Premium paid
    - Ground rent per annum
    - Covenants of lease with regards to
        - ✓ Termination of lease
        - ✓ Renewal of lease
        - ✓ Payment of unearned increase in the event of sale or transfer
        - ✓ Conditions of transfer
- Is land affected by Land Reforms Act, Coastal Regulation Zone, and Revenue Code of the State Government? Or any other Acts.
- Zoning of land as per Master Plan / Development Plan
- Development plan / Master plan / Planning proposals affecting the land such as reservation for public purpose like health facilities, playgrounds, recreation garden, road widening, new road, transport facilities etc. Give details if any.
- What is permissible FSI / FAR? How much is it utilised? If balance FSI is available then is it possible to consume?
- D.C. rules, Bye-laws affecting land values
- In case of industrial property –what is the industrial locational policy of the Government for expansion as well as establishment of new industry.
- Is there any outstanding which can be recovered by attachment of property?
- To collect data regarding sale transactions in the vicinity which have taken place in nearby areas and compare the sale instances with property in question with regard to following factors and prepare an analytical report:-
    - Date
    - Area / Size, shape, frontage etc.
    - Physical
    - Location – including proximity to amenities and facilities like educational, health, shops and markets, transportation, municipal services etc.
    - Social – including type and class of locality
    - Economic
    - Legal

- Utility and potential use
- Transferability

Note:

(a) While valuing large plots of land from sale instances of small plots of land, details of hypothetical and development schemes with estimated values of laid out plots should be given.

(b) Lease-hold land

Income approach to valuation be applied by keeping in mind terms and condition of lease agreements and other relevant facts.

Built-up properties

Is the construction carried out as per plans approved by Municipal Authorities / Local Authority?

Is it owner occupied / vacant / rented / leased / given on leave and licence or any other manner permissible under the law? Specify if there is any other occupancy.

Market Approach

Owner occupied residential/commercial/industrial building, owner occupied apartment in a multi-storied building, owner occupied shops and offices in a multi-storied building to be valued by market approach.

Statement showing sale transactions along with names of seller / purchaser / dates of execution and registration, registration number and plan / scaled map showing property under valuation and sale instances with overall rate of consideration, area and date to be submitted with report, analysis and comparison of sale with property and estimating value of property as on relevant date, by such analysis.

Income Approach

Hotel and Nursing Home buildings to be valued by income approach.

These properties are sold as fully operational business units and the valuation of operational entity includes:

- land and buildings
- trade fixtures, fittings, furniture, furnishings and equipment
- market's perception of the potential together with benefit of existing approvals, licences, permits contracted future bookings, existing membership which are an important part of the ongoing business.

Valuer to report on following issues:

- Validity of various licences, permits etc. required to carry on the business
- Sustainability of the business and possible future fluctuations
- If existing use is not likely to be sustainable due to change in demand for particular trading activity or property likely to sell in the open market for a use other than the existing use, then value on alternative use also reported.

The rented buildings are generally valued by income approach.

The rented buildings can also be valued by market approach if instances of sales of the comparable rented properties are available.

The tenants fall under following two categories:

(a) The tenants protected under the rent control act.

(b) The tenants not protected under the rent control act.

If the property under valuation is occupied by the tenants protected under Rent Control Acts then sale instances to be considered for comparison must also be of the property occupied by the tenants protected under Rent Control Acts.

If the property under valuation is occupied by the tenants not protected under Rent Control Acts then sale instances to be considered for comparison must also be of the property occupied by the tenants not protected under Rent Control Acts.

12 UNAUTHORISED CONSTRUCTION AND VALUATION

12.1 Observations of judiciary on unauthorised construction:

1. The Supreme Court of India in case of Dipak Kumar Mukherjee vs Kolkata Mun. Corp. & Ors in Civil Appeal no. 7356 of 2012 (arising out of SLP (c) no. 23780/2011) on 8 October, 2012.

   (a) Para no. 2

   “In last four decades, the menace of illegal and unauthorised constructions of buildings and other structures in different parts of the country has acquired monstrous proportion. This Court has repeatedly emphasized the importance of planned development of the cities and either approved the orders passed by the High Court or itself gave directions for demolition of illegal constructions –

   - K. Ramadas Shenoy v. Chief Officers, Town Municipal Council (1974) 2 SCC 506;
   - Virender Gaur v. State of Haryana (1995) 2 SCC 577;
   - Pleasant Stay Hotel v. Palani Hills Conservation Council (1995) 6 SCC 127; (4) Cantonment Board, Jabalpur v. S.N. Awasthi 1995 Supp.(4) SCC 595;
   - Pratibha Co-op. Housing Society Ltd. v. State of Maharashtra (1991) 3 SCC 341;
   - G.N. Khajuria (Dr) v. Delhi Development Authority (1995) 5 SCC 762;
   - Manju Bhatia v. New Delhi Municipal Council (1997) 6 SCC 370;
   - M.I. Builders Pvt. Ltd. v. Radhey Shyam Sahu (1999) 6 SCC 464;
   - Friends Colony Development Committee v. State of Orissa (2004) 8 SCC 733;
   - Shanti Sports Club v. Union of India (2009) 15 SCC 705 and
   - Priyanka Estates International Pvt. Ltd. v. State of Assam (2010) 2 SCC 27.”

   (b) Para no. 5

   “…Unwary purchasers in search of roof over their heads and purchasing flats/apartments from builders, find themselves having fallen prey and become victims to the designs of unscrupulous builders. The builder conveniently walks away having pocketed the money leaving behind the unfortunate occupants to face the music in the event of unauthorised constructions being detected or exposed and threatened with demolition. **Though the local authorities have the staff consisting of engineers and inspectors whose duty is to keep a watch on building activities and to promptly stop the illegal constructions or deviations coming up, they often fail in discharging their duty. Either they don't act or do not act promptly or do connive at such activities apparently for illegitimate considerations.** If such activities are to stop some stringent actions are required to be taken by ruthlessly demolishing the illegal constructions and non-compoundable deviations. <u>The unwary purchasers who shall be the sufferers must be adequately compensated by the builder. The arms of the law must stretch to catch hold of such unscrupulous builders.</u>"

(c) Para No. 6

"….Economically affluent people and those having support of the political and executive apparatus of the State have constructed buildings, commercial complexes, multiplexes, malls, etc. in blatant violation of the municipal and town planning laws, master plans, zonal development plans and even the sanctioned building plans. In most of the cases of illegal or unauthorised constructions, the officers of the municipal and other regulatory bodies turn blind eye either due to the influence of higher functionaries of the State or other extraneous reasons…."

"….Unfortunately, despite repeated judgments by this Court and the High Courts, the builders and other affluent people engaged in the construction activities, who have, over the years shown scant respect for regulatory mechanism envisaged in the municipal and other similar laws, as also the master plans, zonal development plans, sanctioned plans, etc., have received encouragement and support from the State apparatus. **As and when the Courts have passed orders or the officers of local and other bodies have taken action for ensuring rigorous compliance with laws relating to planned development of the cities and urban areas and issued directions for demolition of the illegal/unauthorised constructions, those in power have come forward to protect the wrongdoers either by issuing <u>administrative orders or enacting laws for regularisation of illegal and unauthorised constructions in the name of compassion and hardship</u>…."**

12.2 Consumer Protection Council vs A'Bad Muni. Corporation ... on 4 October, 2000 Equivalent citations: (2000) 3 GLR 727 in High Court of Gujarat.

(a) Para no. 2

"The petitioner has pointed out in the petition that in flagrant violation of the rules and regulations and byelaws framed under the Gujarat Town Planning and Urban Development Act (hereinafter referred to as Development Act) and building bye-laws framed under the BPMC Act, construction of buildings had been carried out, and **permission is being granted for erection of buildings in violation of the provisions…."**

(b) Para no. 3.1

"…It is contended before us that despite drawing attention of the municipal authorities, no one has bothered to initiate any concrete action to stop illegal construction and unauthorised use of the premises for commercial purpose in residential zones."

(c) Para no. 3.3

"The petitioner has further pointed out that the action of the respondents is violative of Article 14 of the Constitution of India and violative of the provisions of relevant laws namely the BPMC Act, Building Regulations and the Development Act. It is further contended that the inaction is clearly arbitrary and discriminatory against the citizens of Ahmedabad and for the benefit of the builders, which have a very strong lobby, both amongst the politicians as well as amongst the bureaucrats. **It is pointed out to us that the Corporation is permitting use of the property for purposes other than residential to those persons who are able to pay the charges as demanded by the Corporation illegally, arbitrarily and without authority of law, and those persons who are unable to pay are compelled to put the property to the residential use."**

(d) Para no. 24

"Thus, it appears that playing fraud on the statute, the builders are erecting buildings contrary to the permission granted by the Corporation and the occupiers are putting it to use other than for which the permission is granted. It is also found that persons have approached different Courts and have obtained injunction / stay orders from the Courts, and the Corporation has not taken any concrete steps to see to it that the stay orders are vacated, or suit/applications are heard on priority basis. **On the contrary, it is found that in certain cases, though stay is obtained by only one occupier, no action is taken for the the remaining part of the building. What is the nature of interim order is also not stated. Before this Court, while hearing one matter, it was noticed that the trial Court directed to maintain "status quo" and not to construct further; yet it appears that in breach of order, construction was completed and property was put to use."**

(e) Para no. 25

"25. Later on, in Spl. C.A. No. 6794/92, on behalf of the Corporation, affidavit is filed on 31st August 2000 by Shri K. Kailasnathan, I.A.S, Municipal Commissioner. He has gone through the petition as well as the amended petition and has also perused the records relating to the subject matter and tendered unconditional apology for passing the impugned resolution dated 17.9.1994. **He has stated that the entire C.G. Road is designated as residential zone and has frankly stated that the Corporation was not able to take timely measure when the building units in the residential zone were put to use for commercial purpose. He has further stated that the Development Plan was …"**

(f) Para no. 31

"Mr. Mihir Thakore, Senior Advocate appearing for the petitioner in Spl. C.A. No. 6794/1992 made a grievance that the Municipal Commissioner / Municipal Corporation, in the instant case, has acted in such a way that their act cannot be condoned; They could never be pardoned; **They have collected money from the public without sanction of law and that too, to permit an unauthorised and illegal use of property in a zone where such use is impermissible, more particularly by overreaching the stay granted by this Court….'**

12.3 Regularization of the Unauthorised Development

Many States have enacted Acts to regularize the unauthorised development in development areas in the State and for matters connected therewith or incidental thereto. Many States are in the process of enacting such law.

In the state of Gujarat at present, the Gujarat Regularisation of Unauthorised Development Act, 2011 (GRUDA) is in force.

12.4 Statement of object of GRUDA

There have been unauthorised developments in the city of Ahmedabad and other development areas in the State, on a large scale; and such unauthorised developments are liable to be removed and pulled down. By removal and pulling down of such unauthorised developments, hardship to a large number of people is likely to be caused; therefore it is expedient to have a law to provide for regularisation of certain unauthorised developments. In order to achieve this intention GRUDA has been enacted.

12.5 Section 10 of GRUDA provides for Circumstances in which unauthorized development may be regularized and same is as under:

1. The designated authority **may regularise any unauthorised development** in respect of the following matters, namely:-

   (i) Ground Coverage,
   (ii) Built up area,
   (iii) Height of building,
   (iv) Change of use,
   (v) Common plot, and
   (vi) Parking, subject to the condition that the occupier or owner shall provide parking as per GDCR (General Development Control Regulations) in unauthorised development and where it is not so feasible, in a place owned or occupied by himself or more than one applicant, within such distance not exceeding five hundred meters from the unauthorised development as directed by the designated authority within a period of six months from such direction. However, in the event of non-compliance of the aforesaid directions for any reason, the Designated Authority shall refer matter to the Committee as may

be constituted by the State Government by rules and such committee after making such inquiry as it deems fit, will suggest suitable options which shall be taken into consideration by the Designated Authority for the purpose of implementation;

(vii) Sanitary facility, subject to the condition that the designated authority is satisfied that the sanitary facility provided is adequate;

(viii) such other matters which the State Government may, prescribe.

2. The designated authority **shall not regularise unauthorized development** in respect of the following matters, namely:-

(i) having such floor space index which the State Government may prescribe;

(ii) projections beyond the plot boundary;

(iii) the change of use which in the opinion may cause danger to health or lead to health hazard;

(iv) falling under the alignment of means of water supply, drainage, sewerage, supply of electricity or gas or of any other public utility service; and

(v) such unauthorised development which the State Government may, prescribe.

12.6 Thereafter rules have been published under GRUDA. Under these rules, it has been specified that which type of development can be and cannot be regularized. Some of the provisions are as under:

(a) Unauthorized development made without any non-agriculture permission

The designated authority may in case where the unauthorized development has taken place on the land for which the non-agriculture permission under the provisions of the Gujarat Land Revenue Code 1879, was required but has not been taken, regularize such unauthorized development irrespective of the fact whether proceedings for such permission are pending or whether such permission is not taken. However, while regularizing unauthorized development on such land, the designated authority shall inform the concerned District Collector about not having obtained any such permission.

(b) Development which cannot be regularized

No unauthorised development in respect of matters specified in sub-clause (i) to (vii) of sub-section (1) of section 10 of the Act shall be regularised in case of the following:

(a) Restricted zone where the permissible FSI is less than 1.0;

(b) Uses not permitted in obnoxious and hazardous industrial zone;

(c) Uses of obnoxious and hazardous nature in any other zone other than the zone wherein the same is permitted;

(d) "Hazardous building" or part thereof used for,-

- storage, handling or manufacture or processing of radio-active substances or of highly combustible or explosive materials or products which are liable to burn with extreme rapidity and/or producing poisonous fumes or explosive;

- storage, handling, manufacture or processing of, which involves highly corrosive, toxic obnoxious alkalis, acids or other liquids, gases or chemicals producing flame, fumes, and explosive mixtures or which result in division of matter into fine particles and capable of spontaneous ignition;

(e) Construction in the land occupied by the graveyards, kabrastans, burial grounds and crematoria.

(1) No unauthorised development shall be regularised in respect of any other matter in relation to the buildings used for performance of drama, cinema theatres, multiplex, auditorium, exhibition halls, marriage hall, skating rings, gymnasia, stadia, dance halls, clubs, and stations for public transportation by road, air, sea if there is a breach of parking regulations

(2) The designated authority shall not regularise any unauthorised development unless the same is in conformity with the following,-

a. the Building line and Control line prescribed under the Government Resolution for the classified roads of the State Government and the Panchayat;
b. Right of user acquired under the Petroleum Pipelines (Acquisition of Right of User in Land) Act, 1962;
c. Development regulated and controlled in the vicinity of an oil well installed by Oil & Natural Gas Commission according to provisions of the Indian Oil and Mines Regulations -1933;
d. Development regulated in the vicinity of the Grid Lines laid by the power company under the Indian Electricity Rules, 1956;
e. Development in the funnel of Airport as regulated by Ministry of Civil Aviation, Government of India;
f. Development in the vicinity of the Railway Boundary regulated by the standing orders or instructions of the Railway Authorities.
g. Development in the vicinity of monuments being protected or conserved under the relevant Law;
h. Development regulated under the provisions of Coastal Regulation Zone.

(3) No unauthorised development shall be regularised with respect to road width considering the length of the road or set back required as required under GDCR. In case where the road width is not provided and maintained, the unauthorised development may be regularised after the plot is deducted in such manner that, half the road width or the setback as per GDCR is maintained from the centreline of the existing road.

12.7 GRUDA came into force in the year 2011. According to the Act the construction carried out on or before 28.03.2011 can only be regularised. As per provision the interested parties were to apply for regularisation within six months of enactment of the Act on receipt of the notice and the authorities are required to dispose-off the matter within eighteen months from receipts of the application. However, such time limits have been kept extended from time to time and a few cases have been finalised and the process is very sluggish.

12.8 While carrying out valuation of properties, a valuer comes across unauthorised construction. Therefore, impact of laws related with regularisation of unauthorised construction in force need to be taken in to consideration and same cannot be ignored. Therefore, valuation of unauthorized construction is to be carried out by stating regularisable and not regularisable construction, if such laws are in force on date of valuation. Moreover, due to laws for regularisation of unauthorised construction, risk of demolition of regularisable unauthorised construction is not there.

For example, permissible FSI is 1.5 but at initial stage, construction is carried out with permission to construct building consuming FSI of 1.0. Later on, the building is constructed as per bye laws but without taking permission and consumed balance FSI of 0.5. Such construction is regularisable.

Non-regularisable construction under GRUDA is given under paragraph no. 12.6 (b) above.

12.9 Any fees/cost payable for regularising the authorisable unauthorised construction is a liability and need to be deducted from value of the property.

13 VALUATION OF REAL ESTATE UNDER SECURITIES AND EXCHANGE BOARD OF INDIA (REAL ESTATE INVESTMENT TRUSTS) REGULATIONS, 2014

13.1 Real Estate Improvement Trust (REIT) is a company which owns income fetching real property. It is like any other company traded in stock market with a mandate to invest most of its fund in real estate either commercial, residential or both. REIT shall be governed by the SEBI regulations, which would help to ensure transparency and accountability of REITs. A REIT would have to appoint an independent trustee, managers, auditor and valuer to ensure that the functioning of a REIT is transparent.

Therefore, a valuer has to play an important role in REIT at the time of acquisition, disposal and other major related and nonrelated party transactions as well as at the time of declaration of net asset value twice a year.

13.2 The relevant terms as defined for REITs under Regulation 2:

(i) **"net asset value"** or **"NAV"** means the value of the REIT divided by the number of outstanding units as on a particular date;

(ii) **"real estate"** or **"property"** means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage: Provided that any asset falling under the purview of 'infrastructure' as defined vide Notification of Ministry of Finance dated October 07, 2013 including any amendments or additions made thereof shall not be considered as 'real estate' or 'property' for the purpose of these regulations;

(iii) **"real estate assets"** means properties owned by REIT whether directly or through a special purpose vehicle;

(iv) **"rent generating property"** means property which has been leased or rented out in accordance with an agreement entered into for the purpose;

(v) **"transferable development rights"** or **"TDR"** shall mean development rights issued by the competent authority under relevant laws in lieu of the area relinquished or surrendered by the owner or developer or by way of declared incentives by the government or authority;

(vi) **"under-construction property"** means a property of which construction is not complete and occupancy certificate has not been received;

(vii) **"valuer"** means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 and who has been appointed by the manager to undertake valuation of the REIT assets: Provided that till such date on which section 247 of the Companies Act, 2013 comes into force, valuer shall mean an independent merchant banker registered with the Board or an independent chartered accountant in practice having a minimum experience of ten years;

(viii) **"value of the REIT"** means value of the REIT as certified by the auditor based on the value of REIT assets held directly or through the SPV excluding any debt or liabilities thereof;

(iv) **"value of the REIT assets"** means aggregate value of all the assets under the REIT as assessed by the valuer.

13.3 Role of a valuer in REIT under various regulations:

The REIT manager, in consultation with trustee, shall appoint the valuer(s). He shall submit to the trustee valuation reports as required under these regulations within fifteen days of the receipt of the valuation report from the valuer. He shall ensure that computation of NAV of the REIT is based on the valuation done by the valuer and is declared no later than fifteen days from the date of valuation and such computation shall be done and declared not less than once every six months.

It is mandatory to disclose in initial offer document/follow on offer document the following –

- Summary of valuation as per the full valuation report
- Valuation methodology
- Frequency of valuation and declaration of NAV

It is mandatory to disclose in the Annual Report the following:

- Brief summary of the full valuation report as at the end of the year
- Details of changes during the year pertaining to addition and divestment of assets including the identity of the buyers or sellers, purchase/sale prices and brief details of valuation for such transactions
- Valuation of assets (as per the full valuation reports) and NAV
- Letting of assets, occupancy, lease maturity, key tenants, etc.
- Update on development of under-construction properties, if any

It is also mandatory to disclose in the Half-yearly report about updated valuation report by the valuer taking into account any material developments during the previous half-year.

Under Regulation 18 (3)

With respect to purchase or sale of properties both prior to and after initial offer,-

(a) two valuation reports from two different valuers, independent of each other, shall be obtained;

(b) such valuers shall undertake a full valuation of the assets proposed to be purchased or sold as specified under regulation 21;

(c) Transactions for purchase of such assets shall be at a price not greater than, and transactions for sale of such assets shall be at a price not lesser than, average of the two independent valuations.

13.4 Rights and responsibilities of the valuer (Regulation 12):

The valuer(s) shall comply with the following conditions at all times-

(a) The valuer(s) shall ensure that the valuation of the REIT assets is impartial, true and fair and is in accordance with regulation 21;
(b) The valuer(s) shall ensure adequate and robust internal controls to ensure the integrity of its valuation reports;
(c) The valuer(s) shall ensure that it has sufficient key personnel with adequate experience and qualification to perform property valuations at all times;
(d) The valuer(s) shall ensure that it has sufficient financial resources to enable it to conduct its business effectively and meet its liabilities;
(e) The valuer(s) and any of its employees involved in valuing of the assets of the REIT, shall not,-

    (i) invest in units of the REIT or in the assets being valued; and

    (ii) sell the assets or units of REITs held prior to being appointed as the valuer, till the time such person is designated as valuer of such REIT and not less than six months after ceasing to be valuer of the REIT.

(f) The valuer(s) shall conduct the valuation of the REIT assets with transparency and fairness and shall render, at all times, high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment;
(g) The valuer(s) shall act with independence, objectivity and impartiality in performing the valuation;
(h) The valuer(s) shall discharge its duties towards the REIT in an efficient and competent manner, utilizing his knowledge, skills and experience in best possible way to complete given assignment;
(i) The valuer(s) shall not accept remuneration, in any form, for performing a valuation of the REIT assets from any person other than the REIT or its authorized representative;
(j) The valuer(s) shall before accepting any assignment, disclose to the REIT any direct or indirect consideration which the valuer may have in respect of such assignment;
(k) The valuer shall disclose to the trustee, any pending business transactions, contracts under negotiation and other arrangements with the manager or any other party whom the REIT is contracting with and any other factors that

may interfere with the valuer's ability to give an independent and professional valuation of the property;

(l) The valuer(s) shall not make false, misleading or exaggerated claims in order to secure assignments;

(m) The valuer(s) shall not provide misleading valuation, either by providing incorrect information or by withholding relevant information;

(n) The valuer(s) shall not accept an assignment that includes reporting of the outcome based on predetermined opinions and conclusions required by the REIT;

(o) The valuer(s) shall, prior to performing a valuation, acquaint itself with all laws or regulations relevant to such valuation.

13.5 Valuation of Assets under Regulation 21 (Chapter V):

(1) The valuer shall not be an associate of the sponsor(s) or manager or trustee and shall have not less than five years of experience in valuation of real estate.

(2) Full valuation includes a detailed valuation of all assets by the valuer including physical inspection of every property by the valuer.

(3) Full valuation report shall include the mandatory minimum disclosures as specified in Schedule V to these regulations.

(4) A full valuation shall be conducted by the valuer at least once in every financial year: Provided that such full valuation shall be conducted at the end of the financial year ending March 31st within three months from the end of such year.

(5) A half yearly valuation of the REIT assets shall be conducted by the valuer for the half year ending on September 30 for incorporating any key changes in the previous six months and such half yearly valuation report shall be prepared within forty five days from the date of end of such half year.

(6) Valuation reports received by the manager shall be submitted to the designated stock exchange and unit holders within fifteen days from the receipt of such valuation reports.

(7) Prior to any issue of units to the public and any other issue of units as may be specified by the Board, the valuer shall undertake full valuation of all the REIT assets and include a summary of the report in the offer document: Provided that such valuation report shall not be more than six months old at the time of such offer: Provided further that this shall not apply in cases where full valuation has been undertaken not more than six months prior to such issue and no material changes have occurred thereafter.

(8) For any transaction of purchase or sale of properties,-

(a) if the transaction is a related party transaction, the valuation shall be in accordance with regulation 19;

(b) if the transaction is not a related party transaction,-

(i) a full valuation of the specific property shall be undertaken by the valuer;

(ii) if, -

- in case of a purchase transaction, the property is proposed to be purchased at a value greater than one hundred and ten per cent. of the value of the property as assessed by the valuer;

- in case of a sale transaction, the property is proposed to be sold at a value less than ninety per cent. of the value of the property as assessed by the valuer, approval of the unit holders shall be obtained in accordance with regulation 22.

(9) No valuer shall undertake valuation of the same property for more than four years consecutively provided that the valuer may be reappointed after a period of not less than two years from the date it ceases to be the valuer of the REIT.

(10) Any valuation undertaken by any valuer shall abide by International Valuation Standards (IVS) and valuation standards as may be specified by Institute of Chartered Accountants of India (ICAI) for valuation of real estate assets, provided that in case of any conflict, standards specified by ICAI shall prevail.

Note by CVSRTA:

The professions of Valuation of real estate and Chartered Accountancy are independent of each other. There are no standards published on valuation of real estate by ICAI as it is outside the purview of ICAI.

The judgement of Hon'ble Gujarat High Court in Special Civil Application no. 9762/2001 decided on 27 April 2012 has exhaustively dwelt on qualifications to practice as a valuer of real estate.

(11) In case of any material development that may have an impact on the valuation of the REIT assets, then manager shall require the valuer to undertake full valuation of the property under consideration within not more than two months from the date of such event and disclose the same to the trustee, investors and the Designated Stock Exchanges within fifteen days of such valuation.

(12) The valuer shall not value any assets in which it has either been involved with the acquisition or disposal within the last twelve months other than such cases where valuer was engaged by the REIT for such acquisition or disposal.

13.6 Mandatory Minimum Disclosures in Full Valuation Report (SCHEDULE V [Regulation 21(3)])

The full valuation report shall include the following:

a. Name and brief details of the valuer

b. All material details in relation to the basis of valuation

c. Description and explanation of the valuation methodologies adopted including key assumptions used, justification of the assumptions, explanation of the rationale for choosing the particular valuation method if more than one method is or could have been adopted, etc.

d. Overall structure and condition of the relevant market including an analysis of the supply-demand situation, the market trend and investment activities

e. For every property, the following details shall be mentioned:

   i. Address of the property, ownership and title details including whether the transaction is a related party transaction (Valuer may rely on the title disclosures provided by the manager for the purpose)

   ii. Location of the property (include latest pictures), formal site identification, physical features (e.g. size, configuration, frontage, topography) site services, town planning, etc.

   iii. If the property is completed and revenue generating, the following shall be mentioned:

      - the existing use of the property
      - a brief description of the property including age of the building, the site area, gross floor area, net lettable floor area etc.
      - occupancy rate

   iv. In case of under-construction properties, the following shall be mentioned:

      - Stage of completion of the property
      - Statutory approvals received and pending as on date of valuation
      - Approved use of the property as per approved construction plans

   v. The options or rights of pre-emption and other encumbrances concerning or affecting the property

vi. The nature of the interest the REIT holds/proposes to hold in the property whether freehold or leasehold, percentage of interest of the REIT in the property, remainder of the term in case of leasehold property

vii. Date of inspection and date of valuation

viii. Qualifications and assumptions

ix. Method used for valuation

x. Valuation standards adopted for valuation of real estate assets

xi. Extent of valuer's investigations and nature and source of data to be relied upon

xii. Purchase price of the property by the REIT (for existing properties of the REIT)

xiii. Valuation of the property in the previous 3 years; (for existing properties of the REIT)

xiv. Detailed valuation of the property as calculated by the valuer

xv. Latest ready reckoner rate (as published by the state government)

Note by CVSRTA:

REIT valuation is to be performed as per International Valuation Standards (IVS). Ready Reckoner Rates are not in conformity with IVS.

f. Any matters which may affect the property or its value

g. A declaration by the valuer that:

i. The valuer is competent to undertake the valuation

ii. The valuer is independent and has prepared the report on a fair and unbiased basis

iii. The valuer has valued the properties based on the valuation standards as specified under sub-regulation 10 of regulation 20 of these Regulations

Note by CVSRTA:

Valuation maxims are missing in mandatory disclosures mentioned above. In fact valuation maxims are pillars of valuation.

13.7 Valuation:

Independent valuation is regulatory obligation in India. It is required at the stage of acquisition, disposal and other major transactions as well as during the holding period.

Apart from regulatory requirements, an independent valuation provides an external opinion of the value of a property, effectively providing a benchmark which allows the REIT management team to not only determine that it is not paying too much or accepting too little for a property but also to be able to prove this to relevant stakeholders.

While preparing valuation report following aspects about state of the market need to be examined:

- Rents and Rental trends for comparable premises;
- Vacancy and its rate;
- Terms and conditions of lease and any concession granted due to competing properties;
- Sale prices of comparable sale instances;
- Construction trends and quality of building demanded;
- Local by-laws restrictions on new developments
- Availability of land for development in locality.

The report will also include consideration about the following:

- Present occupancy levels;
- Quality of tenants;
- Requirements of tenants

Valuation for REITs purpose depends upon the mandate/terms of reference of REITs.

Data required for valuation for REITs by a valuer:

- Name of the company.
- Address of the property.
- Date of appointment and date of valuation.
- The purpose of valuation.
- The legal description of the property such as title details and the legal interest to be valued.
- Specific requirement of REIT in valuing the property accordance with IVSC guidelines or any other guidelines.
- Rent agreements of all the property.
- Verification of all approvals
- Any additional matter related to specific property.

For further details refer to section on valuation for various categories of properties and information required for valuation.

14 MISCELLANEOUS TOPICS

This section covers important aspects to be taken in to consideration for valuation for various purposes like:

- Capital Gains Tax
- Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013
- Transfer of land acquired under Land Acquisition Act, 1894 for establishing industries
- Disinvestment/mergers and take-overs
- Bank finance
  And
- Statutory valuation under Schedule-III of Wealth Tax Act, 1957, is not the market value and hence cannot be used where market value is required.

14.1 Capital Gains Tax

Value as on 1.4.1981 under Capital Gain Tax is to be carried out as per the facts of the property as on 1.4.1981. Moreover, improvements to property after 1.4.1981 are to be indexed and not any improvement carried out prior to 1.4.1981; this is because any improvement carried out prior to 1.4.1981 is taken care of when valuation is made as on 1.4.1981. That is why Govt. of India publishes indices for Capital Gain Tax from 1981 onwards.

Important aspects to be borne in mind -

(a) If land was falling in residential zone in 1981 and at the time of sale in the year 2011 it is in commercial zone, then for valuation as on 1.4.1981 residential zone is to be considered.

(b) If Floor Space Index (F.S.I.) in 1981 is 2.0 and at the time of sale in the year 2011 it is 1.0, then for valuation as on 1.4.1981 FSI 2.0 is to be considered.

(c) If property is rented as on 1.4.1981 and at the time of sale it is self occupied then value as on 1.4.1981 will be on the basis of tenant occupation.

(d) If tenant is a protected tenant as on 1.4.1981 and at the time of sale in 2011, tenant is not a protected tenant then for valuation as on 1.4.1981 protected tenant is to be considered. (Note: This is very important due to amendments in Rent Control Laws throughout the country. e.g. in Maharashtra due to amendment in the Rent Act in 1999/2000, banks, multi-national companies which were earlier falling under the category of protected tenants, after amendment, do not fall under the category of protected tenants)

(e) At the time of sale it is a non-agricultural land and as on 1.4.1981 it was an agricultural land then value as on 1.4.1981 is to be considered for agricultural land.

(f) The property consists of an unencumbered open plot of land at the time of sale in April 2015. But as on 1.04.1981, it was a fully developed property entirely occupied by the tenants protected under the Rent Control Act. Capitalised value of the property as on 1.04.1981 worked out by rent capitalisation consists of value of land as well as building. As on 1.4.1981 land is encumbered by a building occupied by the tenants protected under the Rent Control Act and therefore value of land to be estimated also has to be an encumbered open land. It is impossible to get the sale instances of open encumbered land. This is the limiting condition in which valuation is to be performed. Under the circumstances it will be necessary to bifurcate the capitalised value in to two components land and building. What should be the ratio? As said earlier this is a limiting condition and therefore, it is suggested that the value of land and building as on 1.04.1981 be worked out on the basis of vacant possession and ratio of land and building obtained from this value be applied to the capitalized value of the rented property as explain below.

Value of tenanted property (land and building) as on 1.4.1981 is say ₹ 1 lakh.

Value of this property on the basis of vacant possession as on 1.4.1981 is as under :

Value of land	=	₹ 15 lakh (75% of total)
Value of building	=	₹ 5 lakh
Total	=	₹ 20 lakh

Therefore, 75% of ₹ 1 lakh is ₹ 75,000/-, is value of land as on 1.4.1981.

Note: Valuation as on 1.4.1981 is to be carried out as if the instructions to carry out valuation were given in 1981.

14.2 Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013

Important sections from valuation point of view are reproduced below:

S.11 Publication of preliminary notification and power of officers thereupon:-

(1) Whenever, it appears to the appropriate Government that land in any area is required or likely to be required for any public purpose, a notification (hereinafter referred to as preliminary notification) to that effect along with details of the land to be acquired in rural and urban areas shall be published in the following manner, namely:-

(a) in the Official Gazette;
(b) in two daily newspapers circulating in the locality of such area of which one shall be in the regional language;
(c) in the local language in the Panchayat, Municipality or Municipal Corporation, as the case may be and in the offices of the District Collector, the Sub-Divisional Magistrate and the Tehsil;
(d) uploaded on the website of the appropriate Government;
(e) in the affected areas, in such manner as may be prescribed.

(2) Immediately after issuance of the notification under sub-section (1), the concerned Gram Sabha or Sabhas at the village level, municipalities in case of municipal areas and the Autonomous Councils in case of the areas referred to in the Sixth Schedule to the Constitution, shall be informed of the contents of the notification issued under the said sub-section in all cases of land acquisition at a meeting called especially for this purpose.

(3) The notification issued under sub-section (I) shall also contain a statement on the nature of the public purpose involved, reasons necessitating the displacement of affected persons, summary of the Social Impact Assessment Report and particulars of the Administrator appointed for the purposes of rehabilitation and resettlement under Section 43.

(4) No person shall make any transaction or cause any transaction of land specified in the preliminary notification or create any encumbrances on such land from the date of publication of such notification till such time as the proceedings under this Chapter are completed:

Provided that the Collector may, on the application made by the owner of the land so notified, exempt in special circumstances to be recorded in writing, such owner from the operation of this sub-section:

Provided further that any loss or injury suffered by any person due to his wilful violation of this provision shall not be made up by the Collector.

(5) After issuance of notice under sub-section (1), the Collector shall, before the issue of a declaration under Section 19, undertake and complete the exercise of updating of land records as prescribed within a period of two months.

S. 23 Enquiry and land acquisition award by Collector:-

On the day so fixed, or on any other day to which the enquiry has been adjourned, the Collector shall proceed to enquire into the objections (if any) which any person interested has stated pursuant to a notice given under Section 21, to the measurements made under Section 20, and into **the value of the land at the date of the publication of the notification,** and into the respective interests of the persons claiming the compensation and rehabilitation and resettlement, shall make an award under his hand of-

(a) the true area of the land;

(b) the compensation as determined under Section 27 along with Rehabilitation and Resettlement award as determined under ection 31 and which in his opinion should be allowed for the land; and

(c) the apportionment of the said compensation among all the persons known or believed to be interested in the land, or whom, or of whose claims, he has information, whether or not they have respectively appeared before him.

S. 24 Land acquisition process under Act No. I of 1894 shall be deemed to have lapsed in certain cases:-

(1) Notwithstanding anything contained in this Act, in any case of land acquisition proceedings initiated under the Land Acquisition Act, 1894 (1 of 1894),-

(a) where no award under Section 11 of the said Land Acquisition Act has been made, then, all provisions of this Act relating to the determination of compensation shall apply; or

(b) where an award under said Section 11 has been made, then such proceedings shall continue under the provisions of the said Land Acquisition Act, as if the said Act has not been repealed.

(2) Notwithstanding anything contained in sub-section (1), in case of land acquisition proceedings initiated under the Land Acquisition Act, 1894, where an award under the said Section 11 has been made five years or more prior to the commencement of this Act but the physical possession of the land has not been taken or the compensation has not been paid the said proceedings shall be deemed to have lapsed and the appropriate Government, if it so chooses, shall initiate the proceedings of such land acquisition afresh in accordance with the provisions of this Act:

Provided that where an award has been made and compensation in respect of a majority of land holdings has not been deposited in the account of the beneficiaries, then, all beneficiaries specified in the notification for acquisition under Section 4 of the said Land Acquisition Act, shall be entitled to compensation in accordance with the provisions of this Act.

S. 25 Period within which an award shall be made:-

The Collector shall make an award within a period of twelve months from the date of publication of the declaration under Section 19 and if no award is made within that period, the entire proceedings for the acquisition of the land shall lapse:

Provided that the appropriate Government shall have the power to extend the period of twelve months if in its opinion, circumstances exist justifying the same:

Provided further that any such decision to extend the period shall be recorded in writing and the same shall be notified and be uploaded on the website of the authority concerned.

S. 26 Determination of market value of land by Collector:-

(1) The Collector shall adopt the following criteria in assessing and determining the market value of the land, namely:-

(a) the market value, if any, specified in the Indian Stamp Act, 1899 (2 of 1899) for the registration of sale deeds or agreements to sell, as the case may be, in the area, where the land is situated; or

(b) the average sale price for similar type of land situated in the nearest village or nearest vicinity area; or

(c) consented amount of compensation as agreed upon under sub-section (2) of Section 2 in case of acquisition of lands for private companies or for public private partnership projects,

whichever is higher:

Provided that the date for determination of market value shall be the date on which the notification has been issued under Section 11.

Explanation 1 - The average sale price referred to in clause (b) shall be determined taking into account the sale deeds or the agreements to sell registered for similar type of area in the near village or near vicinity area during immediately preceding three years of the year in which such acquisition of land is proposed to be made.

Explanation 2 - For determining the average sale price referred to in Explanation I, one-half of the total number of sale deeds or the agreements to sell in which the highest sale price has been mentioned shall be taken into account.

Explanation 3.-While determining the market value under this section and the average sale price referred to in *Explanation 1* or *Explanation 2*, any price paid as compensation for land acquired under the provisions of this Act on an earlier occasion in the district shall not be taken into consideration.

Explanation 4.- While determining the market value under this section and the average sale price referred to in *Explanation 1* or *Explanation 2*, any price paid, which in the opinion of the Collector is not indicative of actual prevailing market value may be discounted for the purposes of calculating market value.

(2) The market value calculated as per sub-section (1) shall be multiplied by a factor to be specified in the First Schedule.

(3) Where the market value under sub-section (1) or sub-section (2) cannot be determined for the reason that-

(a) the land is situated in such area where the transactions in land are restricted by or under any other law for the time being in force in that area; or

(b) the registered sale deeds or agreements to sell as mentioned in clause (a) of sub-section (1) for similar land are not available for the immediately preceding three years; or

(c) the market value has not been specified under the Indian Stamp Act, 1899 (2 of 1899) by the appropriate authority,

the State Government concerned shall specify the floor price or minimum price per unit area of the said land based on the price calculated in the manner specified in sub-section (1) in respect of similar types of land situated in the immediate adjoining areas:

Provided that in a case where the Requiring Body offers its shares to the owners of the lands (whose lands have been acquired) as a part compensation, for acquisition of land, such shares in no case shall exceed twenty-five per cent of the value so calculated under sub-section (1) or sub-section (2) or sub-section (3) as the case may be:

Provided further that the Requiring Body shall in no case compel any owner of the land (whose land has been acquired) to take its shares, the value of which is deductible in the value of the land calculated under sub-section (1):

Provided also that the Collector shall, before initiation of any land acquisition proceedings in any area, take all necessary steps to revise and update the market value of the land on the basis of the prevalent market rate in that area:

Provided also that the appropriate Government shall ensure that the market value determined for acquisition of any land or property of an educational institution established and administered by a religious or linguistic minority shall be such as would not restrict or abrogate the right to establish and administer educational institutions of their choice.

Note by CVSRTA :

As per above provision what is paid is the amount of compensation and not the market value. Because definition of market value in the Act is not as per the definition of market value as per Para 45 of Law Commission of India's report of the year 1958 as well as judicial pronouncement by the Supreme Court.

Criteria as laid down above for determining the Market Value of land are grossly violating following-

- ***Principles of valuation,***
- ***Characteristics of real estate market***
- ***Urban land economics,***
- ***International valuation standards***
- ***Judicial pronouncements in our country***
- ***Market value defined by the Law Commission of India in their report of the year 1958.***

S.27 Determination of amount of compensation:- The Collector having determined the market value of the land to be acquired shall calculate the total amount of compensation to be paid to the land owner (whose land has been acquired) by including all assets attached to the land.

S.28 Parameters to be considered by Collector in determination of award.-

In determining the amount of compensation to be awarded for land acquired under this Act, the Collector shall take into consideration-

firstly, the market value as determined under Section 26 and the award amount in accordance with the First and Second Schedules;

secondly, the damage sustained by the person interested, by reason of the taking of any standing crops and trees which may be on the land at the time of the Collector's taking possession thereof;

thirdly, the damage (if any) sustained by the person interested, at the time of the Collector's taking possession of the land, by reason of severing such land from his other land;

fourthly, the damage (if any) sustained by the person interested, at the time of the Collector's taking possession of the land, by reason of the acquisition injuriously affecting his other property, movable or immovable, in any other manner, or his earnings;

fifthly, in consequence of the acquisition of the land by the Collector, the person interested is compelled to change his residence or place of business, the reasonable expenses (if any) incidental to such change;

sixthly, the damage (if any) bona fide resulting from diminution of the profits of the land between the time of the publication of the declaration under Section 19 and the time of the Collector's taking possession of the land; and

seventhly, any other ground which may be in the interest of equity, justice and beneficial to the affected families.

Note by CVSRTA:

The matters not to be taken into consideration as per S. 24 of the old Act have not been provided in the new Act, which will result into litigation and excess compensation.

S.29 Determination of value of things attached to land or building:-

(1) The Collector in determining the market value of the building and other immovable property or assets attached to the land or building which are to be acquired, use the services of a competent engineer or any other specialist in the relevant field, as may be considered necessary by him.

Note by CVSRTA : Market value of the building is not the subject matter of valuation in any valuation exercise. But the estimation of value of rights and interests like freehold, leasehold, tenancy, etc., are the subject matter of valuation. For this purpose academically qualified valuer is required.

(2) The Collector for the purpose of determining the value of trees and plants attached to the land acquired, use the services of experienced persons in the field of agriculture, forestry, horticulture, sericulture, or any other field, as may be considered necessary by him.

(3) The Collector for the purpose of assessing the value of the standing crops damaged during the process of land acquisition, may use the services of experienced persons in the field of agriculture as may be considered necessary by him.

S.30 Award of solatium:

(1) The Collector having determined the total compensation to be paid, shall, to arrive at the final award, **impose** a "Solatium" amount equivalent to one hundred per cent of the compensation amount.

Explanation -For the removal of doubts it is hereby declared that solatium amount shall be in addition to the compensation payable to any person whose land has been acquired.

(2) The Collector shall issue individual awards detailing the particulars of compensation payable and the details of payment of the compensation as specified in the First Schedule.

(3) In addition to the market value of the land provided under Section 26, the Collector shall, in every case, award an amount calculated at the rate of twelve per cent per annum on such market value for the period commencing on and from the date of the publication of the notification of the Social Impact Assessment study under sub-section (2) of Section 4, in respect of such land, till the date of the award of the Collector or the date of taking possession of the land, whichever is earlier.

14.3 Land acquired for companies under the Land Acquisition Act, 1894 - Peculiar issues:

S.24 (1)(b) of Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 is reproduced:

> "where an award under said Section II has been made, then such proceedings shall continue under the provisions of the said Land Acquisition Act, as if the said Act has not been repealed."

The **banks and financial institutions** are advancing loans to industries established on land acquired under old Land Acquisition Act, 1894. The terms and conditions imposed for disposal of land are worth considering by banks and financial institutions to avoid any complication in the event of default by the borrower.

Section 41 deals with agreement with the appropriate Government and same is reproduced below:

Agreement with appropriate Government -

If the appropriate Government is satisfied after considering the report if any, of the Collector under Section 5-A, sub-section (2), or on the report of the officer making an inquiry under Section 40 that the proposed acquisition is for any of the purposes referred to in clause (a) or clause (aa) or clause (b) of sub-section (1) of Section 40, it shall require the company to enter into an agreement with the appropriate Government for the following matters, namely:

(1) the payment of the cost of the acquisition;
(2) the transfer, on such payment, of the land to the company;
(3) the terms on which the land shall be held by the company;
(4) where the acquisition is for the purpose of erecting dwelling houses or the provision of amenities connected therewith, the time within which, the conditions on which and the manner in which the dwelling houses or amenities shall be erected or provided;
(5) (4-A) where the acquisition is for the construction of any building or work for a company which is engaged or is taking steps for engaging itself in any industry or work which is for a public purpose, the time

within which and the conditions on which, the building or work shall be constructed or executed; and

(6) where the acquisition is for the construction of any other work, the time within which and the conditions on which the work shall be executed and maintained, and the terms on which the public shall be entitled to use the work.

Matters to be provided in the agreement under Section 41 is given under Rules 5 to 6 of the Land Acquisition (Companies), Rules, 1963 and same have been reproduced below :

Rule 5. Matters to be provided in the agreement under Section 41

(1) The terms of the agreement referred to in Section 41 of the Act shall include the following matters, namely -

(i) that the company shall not, except with the previous sanction of the appropriate Government, use the land for any purpose other than that for which it is acquired;

(ii) that the time within which the dwelling houses or amenities directly connected therewith shall be erected or provided or the building or work shall be constructed or executed shall not exceed three years from the date of transfer of the land to company;

(iii) that where the appropriate Government is satisfied after such enquiry as it may deem necessary that the company was prevented by reasons beyond its control from providing, constructing or executing dwelling houses or amenities or any building or work within the time specified in the agreement, the appropriate Government may extend the time of that purpose by a period not exceeding one year at a time so, however, that the total period of extension shall not exceed three years;

(iv) that if the company commits a breach of any of the conditions provided for in the agreement, the appropriate Government may make an order declaring the transfer of the land to the Company as null and void whereupon the land shall revert back to the appropriate Government and directing that an amount not exceeding one-fourth of the amount paid by the company to the appropriate Government as the cost of acquisition under clause (1) of Section 41 of the Act shall be forfeited to the appropriate Government as damages and the balance shall be refunded to the company, and the order so made shall be final and binding;

(v) that if the company utilizes only a portion of the land for the purpose for which it was acquired and the appropriate Government is satisfied that the company can continue to utilize the portion of the land used by it even if the unutilized part thereof is resumed, the appropriate Government may make an order declaring the transfer of the land with respect to the unutilized portion thereof as null and void whereupon such unutilized portion shall revert back to the appropriate Government and directing that an amount not exceeding one-fourth of such portion of the amount paid by the company as cost of acquisition under clause (1) of Section 41 of the Act as is relatable to the unutilized portion shall be forfeited to the appropriate Government as damages and that balance of that portion shall be refunded to the company and the order so made shall, subject to the provisions of clause (vi), be final and binding;

(vi) that where there is any dispute with regard to the amount relatable to the unutilized portion of the land, such dispute shall be referred to the Court within whose jurisdiction the land or any part thereof is situated and the decision of that court thereon shall be final.

(2) Where the company commits a breach of any of the terms of the agreement, the appropriate Government shall not make an order under clause (vi) or clause (v) of sub-rule (1), unless the company has been given opportunity of being heard in the matter.

(3) The appropriate Government shall consult the Committee before according any sanction under clause (i) of sub-rule (1) or extending the time under clause (iii) or making any order under clause (iv) or clause (v) of that sub-rule.

Rule 6. Additional matters which may be provided in the agreement under Section 41 –

(1) Without prejudice to the provisions of Rule 5, the terms of the agreement referred to in Section 41 of the Act may also include the following matters, namely:

That before an award has been made under Section 11 of the Act, the company shall deposit with the Collector, free of interest, such amount (being not more than 2/3rd of the approximate amount of compensation payable in respect of the land) as determined under clause (ii) of sub-rule (2) of Rule 4 and within such time as the Collector thinks fit, to specify in this behalf.

(2) Where any amount has been deposited with the Collector under sub-rule (1), the Collector shall tender payment of the amount so deposited to the persons interested who in the opinion of the Collector, are entitled to receive payment of compensation under sub-section (1) of Section 31 of the Act and shall pay it to them, unless prevented by someone or more of the contingencies mentioned in sub-section (2) of Section 31 of the Act, subject to the following conditions, namely :

(i) the execution of an agreement by each recipient that the amount received by him would be adjusted against the compensation finally awarded and that where the amount received by him exceeds the amount of the compensation finally awarded, the excess amount shall be recoverable from him as an arrear of land revenue and that he shall not claim any interest under the provisions of the Act in respect of the amount received by him under this sub-rule, and

(ii) the execution of a bond by each recipient with or without security as the Collector may decide or undertaking to indemnify the appropriate Government against any claim for compensation or payment thereof by any other person.

(3) If the amount deposited by the company under sub-rule (1) or any part thereof is not paid under sub-rule (2) the Collector shall, as soon as practicable, refund the same to the Company.

Rule 8: Condition under which sanction may be given for transfer of land –

Where a company for which land has been acquired under the Act applies for the previous sanction of the appropriate Government for the transfer of that land or any part thereof by sale, gift and lease or otherwise, no such sanction shall be given unless-

(1) The proposed transfer of land along with dwelling house, amenities, buildings of work, if any, is to some other company or where the company is a co-operative society, such transfer is to any or all of its members, or

(2) Where the land has been acquired solely for the erection of dwelling houses for workmen employed by the company, the proposed transfer of the land along with dwelling houses, if any, is to such workmen or their dependent heirs:

Provided that before giving any such sanction the appropriate Government shall consult the Committee.

When the land is acquired for establishing industry under the Land Acquisition Act, 1894, its transfer is governed by the rules framed there under. As per rules laid down in Gujarat, in the event of sale or transfer, 50% unearned increase is payable to the Government.

14.4 Vital issues to be taken into consideration in valuation for disinvestment, mergers and acquisitions:

The main purpose of valuation exercise for disinvestment, mergers and acquisitions for an enterprise is to derive maximum value and therefore if following exercise is

undertaken prior to sale/merger it will lead to better realization.

(a) There is a saying that ‘possession’ is nine points in law.

If a company is in possession of land as a lessee, and if it is profitable to sell the land as a free holder then it is desirable to acquire the lessor’s interest first and then to sell the land as a freeholder, this will be beneficial to enterprise and it will gain considerably as explained hereinafter.

Let us consider that market value of lessor's interest is ₹ 3 million and the lessee acquires freehold interest by paying ₹ 3 million to the lessor.

Market value of freehold interest in land is ₹ 16 million indicating considerable increase in value from ₹ 3 million to ₹ 16 million which is really good.

(b) Let us consider a case of a company that has occupied office premises as tenants and they are located throughout the country. The built-up area of such premises is say 500 sq. m. and they are not appearing in the balance sheet, as the enterprise is not the owner. As a protected tenant, these premises can be acquired at a very low price, say ₹ 5 million. After acquiring ownership right, they can be sold for say ₹ 50 million. These tenanted premises are known as **off-balance sheet assets,** as these premises are not purchased by the entity, they do not appear in the fixed asset register of the company. As no capital expenditure is incurred to acquire the tenancy rights, it is not reflected in balance sheet as a capital asset. Rent paid is shown as revenue expense, but it creates a legal right, and value of this legal right depends on how it is traded in the market.

14.5 Valuation for Bank Finance

(a) Valuation for security against loan must satisfy S.5(n) of Banking Regulation Act, 1949.

Secured loan or advance has been precisely defined in clause (n) of Section 5 of Banking Regulation Act, 1949 as:

> *"a loan or advance made on the security of the assets the **market value** of which is not at any time less than the amount of such loan or advance."*

From the point of view of bankers, the security offered must be sufficient to recover principal amount with interest in the event of default by the borrower.

Therefore, periodical review of security from the angle of market value is required. **<u>Even if there is a repeat job of the same property, the input required from valuer remains same in each valuation.</u>**

The following input by valuers on risk analysis will be helpful to the bankers:

Market Risk Rating: 1 = Low,
2 = Low to Medium,
3 = Medium to High,
4 = Medium to High and
5 = High

Valuer shall give his opinion on -
- Recent Market Direction
- Market Volatility
- Local economy impact

Issues to be taken in to consideration for estimation of market value are exhaustively dealt earlier, hereinafter liquidation and forced sale value are discussed.

(b) Liquidation value

(i) Auction sale

Where the auction sale is by banks or financial institutions, courts, etc. to recover dues, there is an element of distress, a cloud regarding title, and a chance of litigation, which have the effect of dampening the enthusiasm of bidders and making them cautious, thereby depressing the price.

On the other hand when purchasers start bidding, an element of competition enters into the auction. Human ego, and desire to do better and excel other competitors, lead to competitive bidding, each trying to outbid the others. Thus in a well-advertised auction sale, where a large number of bidders participate, there is a tendency for the price of the auctioned property to go up.

(ii) Let us consider a hypothetical case of valuation of apartments located in a multi storied building having construction on ground plus 10 upper floors. There are five apartments per floor. The single owner of 5 apartments has offered all his five flats as a security to the bank. While taking these apartments as a security the bank requested valuer to report market value, orderly liquidation value and forced sale value.

The local inquiry revealed that one week prior to the date of valuation, the flats on 4th and 5th floor of same building (total 10 nos.) are sold on same day as per rates indicated below:

- 5 numbers of flats (a to e) are sold in the range of ₹ 5,000/-to ₹ 5,500/- per sq. ft.
- 3 numbers of flats (f to h) are sold in the range of ₹ 4,000/-to ₹ 4,500/-per sq. ft.
- 2 numbers of flats (i and j) are sold in the range of ₹ 3,000/- to ₹ 3,500/-per sq. ft.

In order to ascertain whether the transactions referred above satisfy the definition of market value local inquiry was made and even sellers and purchasers were also contacted. Local inquiry revealed that:

- Flat numbers a to e were sold with proper marketing and large number of buyers interacted and sellers were not prepared to sell at any price.

- In case of flat numbers f to h marketing time was not sufficient as seller was in little hurry.
- In case of flat numbers i and j the seller had given only 15 days to broker to find a buyer.

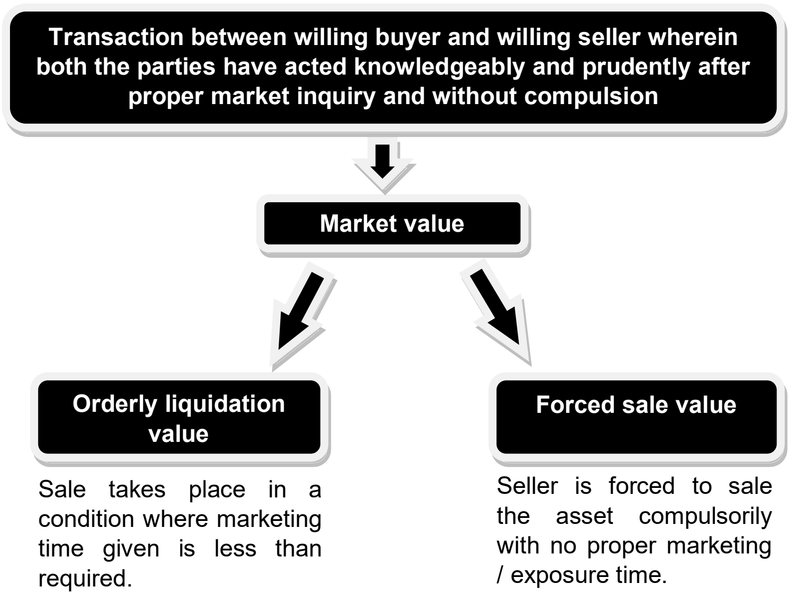
We can conclude from above as under:

- Market value is in the range of ₹ 5,000/- to ₹ 5,500/-
- Orderly liquidation value is in the range of ₹ 4,000/- to ₹ 4,500/-
- Forced sale value is in the range of ₹ 3,500/- to ₹ 4,000/-

In case of flats (i) and (j) instead of 15 days, only 5 days were given to broker then in that case the price realized could have been in the range of ₹ 3,000/- to ₹ 3,500/- or even less. This gives the idea about situation under forced sale.

The above transactions give proper idea about the difference amongst market value, orderly liquidation value and forced sale value. But in practice it is practically impossible to get the data for sale as above unless valuer himself developed a data bank by comparing the price realized in auction with market value of the same.

(iii) Chart showing difference amongst market value, orderly liquidation value, and forced sale value.



Orderly liquidation value is an estimate of the gross amount that the tangible assets would fetch in an auction- style liquidation with the seller needing to sell the assets on an as-is, where-is basis. The term ‘orderly’ implies that the liquidation would allow for a reasonable time to identify buyers, and the seller would have control of the sale process. The marketing time is less than required for a sale as per market value definition and more than required under forced sale condition.

Forced sale value is an estimate of the gross amount that the tangible assets would fetch when the seller is forced to sell the assets compulsorily without proper marketing time/ exposure time. There is urgency to sell and the seller does not have control of sale process (generally the banks/ courts/receivers, etc. do).

Note: So far as price obtainable in the forced sale condition is concerned, it is very difficult to predict because one is attempting to define a moving target. Is forced sale the one which is expected to take place within 3 months, 2 months, 1 month, 1 week or 1 day?

The price realized under orderly liquidation scenario and also under forced sale scenario are subjective and therefore instead of terms orderly liquidation value and forced sale value the terms price realized under orderly liquidation condition and price realized under forced sale condition are appropriate.

(c) The banks to ensure that valuation report contains following vital issues:

1. Relation between borrower and owner of the property to be mortgaged.
2. Site plan indicating location with land marks.
3. Details of property to be financed including description of locality and availability of infrastructure facilities (detailed specification and location of property vis-à-vis school, markets, bus station, railway station, central business district etc).
4. Basis of valuation approach adopted with justification and explanation.
5. Sale statistics/statement/instances and plan showing property in question and sales statistics with land marks.
6. Logical report, which shows comparison of sale instances with property in question with regard to relative merits and demerits as mentioned in the guidelines when market approach is adopted.
7. Logical report, which shows analysis of income and outgoings as mentioned in the guidelines when income approach is adopted.
8. Logical report of built up properties valued by cost approach showing computation of
   - Land value as per market approach indicated above.
   - Depreciated Replacement cost by considering following factors.
     - Reproduction cost or Replacement cost new as the case may be

- Physical wear and tear (Depreciation)
- Technological Functional and Economic obsolescence if any.

9. Approved Plans of existing building.

10. In case of proposed new development project report with attested copy of approved building plans or attested copy plan submitted for approval.

11. Marketability of the property.

14.6 **Statutory valuation** like valuation as per Schedule – III under the Wealth Tax Act,1957, to be used only for the purpose of Wealth Tax Act only; the value worked out as per Schedule-III is not the '**market value'** and does not satisfy criteria of **'willing buyer'** and **'willing seller'.** Valuation of the property having market value of Rs.5.0 cr. gets reduced to as low as Rs.2.0 lacs **(0.4% of market value)** as per valuation of Schedule-III of Wealth Tax Act, 1957.

The Supreme Court of India in case of Jawajee Naganatham vs. Revenue Divisional Officer reported at 1994 (4) SCC 595 have observed that the basic valuation register prepared by stamp duty authority do not satisfy 'willing buyer' and 'willing seller' criteria and hence cannot form the foundation to determine market value.

Similarly, valuation as per Schedule-III of Wealth Tax Act, 1957, cannot form the foundation to determine market value.

In our country, there is a tendency to value lease hold property by Schedule-III which is also not correct. Because in a lease hold property interests of lessor's and lessee's are required to be valued which is governed by terms and conditions of the agreement between lessor and lessee. **The following points ought to be considered in order to estimate value of lessor's and lessee's interest in a property:**

(i) What is the lease rent for land?
(ii) What is total lease period and unexpired period of lease?
(iii) Whether lease is renewable or not?
(iv) In case of renewal of lease, will lease rent remain same, as old or new rent will be fixed?
(v) What amount will be payable to lessor as premium or capital investment in case of sale/assignment of property or extension of lease?
(vi) On maturity of lease, if land reverts to the lessor then what will happen to building constructed by the lessee on the leased land? Will building vest free of cost with the lessor or the lessor has to buy from the lessee?

Valuation of lease hold property under Schedule-III does not consider above factors and the result is not the market value as it is not from the market derived data.

15 VALUATION REPORT

Report on valuation is always written in a simple language like an essay for easy understanding by a non-professional. It should be able to create interest in the mind of a reader to read it from the beginning to the end, like reading a story or a novel. It is, therefore, necessary that a report should have certain specific qualities.

15.1 Qualities of a Report on Valuation

1. **Orderly and organised**

   The report should be orderly and organized. This implies that before writing a report, an order in which following points shall be incorporated, should be decided

   - Information and data/facts,
   - analysis,
   - findings, and
   - conclusion

   The order must follow -

   - a definite,
   - systematic, and
   - logical sequence.

   The information and data/facts, their analysis and findings must then be described in a series of paragraphs and each paragraph needs to be independent and yet logically following the earlier paragraph. Conclusion shall be given at the end.

2. **Continuity**

   In order to maintain continuity of a report while reading, no break should be felt between any of the parts of the whole report. It is, therefore, necessary that schedules, statements, maps, graphs and such other information should not form part of the main body of the report, but be attached to the report as annexures/appendices. The executives referring the report are generally not interested in such statements or maps and in case if they are interested, the same can be referred in annexure.

3. **Properly arranged**

   A report should be arranged in such a manner that a client can easily refer to any particular part of report without any difficulty. Headings and sub-headings to paragraphs should be given in such a way that a reader can visualize what it contains.

4. **Definite and concise**

The report should be brief and to the point. The length of the report should just be required to convey forcefully the information, facts, analysis and opinion with reasoning. It should not be too long or too short, than required. The ambiguity has no place anywhere in the report. The words, sentences and paragraphs should be such as to convey maximum meaning in minimum use of words.

15.2 General Structure of a Valuation Report

Parts of a Report

- Purpose of valuation
- Executive summary
- Collection of data and narration of facts
- Analysis of information and data
- The conclusion
- Supporting material i.e. statements, tables, charts, graphs, plans, maps, photographs etc. forming annexure to the main descriptive report.

The report shall also include

a) The definition of value
b) Assumptions and limitations
c) Method of valuation adopted
d) Caveats

(a) The definition of value

In the last 60 years, in a number of land acquisition cases the Supreme Court of India has held that the **'market value'** must satisfy the **'willing buyer'** and the **'willing seller'** concept. Similar view is expressed by the Law Commission of India in their report of the year 1958.

As a general rule, where no definition of the 'market value' is given in a report then it is to be presumed that the standard definition of market value satisfying the 'willing buyer' and the 'willing seller' mentioned above has been adopted.

In cases, where the 'value' estimated is different from the standard definition, it must necessarily be clearly defined in a report.

(b) Assumptions and limitations

Limiting conditions will mostly arise in collection of information and data where a valuer is unable to collect and verify the same. In such cases, the limitations must be stated along with the assumptions made for limiting conditions. In certain circumstances, the value statement can also be subjected to qualifying clauses. Utmost care should, however, be taken to ensure that such qualifying clauses shall not, in any case, render value statement almost meaningless.

If there are any limiting conditions regarding the use of a report, then they must be clearly mentioned.

(c) Caveats

Caveats are essential part of instructions, setting limits to the extent of contract between the parties. Caveats are especially in respects of -

- confidentiality
- physical
- information
- miscellaneous
- special circumstances.

Confidentiality

In giving and accepting instructions, a contract has been created whereby a professional owes certain duty to a client. It is necessary to make the extent of such liability clear and limited to the client only. While writing a report it must be borne in mind as to how the data and information in a report will be used especially when such data and information is passed on to solicitors or third parties. In order to limit the liabilities, it should be stated in the report that –

> The report is prepared for specific purpose and same is confidential to the client. It may be disclosed to other professional advisors assisting the client in respect of that purpose only, but the client shall not disclose the report to any other person.

It should also be clearly stated that –

> No responsibility can be accepted to any third party in respect of whole or part of the report.

Further, considering the eventuality of litigation in respect of the subject matter of valuation, it is advisable to include a clause in the report that –

> The valuer does not agree to any appearance or giving testimony / evidence in any court, any hearing or any other proceedings by reason of rendering this report unless prior arrangements have been made in that respect.

Physical

A detailed inspection of the property to be valued is a **'must'** for a valuer. However, even after carrying out the most searching and comprehensive site inspection and investigations, latent defects i.e. defects, which cannot be normally revealed, even after thorough search of record and site inspection, will remain hidden. A valuer can be further protected by stating that no investigations were possible for latent defects, if any.

In case where a reasonably competent professional valuer comes to know from the age and type of construction that there is likelihood of latent defects, then the client should be advised to make more detailed investigation and analysis. The same thing would hold good in respect of services like plumbing, electrification, etc. especially when concealed.

Information

In carrying out the work as per instructions, several types of data and information are required to be collected from various sources. While data and information regarding physical condition of properties, location and situation is collected at the time of site inspection, the data regarding property market conditions and economic conditions is collected from Govt. records, enquiries during the site inspection and also from data published in various journals and other publications like census books, economic journals etc. All such data should be verified and ascertained and only such data and information, which have been personally verified by a valuer, should be included in the report.

Further, it is advisable to quote the source of information such as public records, census reports, publications, journals etc. in a report. Any information, if attributed to its source, creates no liability for a valuer unless it is so erroneous or misleading, which a reasonably competent professional is expected to realise.

Any property or its use in contravention of any statutory requirements or otherwise, any statutory notice served etc. is a matter, which usually affect the value of a property. Necessary enquiries can be made with the Local Planning Authority or Local Municipal and Govt. authorities, and copies of consents, licences, certificates, permissions etc. can be obtained to reduce the scale of caveats.

A valuer interprets legal and statutory documents on the basis of his academic and professional education in valuation.

He is, however, not held responsible for finer points of law and in cases involving finer points of law; a client may be clearly advised to seek legal opinion.

Miscellaneous

In valuing a number of properties in a portfolio, it is necessary to make it clear whether properties have been valued independently or as a group, where they together enjoy certain benefits, which would not be enjoyed separately.

Market value estimated by the valuer does not include:

- the cost of acquisition or disposal (e.g. agent's commission, stamp duty, registration charge, legal fees etc)
- any liability to taxation
- in case of a flat / plot in a co-operative housing society or apartment association, transfer fee payable

Special Circumstances

Sometimes, it is necessary to continue or renew particular licences for certain types of specialized users like hotels, restaurants, nursing homes, etc. for which necessary charges are required to be paid. In such cases this fact should be clearly stated in a report

The client's attention must be drawn in respect of the following issues:

- validity of licence
- any defects in property
- condition requiring repairs/immediate repairs
- outstanding property tax
- any other relevant matter

Caveats are for preventing:

- liabilities to third parties and misuse of a report by the client or other persons
- to limit the responsibility, of a valuer in respect of the quality of information supplied by others as well as for finer points of law,
- the task being limitless, to set limitations to the task.

The limits to be established by caveats however, must be relevant to the client's needs and practice in terms of the task that can be undertaken by a reasonably competent valuer; otherwise it will be of little or no benefit to the client. By pointing out the limitations of the report in certain specific matters, the caveats in general also guard the client against misinterpretation of the report and thereby being misled. A reasonably qualified and experienced professional valuer, in fact, needs no other safeguard than that provided by his professional integrity and honesty.

16 INFORMATION REQURED FOR VALUATION OF IMMOVABLE PROPERTY

16.1 General

1. Instruction and purpose for which valuation is required.
2. Name of owner / owners / share of each owner, along with nature of their interest in property. Is it under joint ownership or co-ownership?

   It is worthwhile to know the difference between joint ownership and co-ownership as given below -

   In case of joint ownership, the joint owners have equal and undivided shares in the property and on the death of one of the joint owners – his share will pass on equally to the surviving joint owners whereas in case of co-ownership on the death of one of the owners in common, his share will pass on to his legal heir.

3. Date as on which valuation is made.
4. Ward No., Cadastral Survey (C.S.) No., Plot No., Street No., C.T.S. No., Final Plot No., Town Planning Scheme No., of property with details of village, town or city, etc.

16.2 Land

5. Survey no. wise area of land supported by documentary proof - site plan/location plan/layout plan with its demarcation.
6. What is the tenure of land - freehold or lease-hold?

   If lease-hold –

   - Names of lessor / lessee,
   - Date of commencement of lease,
   - Period of lease,
   - Terms and conditions of renewal of lease,
   - Ground rent per annum,
   - Premium paid,
   - Payment of unearned increase in the event of sale or transfer,
   - Condition of transfer,
   - Covenant regarding repair and maintenance, reversion, etc.
   - Copy of lease deed.

7. Is the land covered under –

   - Coastal Regulation Zone (CRZ),
   - Urban Land Ceiling Act,

- Land Revenue Code,
- Land Reform Act, or
- Any other Act?

If yes, give details of compliances.

8. Does the land fall under any Town Planning Scheme?
9. Has any contribution been made towards development or is any demand pending?
10. Has the whole or part of land been notified for acquisition for road widening or any other purpose?
11. Is there any reservation on land such as playground, garden etc. by Municipal Authorities?
12. Copy of land record from revenue department.
13. Zoning of land - residential / commercial / industrial as per Development / Master / Town Plan of the town/city.
14. What is the permissible Floor Space Index (FSI) / Floor Area Ratio (FAR) ? How much is it utilised or unutilized or balance? and other Development Control Regulations affecting land values.
15. Classification of locality - high class / middle class / poor class.
16. Proximity to civic amenities like –
    - schools,
    - colleges,
    - hospitals,
    - place of worships,
    - market,
    - cinemas
17. New construction activities in the neighbourhood.
18. Mode of transport available. Quantity and quality of infra-structure / utility services. Distance and direction from employment centre, airport, railway station, bus depot etc.
19. Year wise details of land sold in last three years in the locality with
    - Names of purchaser / seller,
    - Dates of execution / registration of agreement,
    - Area of property sold,
    - Address, survey no. of property sold
    - Sale price
    - Registration No.

20. Location of sale instances referred in 19 above.
21. Details from the Land Acquisition Officer / Collector for award given for land acquired in surrounding area.
22. Details of land price from District Industrial Centre or any other State Industrial Development Corporation.
23. What is the required depth of foundation of structure?
24. What is land revenue per annum? Is there any outstanding liability for property tax, income-tax or any other taxes, levies which can be recovered by attachment of property, mortgage, charges, etc.
25. Industrial locational policy of the Govt. for expansion of existing industry.

16.3 Buildings (apartments in multi-storied apartment buildings)

26. Copy of share certificate issued by the society.
27. Registration no. of society.
28. Copy of approved plans of the property
29. Year of commencement and completion of construction of building.
30. Occupation / completion certificate obtained from municipal authority.
31. (a) Is the property rented-tenants are protected or not protected under rent control act/given on lease, given on leave and license, etc.? Annual rent, taxes, repair charges etc. paid by each occupier with copy of agreement.

    (b) Has any standard rent been fixed by the Court or by mutual agreement?

    (c) Are any of the tenants related or business associates of owners? Give details.

    (d) Is there any litigation pending in court of law?
32. Copy of maintenance bill / property and water tax bill.
33. If the owner has not purchased the premises directly from the developer, then over and above his agreement with seller / vendor, the first agreement between the builder / developer / first purchaser.

    If land is a leasehold land then in that case terms and conditions of lease are given in the first document.

34. Year wise details of flats transferred in last three years in the society or in nearby area with names of purchaser / seller / date of execution / sale price / area of flat sold.

Any other relevant information from Sr. nos. 5 to 25

16.4 Buildings other than apartments in multi-storied buildings

35. Copy of share certificate issued by the society

36. Copy of approved plans for all buildings under valuation.

37. Copy of permission for commencement of construction issued by municipal authorities.

38. Is there any notice from municipal authorities for violating rules and regulations in constructing the buildings? If yes, give details.

39. Year wise amount spent on repairs.

40. Year wise additions to each building.

41. Repairs required, if any.

42. Is the building insured? - copy of insurance policy.

43. Any litigation pending in the Court of Law for standard rent, title of property, etc. If yes, give details.

44. Current rates of building material and labour at site.

45. Original bill of quantity of each building.

46. Year wise details of property transactions for last three years in the locality

Any other relevant information from Sr. nos. 5 to 34

16.5 Other information

47. Growth of population in the last decade and its projection.

48. Main economic activity and its growth and its projection, especially secondary and tertiary sector employment.

49. Physical development – actual in recent past and proposed.

50. Growth potential giving overall and general idea of the property market.

51. Trend and potential for development.

Any other relevant information not covered above under sr. nos. 1 to 51.

16.6 The following programme is represented as a guideline to be pursued for valuation exercise for immovable property:-

Step I: Terms of reference

- The source of instruction
- The purpose of valuation
- The date of valuation

Step II: Definition of the assignment

- Identification of the assets
- Identification of rights, title and interest
- Scope of assignment and its limits
- Date as on which valuation is to be made
- Applicable basis of valuation

Step III Data collection, selection and analysis

- Government sources
- Sources of local bodies and developmental authorities
- Neighbourhood sources
- Market sources
- Literature sources
- Client sources

Step IV Application of valuation approaches

The following approaches to value shall be applied depending upon the nature of the asset.

(a)	Income capitalization approach	-	Investment assets
(b)	Sales comparison approach	-	Marketable assets
(c)	Cost approach	-	Specialised assets

The interest in the real estate to be valued may include ownership right, lease-hold, tenancies, leave and license, etc.

The real estate like land and building yielding periodical income by way of rent will be valued by income capitalization approach. The other items of real estate which are commonly transacted in the market will abide by the market approach.

Specialised real estate which are neither income yielding nor marketable shall be valued by cost approach comprising market value for land and depreciated replacement cost for buildings which will take into account all forms of obsolescence.

Centre for Valuation Studies, Research and Training Association (CVSRTA)

Government of India way back in 1968 appointed a committee to introduce course in valuation of real estate. But no universities came forward to introduce the course till 1994.

A group of practicing valuers actively engaged in the profession, regularly attending seminars, conferences and fellowships on valuation came in contact with some practitioners and academicians from all over the globe by attending the World Valuation Congresses in Vancouver, Singapore and London.

While interacting with them, it was found that there was a difference in valuation practiced in India and that outside India. The practice developed outside India appealed to them mainly because the practitioners outside India, even in developing countries like – Sri Lanka, Ghana, Gambia, Nigeria, Kenya, Tanzania etc. could not practice without an academic qualification in valuation due to the Valuers' Act regulating the valuation profession. Whereas, even today, in India there is no such Act to regulate the valuation profession and therefore most of the valuers are practicing without academic qualification in valuation.

This group studied the courses offered across the globe and developed a curriculum suitable to Indian requirements and approached the universities for introduction of the courses and BVM Engineering College, affiliated to Sardar Patel University (SPU), Vallabh Vidyanagar, Gujarat came forward for introduction of the valuation courses. Late Dr. B. P. Swadas, the then Principal of the BVM Engineering College cum Dean Faculty of Engineering and Technology, SPU and late Dr. D.D. Jadeja, the then Vice Chancellor, SPU immediately agreed on following conditions:

(a) The course shall be leading to the post-graduate degree on similar line of business administration and environmental engineering which were first introduced as PG courses and subsequently undergraduate courses were introduced in these two disciplines. This is mainly because introduction of PG courses is under the power of vice chancellor and for introduction of under graduate degree courses there is a long process.

(b) The university will not be able to provide any finance.

(c) Someone has to take charge in honorary capacity until the core faculty is developed.

Kirit P. Budhbhatti, one of the members of the group agreed to take charge as administrative head in honorary capacity until the core faculty was developed.

Dr. C.L. Patel, Chairman, Charutar Vidya Mandal – a charitable trust managing more than 45 educational institutions in Vallabh Vidyanagar agreed to offer excellent support to run the courses.

SPU introduced following full time courses in the year 1994:

Master of Valuation (real estate) - first in India
Master of Valuation (plant and machinery) - first in the whole world

Thus, the group was involved right from the beginning - convincing the SPU for a need of the courses, framing syllabi, selecting faculty from all over India, teaching and helping the university in offering the courses almost for 10 years (till 2003) absolutely in honorary capacity till the core faculty - Nelson J. Macwan, Amish S. Patel and Rupesh T. Shah (the students of the first batch) was developed out of the students who completed the courses.

On introduction of the course, group made representations to the Central Board of Direct Taxes, Ministry of Finance, GOI through Sardar Patel University for amendment to Wealth Tax Rules 8A(2) and 8A(8) for registration as valuers of immovable property and plant & machinery so that the holders of these two degrees can be registered in respective disciplines with 2 years of experience instead of 10 years (for engineers and architects). **The representation was accepted and a Gazette Notification was issued on 5th March 1997**.

The Royal Institution of Chartered Surveyors, U.K. (RICS) accredited both the courses in September 1998 initially for an intake of students during 1996 - 2000 and now also admits applicants with above qualifications as their members. This was possible due to support of Dr. C.L. Patel, Chairman, Charutar Vidya Mandal, who agreed to invite RICS team consisting of six members at the cost of ₹ 5 lakhs by Charutar Vidya Mandal in September, 1998.

The practicing valuers approached the above group for introducing the courses under the distance learning as they cannot take up full time courses. Dr. Babasaheb Ambedkar Open University, Ahmedabad (BAOU) introduced above courses under distance learning in the year 2006. BAOU approached the above group of valuers for a help in preparing the study material. The group helped the university in preparing the study material. It will be interesting to know that a good number of officers in valuation department of Maharashtra State had taken the admission.

The group floated the idea of establishing a professional organization of academically qualified valuers in a meeting organized by Alumni of SPU valuation courses in December 2006 at Vallabh Vidyanagar, Gujarat and the same was readily accepted and Centre for Valuation Studies, Research and Training (CVSRT) was established. It was decided to carry out some professional activity before registering the organization. Accordingly, the conferences were organized on Valuation of Assets for safety and security of Banking Sector in Mumbai, Ahmedabad and Surat which were very well attended by executives from National Housing Bank (NHB), ICICI Bank, Kotak Mahindra Bank, Indian Banks' Association (IBA), State Bank of India, Bank of India, other private/ public sector banks and professional valuers from length and breadth of India.

Institution of Valuers (Kolhapur Branch) approached the CVSRT in September 2007 for a help in introducing Master of Valuation (real estate) course under distance learning at Shivaji University, Kolhapur.

CVSRT prepared the study material for all the 21 subjects of the course and also rendered full help for two years in running the course. Now also members of CVSRT are rendering the help. It is note-worthy to mention here that the students of the distance learning course at Shivaji University, Kolhapur include the following:

- Govt. registered valuers with more than 20 years' experience
- Officers in the banks
- Assessor and Tax Collector, Kolkata Municipal Corporation
- Senior executive of big 4 accounting firm
- Chairmen of Institution of Valuers, Chennai and Hyderabad branches.

Annamalai University, Chennai introduced the valuation course in the year 2010 and CVSRT also helped Annamalai University.

Thus, some of the members of CVSRT have been the focal point of expertise in valuation to fill up a gap that exists in this area of felt need. It is unique in the sense that it does not survive by strength of membership but by the critical role it plays in providing intellectual inputs in the field of valuation. The CVSRT has prepared the study material for following subjects for distance learning courses introduced by various universities.

Real Estate

- Principles of economics*
- Book keeping and accountancy*
- Elementary surveying*
- Introduction to statistics*
- Principles of valuation*
- Town and regional planning*
- Elements of laws and jurisprudence*
- Engineering drawing*
- Principles of insurance & loss assessment*
- Building technology – I
- Building technology – II
- Law – I
- Law – II
- Principles of rating
- Valuation of real estate – I
- Valuation of real estate – II
- Urban land economics
- Environmental impact assessment
- Maintenance & repairs of buildings & dilapidations
- Building technology– III
- Real estate management
- Report writing

* indicates subjects common in both the courses real estate as well as plant & machinery

Plant & Machinery

- Principles of machine tools and factory equipment
- Industrial processes – I
- Industrial processes – I
- Legal study – I
- Valuation of plant & machinery – I
- Valuation of plant & machinery – I

It is also in constant touch with organizations that are relevant in the field of practicing valuers and at the same time remains hands in gloves with the expertise that have matured the world over.

It is note-worthy to mention here that the Royal Institution of Chartered Surveyors U.K. assigned the job of preparing Indian version of (Valuation Information Paper) VIP 10 and VIP 12 of their Manual of Appraisal and Valuation to CVSRT.

CVSRT took a lead in preparing a document on vital issues concerning banking sector like – Qualifications and experiences of valuers, check-list for bankers, format for valuers and circulated to Chairman, National Housing Bank (NHB) and to all the professional valuation societies which attended the meeting convened by NHB on 20th February, 2008 at Delhi for their views and also suggested that in USA there is an organization - Appraisal Foundation which is supported by all the valuation societies; similarly, there is a need to establish Federation of Valuation Societies supported by all the valuation societies of the country. In US, Appraisal Foundation plays vital role in the matters of qualifications, standards and framing guide lines etc.

Centre for Valuation Studies, Research and Training as stated hereto before was ultimately registered as Centre for Valuation Studies, Research and Training Association (CVSRTA) under Society's Registration Act, 1860 vide no. 816/2010 G.B.B.S.D. dated 30th March 2010 at Mumbai to have an independent status and avoid control by individual members.

Outstanding contribution at international and national levels:

International

The past and some of the present office bearers of CVSRTA are instrumental in following:

Helping International Valuation Standards Committee (IVSC) in framing basic document in the year 1994 for International Valuation Standards on:

- Valuation of plant & machinery
- Consideration of environmental factors in valuation

As there was a dearth of literature in the field of plant & machinery valuation it became essential to create literature by extracting from minds of outstanding plant & machinery valuers of the world. For this purpose, Kirit P. Budhbhatti – Founder Secretary, CVSRTA in collaboration with BVM Engineering College did pioneering work in the field of plant & machinery valuation and organized first, ever plant & machinery valuation conference at Anand, Gujarat, in India in 1998, which created tremendous interest in the international arena.

The main idea behind organizing the conference was to create a literature in the discipline of plant & machinery valuation. This was essential for offering academic programme. The excellent literature was created through conference due to active participation by stalwarts from advanced and developing countries like:

- Chairman, International Valuation Standards Committee
- President, American Society of Appraisers (ASA)
- Prof. from Sheffield University, UK
- Former - Chairman, Machinery and Equipment Committee, ASA
- Former - Chairman, Plant & Machinery Committee the Royal Institution of
- Chartered Surveyors (RICS)
- Superintendent Valuer, Her Majesty's Valuation Office, London
- Former - Chairman, Central Valuation Board, Kolkata, India
- Executive Vice President, American Appraisals, Milwaukee, USA
- Head, Rating Valuation - British Telecommunication, London
- CEO, BC Assessment, Victoria, Canada
- Member, Machinery and Equipment Committee, ASA
- 12 executives from Bharat Heavy Electricals Ltd.
  and
- Valuers from UK, USA, Canada, France, Malaysia, Fiji, Philippines, Nigeria, Kenya, Zimbabwe, Botswana, Mauritius, Ecuador, Thailand, and from length and breadth of India.

This was followed by a regular biennial international conference of meaningful nature. On success of the first conference a committee was formed and Kirit P. Budhbhatti became Founder Chairman (1998-2007) of International Plant & Machinery Valuation Conference Committee (IPMVCC). IPMVCC organized conferences in KL, Sydney, Hong Kong, London, San Francisco, Beijing and St. Petersburg in 2000, 2002, 2005, 2007, 2009, 2011 and 2013 respectively. The next conference will be organized in Tokyo in October 2015.

The first conference was inaugurated by Shri. N. Vittal, the then Chairman Public Sector Enterprises Selection Board.

Shri. N. Rangachary and Shri. G.V. Ramakrishna, the then Chairmen Insurance Regulatory and Development Authority and Dis-investment Commission respectively chaired the sessions on valuation for insurance and dis-investment respectively.

Shri. S.S. Sahai, the then High Commissioner of India in Malaysia inaugurated the conference in Kuala Lumpur in 2000 and Shri. Ganpathy and Shri. Gupta, the then Consul Generals of India in Sydney and Hong Kong were the Chief Guests in the concluding sessions in Sydney and Hong Kong conferences respectively.

National

The past and some of the present office bearers of the centre are also instrumental for:

- Training programmes of four day duration for senior executives of Bharat Heavy Electricals Ltd. (BHEL).

- Presentation to the officers in the office of Comptroller and Auditor General of India regarding relevance of valuation in public audit and disclosure of value of public assets for the sake of public accountability which was attended by Dy. Comptroller and Auditor General of India.

- Half a day programme in office of Comptroller and Auditor General of India regarding relevance of valuation which was attended by Dy. Comptroller and Auditor General of India.

- Training programme in valuation for the officers in the rank of Dy. Accountant General and Directors in the office of Comptroller and Auditor General of India at International Training Centre at Ghaziabad.

- Conference on valuation for safety and security of banking sector organized jointly by Indian Banks' Association and ISTAR. These were attended by officers in the rank of Dy. GM and AGM from various public and private sector banks from length and breadth of India.

- 5 days training programme in valuation for officers of stamp duty department of the Government of Gujarat.

- Continuing education programme for professional valuers at Anand, Mumbai, Ahmedabad, Surat and Chennai.

- 5 days training programme for 'Appraisal Team' of HUDCO at New Delhi.

Due to efforts of the group of valuers in organizing above conferences/training programmes/providing consultancy services an amount of ₹ 12,50,000/- was collected during the years 1995 to 2002 and said amount was utilized in running the postgraduate valuation courses offered by ISTAR.

Need of an Hour – Creation of Separate Cadre of Valuers of Real Estate and Plant & Machinery

1.0 Professions of valuation of real estate, valuation of plant and machinery, civil, mechanical, electrical engineering and architecture are independent disciplines and in order to practice each one degree in respective discipline is essential.

The judgement of Hon'ble Gujarat High Court in case of Special Civil Application no.9762/2001 between Institution of Valuers and others and Union of India and others decided on 27th April 2012; clearly establishes **so far as issue of valuation is concerned** that professions of valuation of real estate, valuation of plant and machinery, civil, mechanical, electrical engineering and architecture are independent disciplines and in order to practice each one degree in respective discipline is essential. The relevant extracts are reproduced below:

"Inviting attention to the qualifications required by a person for a degree in Valuation under the Valuers Act of Zimbabwe, 1996 as well as the Valuers, Appraisers and Estate Agents Act of Malaysia, the course of land economy offered by the University of Cambridge, the course structure of valuation in real estate taught at Shivaji University, Kolhapur, under the heading "Inter Disciplinary Study" as well as the course of M. Sc. in real estate valuation offered by Annamalai University, it was submitted that the courses so offered by universities and colleges all around the world, as well as in India, recognize the ***valuation as a separate course altogether and are very different from any fields or discipline of engineering. Valuation as a discipline, whether in plant and machinery or in real estate, is poles apart from mechanical, electrical or civil engineering.*** *Though a valuation course might contain a subject or two having an engineering background,* ***the discipline of valuation predominantly consists of law, economics, finance, town planning, industrial process and insurance.***

The syllabi of various Universities for the course of Master of Valuation show that the subjects related to disciplines of engineering are very limited. Further the qualifications prescribed for admission to the said course make it amply clear that it is not mandatory for a person to be a graduate in engineering or to otherwise possess knowledge of civil engineering or a mechanical/electrical engineering, as the case may be, to be eligible for the said course."

2.0 CBDT made amendment to Wealth Tax Rules in 1977, by inserting 'Explanation 2' vide Wealth Tax (Amendment) Rules, 1977, w.e.f. 1.1.1977 which reads as under:

"Where the membership of any institution is recognized by the Central Government as a qualification for the purpose of recruitment to superior services or posts under the Central Government in any field, such membership shall not be regarded as a requisite qualification for the purposes of this rule, unless the membership has been granted on the basis of passing the examinations conducted by the institution."

3.0 This clearly establishes that in order to practice as a real estate as well as plant & machinery valuer one must possess an educational qualification obtained by undergoing a regular course from a recognized university in respective disciplines. **This is an essential parameter. Rules for registration/empanelment need to be amended so that only academically qualified valuers can practice in respective disciplines and there is a necessity for creating a separate cadre of real estate and plant and machinery valuers.**

4.0 Shortcomings in the criteria for registration as valuers under Wealth Tax Act, 1957, draft rules for registration as valuers under Companies Act, 2013, REIT rules framed by SEBI and Clause 48 under Real Estate (Development and Regulation) Bill, 2013.

Criteria for registration as valuers under Wealth Tax Act, 1957

In our country there is no Act to regulate the profession of valuation. However, Ministry of Finance, Govt. of India registers valuers u/s 34 AB of Wealth Tax Act, 1957 (WT Act). The qualifications of various categories of valuers are laid down under Rule 8A of Wealth Tax Rules. There are shortcomings in these rules and representations are made since 2000 to remove the shortcomings and same are still under consideration.

In absence of Valuer's Act in our country the rules for registration of valuers laid down under Wealth Tax Rules have become valid practically for all purposes. Therefore, shortcomings in rules for registration as valuers under WT Act are explained first.

The provisions under the WT Act are such that an applicant without academic degree in valuation as well as experience in valuation is eligible for registration as explained below:

Ministry of Finance started registering valuers u/s 34AB read with Rule 8A (2) and 8A (8) of WT Act w.e.f. 15.11.1972.

On introduction of post-graduate degree courses leading to the degrees - Master of Valuation (real estate) and Master of Valuation (plant & machinery) by Sardar Patel University, Ministry of Finance, GOI, issued Gazette Notifications dated 31.01.1995 and 05.03.1997 for following amendments:

(a) PG Degrees in valuation of real estate and plant & machinery have been included in the list of qualifications for registration in respective disciplines (Vide 52nd and 70th amendments).

(b) Experience in valuation of real estate and plant & machinery also have been included in the experience criteria for applicants satisfying Rule 8A(2) (ii) (B) and Rule 8A (8) (ii) (B) (Vide 57^{th} and 74^{th} amendments).

(c) Experience criteria for 10 years (in case of civil/mechanical/electrical engineers and architects) reduced to 2 years for holders of PG degrees in valuation (Vide 58^{th} and 75^{th} amendments).

Thus, for the first time in 1995/1997 academic qualifications in valuation and experience in valuation for applicants satisfying Rule 8A (2) (ii) (B) and Rule 8A (8) (ii) (B) have been recognized for registration as valuers in respective disciplines.

This means for almost 25 years from 15.11.1972 valuers were registered without academic degree in valuation as well as experience in valuation for applicants satisfying Rule 8A (2) (ii) (B) and Rule 8A (8) (ii) (B).

Even at present also such valuers are continued to be registered and majority of valuers registered fall under this category.

In case of valuers of immovable property, the applicants satisfying Rule 8A(2)(ii)(A)(b), experience criteria stipulated are – as a valuer, architect or town planner or in the field of construction of buildings, designing of structures or development of land w.e.f.15.11.1972.

In fact from 15.11.1972 to 31.1.1995 the valuers of immovable property were registered on the basis of experience other than valuation of immovable property/real estate. Therefore, this is not an appropriate provision; even as on today it is in the statute book.

In case of immovable property for applicants satisfying rule 8A (2) (ii) (B) the experience as a valuer of real estate is included as one of the experiences first time w.e.f. 31.1.1995.

In case of plant and machinery, the applicants satisfying the Rule 8A (8) (ii) (b) and 8A (8) (ii) (B), the experience as a valuer of plant and machinery is first time added as one of the criteria w.e.f. 5.3.1997.

No improvement has been made after 05-03-1997 in the matter of registration as valuers under WT Act and as on today also registration for valuers of immovable property as well as plant & machinery is granted even to applicants who do not possess academic degree as well as experience in valuation. <u>Very large number of Valuers registered fall in this category even today</u>.

<u>The Ministry of Finance, Govt. of India continues to register as valuers of immovable property the applicants who have passed the examinations in civil engineering, architecture and town planning. These courses do not cover the majority of the issues to be taken into consideration for valuation of immovable property. Similarly, applicants with the degrees in mechanical, electrical, production, industrial, chemical, computer engineering are continued to be registered as valuers of plant & machinery. These courses do not cover the majority of the issues to be taken into consideration for valuation of plant & machinery.</u>

Till the lacuna in criteria for registration is rectified, any one satisfying the criteria for registration in force shall continue to apply and get registration without having basic requisite for purposeful deliverance.

The users of valuation services viz. Government agencies as well as general public are deprived of proper valuation services because majority of valuers are not academically qualified as well as not having right type of experience in valuation as the required amendments have not been made under WT Act as well as the Valuer's Act has not been enacted.

However, as per current situation in our country the number of academically qualified real estate and plant & machinery valuers available are less. Therefore, the valuers in practice with engineering and architecture qualifications must be allowed to practice with grandfathering provision as given below.

The practitioners who are having age less than 50 years need to undergo a course for a duration of one semester in the subjects which are vital for valuation and not covered in civil, architecture, mechanical, electrical, chemical, production etc. engineering courses under distance learning and those who have attained the age of 50 years and above for them a training for a duration of two weeks may be recommended. They must complete this requirement by 31st December 2018 otherwise their registration/empanelment shall be cancelled.

The course curriculum and topics to be covered in training programme in both the disciplines plant & machinery and real estate are enclosed at the end.

From 1.1.2019 only academically qualified valuers shall be registered/ empanelled.

The valuers who undergo one semester course/training programme before 31st December 2018 as suggested above shall be allowed to continue practice even after 31st December 2018.

<u>Serious error in draft rules framed for registration as valuers under Companies Act, 2013</u>

S.247 (1) of Companies Act, 2013 stipulates that the assets shall be valued by a person having such qualifications and experience.

It is therefore essential to include all the valuation disciplines concerning following assets as companies established under the Companies Act possess assets mentioned in the following categories:

- **Tangible assets** like urban real estate; plant & machinery; rural property comprising agricultural land, orchard, plantation, forest; wasting assets like mines and minerals; gem and jewellery.

- **Intangible assets** like intellectual property, know-how and goodwill.

- **Financial assets** like stock, share, debenture and other forms of receivables. It is laid down in the rules 17.2 (c) and (d) of Rules made under the

Companies Act, 2013 that **the technical valuation to be carried out by members of Institution of Engineers and Institute of Architects who are in whole time practice.** If we consider that technical valuation means valuation of assets other than financial and intangible assets then all the tangible assets mentioned below fall under the category of technical valuation:

- Urban real estate
- Plant & machinery
- Rural property comprising agricultural land
- Orchard
- Tea plantation
- Coffee plantation
- Rubber plantation
- Forest
- Wasting assets like mines and minerals
- Gem and jewellery

and therefore, members of all the disciplines of Institution of Engineers (civil, electrical, mechanical, chemical, production, industrial engineering etc.) and Institute of Architects are entitled to value all the above assets. **This is not correct at all and same is explained hereinafter.**

As per above provision, members of Institutions of Engineers and Architecture who are holders of degrees in civil engineering and architecture are eligible to carry out the valuation of all the tangible assets like – real estate, plant & machinery, mines and minerals, gems & jewelry, tea plantation etc. <u>Therefore, course curriculum of civil engineering and architecture must cover the issues to be taking into consideration of valuation of real estate, plant & machinery, mines and minerals etc.</u> **In fact these two courses do not <u>even</u> cover the issues to be taken into consideration valuation of real estate forget about the other assets.**

Members of Institution of Architecture **who are not holders** of degrees in mechanical and electrical engineering, members of Institutions of Engineers **who are holders** of degrees in mechanical and electrical engineering are eligible to carry out the valuation of all the tangible assets like – real estate, plant & machinery, mines and minerals, gems & jewelry, tea plantation, etc. <u>Therefore, course curriculum of mechanical and electrical engineering must cover the issues to be taking into consideration of valuation of real estate,plant & machinery, mines and minerals etc.</u> **In fact these two courses do not even cover the issues to be taken into consideration for valuation of plant & machinery forget about the other assets. <u>This is totally incorrect and need to be rectified immediately.</u>**

The above fact was brought to the notice of the Secretary, Ministry of Corporate Affairs, Govt. of India in October 2013 with what should be stipulated with reasons. The matter is still under consideration.

Repetition of serious error by SEBI

In May/June 2007 an e-mail was addressed to Chairman, SEBI intimating that valuers of real estate are only competent to carryout valuation of Real Estate Investment Trust and not the Chartered Accountants. In support of this following information was submitted.

(a) The details of subjects covered in course curriculum of valuation of real estate.

(b) The details of subjects covered in course curriculum of examination conducted by Institute of chartered Accountants of India.

The above submissions clearly establish that valuation of real estate and CA are two different disciplines. In order to practice each one academic qualification in each one is essential.

In October 2013, SEBI under draft regulations on Real Estate Investment Trust Regulations 2013, defined Principal Valuer u/s 2(cc) as under:

> "Principal Valuer" means any person who is a "registered valuer" u/s 247 of the Companies Act, 2013 and assigned as such and who has been appointed by the manager.

An e-mail was sent to Chairman, SEBI on 16th October, 2013 intimating serious error in rules framed under S.247 of the Companies Act, 2013 as well as earlier communication made in the year 2007 was also forwarded.

Again, SEBI issued a notification on 26th September, 2014 defining valuers under clause 2(1)ZZ as under:

> *"Valuer" means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 and who has been appointed by the manager to undertake valuation of the REIT assets:*
>
> *Provided that till such date on which section 247 of the Companies Act, 2013 comes into force, valuer shall mean an independent merchant banker registered with the Board or an independent chartered accountant in practice having a minimum experience of ten years."*

It is note-worthy to mention that world over valuation for Real Estate Investment Trust (REIT) is carried out by academically qualified valuers of real estate.

The above clearly establishes repetition of serious error by SEBI.

This was also brought to the notice of Chairman, SEBI vide letter dated 6th April, 2015 along with all the previous communication since 2007.

The matter is still under consideration.

Real Estate (Regulation and Development) Bill 2013

A letter dated June 11, 2007 was addressed to Secretary, Ministry of Urban Development, Govt. of India intimating that the following subjects are relevant for real estate development:

- Urban Land Economics
- Town Planning
- Real Estate Management
- Building Bye-laws
- Surveying
- Building Construction
- Laws of Contract and Tort
- Economics
- Land Acquisition Act
- Rent Control Acts
- Arbitration
- Valuation
- Transfer of Property Act
- Law relating to Inheritance

All the above subjects are covered in the course curriculum of valuation of real estate and therefore those who have completed a course leading to degree <u>in valuation of real estate are only competent to represent under the proposed Bill</u>. But they <u>are not made eligible</u> to represent under the proposed Bill.

Some of the above subjects are covered in course curriculum leading to degrees in Civil Engineering, Architecture and also in Building & Quantity Surveying examination held by Institution of Surveyors of India which is recognized by the GOI for recruitment to superior services and posts. **These examinations also can be considered to represent under the Bill. But <u>they are also not made eligible</u> to represent under the proposed Bill.**

None of the above subjects are covered in course curriculum of Chartered Accountancy, Cost Accountancy and Company Secretary. Still however, clause 48 of the Real Estate (Regulation and Development) Bill 2013 provides for representation by Chartered Accountants, Cost Accountants and Company Secretaries which is not correct at all.

This fact is brought to the notice of Secretary UD, GOI, in the year 2007 and May 2015, all the Members of Lok Sabha and to the select committee of Rajya Sabha on Real Estate (Regulation and Development) Bill, 2013 in May, 2015.

5.0 **D.N. Banerjee,** former Secretary, Urban Development and former Chairman, Central Valuation Board, Govt. of West Bengal,

P.T. Hardikar, Director (Retired) – Town Planning and Valuation, Govt. of Maharashtra and

Kirit P. Budhbhatti, former President, Institution of Surveyors

who were actively involved in introducing/offering PG courses in valuation at BVM Engineering College and Institute of Science & Technology for Advanced Studie & Research (ISTAR), Sardar Patel University have held several meetings with concerned authorities.

The details of communications of representations made are given below. These representations are still under consideration except representations made to Indian Banks' Association (IBA). The outcome of representations to IBA is given under paragraph 6.0

(a) Amendment to Rules 8A(2) and 8A(8) for registration of valuers of immovable property and plant & machinery under WT Act.

- The letters dated 23.11.2000 and 25.09.2006 were addressed to Central Board of Direct Taxes, MoF, Govt. of India.

- The letter dated 15.11.2000 was addressed to Minister of Law, Govt. of India.

(b) Constitution of Central Valuation Board to carry out valuation for various fiscal and non-fiscal purposes by Govt. of Gujarat and Govt. of India

- It is note-worthy to mention here that the representation was made to Govt. of Gujarat in September, 1995. Finance Minister, Govt. of Gujarat in his budget speech as published in Times of India, Saturday, February, 1997 announced to constitute Central Valuation Board.

- Subsequently meetings were held with officials of Government of Gujarat on 07.08.2001, 19.03.2006, 11.08.2008, 21.10.2008, 19.12.2008, and 30.01.2009

- Letters dated 05.06.2001, 30.08.2001, 28.04.2002 and 25.07.2002 were addressed to Member, Cabinet Committee on Disinvestment, Govt. of India and meetings were also held.

- Central Vigilance Commissioner addressed letters dated **17.07.2001 to Secretaries UD, Finance, Revenue and Disinvestment, Govt. of India for establishing Valuation Board / to enact Valuer's Act.**

(c) Creation of separate cadre of valuers

- Letter dated 04.09.2003 was addressed to Department of Personnel & Training, Govt. of India and meeting was also held with Hon'ble Minister.

(d) Empanelment of academically qualified valuers by Banks

- Letter dated 01.11.1999 to Chairmen and Managing Directors of all the public sector banks
- Letter dated 24.12.1999 to Deputy Governor, Reserve Bank of India
- Meeting with Chief General Manager, Reserve Bank of India on 05.01.2000
- Letter dated 15.06.2000 to Chairmen and Managing Directors of all the public sector banks and Deputy Governor, Reserve Bank of India
- Letter dated 15.06.2000 to Secretary Banking, MoF, Govt. of India.

- Letter dated 31.10.2001 to Deputy Governor, Reserve Bank of India
- Meeting with Executive Director, Reserve Bank of India on 07.11.2001
- Letter dated 14.11.2001 to Executive Director, Reserve Bank of India
- Letter dated 27.03.2002 to Chairmen and Managing Directors of all the public sector banks
- Letter dated 02.06.2004 to Additional Secretary, Department of Banking, MoF, Govt. of India
- Letter dated 18.05.2004 to General Manager, DBOD, Reserve Bank of India
- Letter dated 10.12.2004 to Manager, Reserve Bank of India
- Letter dated 02.06.2004 to Secretary, IBA
- E-mail dated 26.05.2006 to Director, Reserve Bank of India and Senior Executive, IBA
- E-mail dated 05.07.2006 to CGM, Reserve Bank of India
- E-mail dated 07.05.2007 to Canara Bank, UCO Bank, Bank of India
- E-mail dated 03.07.2007 to IBA
- E-mail dated 24.09.2009 to Chairmen and Managing Directors of all the public sector banks
- E-mail dated 31.08.2009 to IBA and NHB
- Meeting with Deputy Governor, Reserve Bank of India on 26.08.2010
- Letter dated 26.08.2010 and 27.08.2010 addressed to Deputy Governor, Reserve Bank of India
- E-mail dated 28.10.2010 to Executive Director, Reserve Bank of India

(e) Valuation Professional Bill drafted by Ministry of Corporate Affairs, Govt. of India.

- Letters dated 21.09.2007, 03.12.2008, and 05.01.2009 to Director, Ministry of Corporate Affairs, GOI on qualifications of valuers and other issues.

(f) Representations to Hon'ble Minister of Human Resource Development, Govt. of India on valuation education in our country.

- Email dated 21.10.2010 was sent to the Hon'ble Minister
- Email dated 27.10.2010 was received from the office of the Hon'ble Minister to meet the Advisors to the Hon'ble Minister on 2.11.2010
- Presentation was made to the Advisors on 2.11.2010
- Follow up emails were sent on 8.10.2010 and 18.12.2010
- Email dtd. 10 July 2014 to the Jt. Secretary of Ministry

6.0 Handbook 2011 on Valuation of Real Estate published by IBA stipulates that after 1st April 2015 only academically qualified valuers shall be empanelled. It also stipulates that civil engineers and architects on the panel of valuers shall have to pass an examination of duration of one semester in the subjects vital for valuation of real estate and not covered in the course curriculum of civil engineering and architecture before 31.3.2015 to continue in the panel after 1.4.2015.This decision is yet to be implemented. Again in October 2014 IBA on direction from Reserve Bank of India has prepared a draft paper on Standardization of Procedure for Empanelment of Valuers. The draft incorporates suggestions on one sensible examination and grandfathering provision referred under paragraph 4.0 earlier.

7.0 Therefore, it is essential to create separate cadre of real estate and plant & machinery valuers.

8.0 Course curriculum for duration of six months in the subjects vital for valuation of real estate but not covered in civil engineering and architecture and topics to be covered in two week programme in the subjects vital for valuation of real estate but not covered in civil engineering and architecture are enclosed at page numbers 174 to 177.

9.0 Course curriculum for a duration of six months in the subjects vital for valuation of plant and machinery but not covered in mechanical, electrical, textile etc. engineering courses and topics to be covered in two week programme in the subjects vital for valuation of plant and machinery but not covered in mechanical, electrical, textile etc. engineering courses are enclosed at page numbers 178 to 181.

10.0 Valuation is essential for various fiscal and non-fiscal purposes.

(A) The fiscal purposes are:-

Levy of Taxes such as:-

(i) Municipal Taxes on Land and Buildings collected by Local Self Government.
(ii) Stamp Duty collected by State Governments, on documents for transfer of properties.
(iii) Income – Tax on Capital Gains arising on transfer of property and Wealth – Tax, collected by Government of India.

(B) The non-fiscal purposes are:-

(i) Award of compensation for compulsory acquisition of property for public purposes.
(ii) Computation of betterment levies under town planning laws.
(iii) Valuation of tangible and intangible assets owned by the Govt. of India, State Governments, Public Sector undertakings and statutory bodies like port trusts, for privatisation as well as ascertaining return on investment.
(iv) Liquidation of assets for recovery for settlement of financial disputes by commissioner, High Courts and Official Liquidator.
(v) Computation of rent at the time of leasing of property and subsequent renewal of leases in Government/Semi Government organisation.
(vi) Grant and recovery of loans and advances by Banks.
(vii) Insurance of Immovable and Movable property.

At present the above functions are discharged by officers as per the table given below **who are not academically qualified in valuation.**

Governmental agencies requiring valuation services	Purpose	Nature of job	Qualifications of officials handling job
(A) Municipal Corporations or Local Authorities	1. Property taxes	To estimate Property tax	B.A./B.Sc. B.Com/L.L.B without adequate knowledge of valuation
	2. Land acquisition for road and reservations	To estimate market value of property acquired	Civil Engineers without adequate training in valuation
(B) State Governments	1. Levy of stamp duty	To estimate value of property	L.L.B. without adequate knowledge of valuation
	2. Land Acquisition	To estimate market values of property acquired	S.L.A.O. relies on land values submitted by Town Planning Dept. and building values by P.W.D Civil Engineers who do not have adequate training in valuation
(C) Central Government	1. Wealth Tax Income Tax Capital Gains Tax	To estimate value under Schedule – III of Wealth Tax Act/market value of property/ cost of construction of buildings	P.W.D Engineers transferred to valuation cell without adequate training in valuation.
	2. Land Acquisition	To estimate market value of property acquired	S.L.A.O. relies on land values by Town Planning Dept. and building values by P.W.D Civil Engineers without adequate training in valuation.
(D) Banks and Financial Institutions	1. Mortgage	To estimate values of properties for loan advances	Panel Valuers For majority of Panel valuers of Banks this is a secondary professional activity. Banks do not have academically qualified and experienced valuers to judge the reports submitted by Panel valuers

Syllabi for Six Months
Course in Valuation of Real Estate
for
Graduates in Civil Engineering, Architecture and those who have passed examination in Building and Quantity Surveying conducted by the Institution of Surveyors (India)

Subjects to be covered:

- Valuation – I
- Valuation – II
- Valuation – III
- Law – I
- Law – II
- Case studies
- Report writing

1.0 Valuation - I

Cost, price and value; types of value;

Value – elements, ingredients, characteristics; highest and best use; value in use; value in exchange

Annuities – capitalization – rate of capitalization– sinking fund – redemption of capital

Depreciation – various methods of computation of depreciation, technical and accounting depreciation, depreciation from market derived data

Valuation maxims- Physical, Legal, Social, economic, marketability, transferability, scarcity, utility

Characteristics of sound investment

Income approach to value:

Rent: Types of rent – outgoings – income – yield – years' purchase

Lease: Types of leases - building/occupation, lessor and lessee, covenants of lease - terms and conditions of leases.

Valuation: lessor's interest, lessee's interest, lease granted by private and statutory bodies

Investment comparisons: Yield from real estate and other forms of investment,

Sale analysis techniques for rented property, deriving YP, rate of interest from sale transactions, Reversionary value of land.

Market approach to value:

Bell type curve- market value;

Market comparison techniques, adjustment grid model, automated sales analysis, comparison by weightages assigned to various factors of comparison.

Residual technique.

Cost approach to value:

Reproduction cost new, Replacement cost new, reinstatement value and depreciated reproduction cost /depreciated replacement cost.

Age – effective age – economic life and remaining life

Technological, functional and economic obsolescence and computation of the same

Depreciated replacement cost subject to demand and supply/potential profitability

2.0 Valuation - II

Valuation for various fiscal and non-fiscal purposes

The fiscal purposes of valuation for the statutory exaction as taxes like:

(i) Income-Tax, Capital Gains Tax
(ii) Stamp duty collected by State Governments on documents for transfer of properties.
(iii) The levies under other forms not covered above

The non-fiscal purposes of valuation are those activities which are meant not for taxation but other exercise like:

(i) Dis-investment / privatization
(ii) Mortgages: Loans and advances
(iii) Insurance
(iv) Acquisition of land
(v) Sale / purchase
(vi) Fixation of rent
(vii) Activities other than those not covered above

3.0 Valuation - III

Limitations of various approaches to value.

Real-estate market: investments in real estate

Factors affecting urban land value

Valuation of special types of properties: Hotels, Cinema, Petrol Pump

Valuation of transferable development rights

Effects of legislation on valuation: rent control law, town planning law, CRZ etc.

Principles and legal concepts in relation to insurance of buildings, the contract of insurance, insurable interests and liability to insure.

Duties of the insurer and the insured.

The insurance policy; terms and conditions, perils,

Valuation principles and techniques in relation to insurance loss assessment; valuation bases, value at risk, sum insured and condition of average, inflation provisions, other contents, obsolescence and betterment.

Valuation for REITs

Case laws on valuation

Valuation Standards published by-

- International Valuation Standards Council
- Royal Institution of Chartered Surveyors, U.K.

4.0 Law - I

Immovable property: meaning; ownership and possession; joint tenancy and tenancy in common; life interest, remainder and reversion.

Co-ownership and concurrent ownership – co-operatives and condominiums

Outline of procedure for sale of immovable property: contract and conveyance;

Land Acquisition Act,

Salient features of planning laws and development control regulations.

Salient features of Arbitration Act and SARFESI Act

5.0 Law - II

Salient features of Transfer of Property Act, 1882:

> Transfer of immovable property: sale, mortgage, gift, exchange, assignment, charge, lien, tenancies/sub-tenancies.

Salient features of Indian Easement Act, 1882: Leave and licence

Salient features of Laws relating to Inheritance/Succession.

6.0 Case studies

Case studies on valuation of real estate for various purposes.

7.0 Report writing

The subject will cover how to write reports for various purposes for which a valuer is normally called upon for advice in general practice.

Two Week Training Programme for

Real Estate Valuers

The topics to be covered will be same as given under six months programme and will be tailored accordingly.

Syllabi for Six Months Course in Valuation of Plant and Machinery for Graduates in automobile, chemical, computer, electrical, industrial, mechanical, mining, production and textile engineering in the subjects vital for valuation of PME and not covered in their course curriculum.

Subjects to be covered:

- Industrial processes
- Valuation – I
- Valuation – II
- Principles of insurance and loss assessment
- Law
- Case studies
- Report writing

1.0 Industrial Processes

Types of factory/plant layout, production techniques, automation, mass production, batch and one-off production, material flow, process sequences, automation and process control.

The normal processes, methods of manufacture, plant and machinery utilized, flow diagrams and inventory compilation for the following specific industries.

- Textiles
- Dairy
- Vegetable oil
- Iron, steel & non-ferrous metal production
- Chemical and pharmaceutical
- Plastic and rubber
- Paper and paper products
- Printing, binding and publishing
- Food and beverages

The nature and function of trade specific machinery in above industries.

2.0 Valuation – I

- Cost, price, value and worth
- Various types of value
- Value elements – ingredients – characteristics
- Investment property, marketable non-investment and non-marketable non-investment property

- Annuities – capitalization – rate of capitalization– sinking fund – redemption of capital
- Construction and use of valuation tables
- Valuation maxims
  - Physical
  - Legal
  - Social
  - Economic
  - Utility
  - Marketability
  - Transferability
  - Scarcity
  - Value means present worth of future benefits
  - Valuation involves estimating value of individual's rights in owning assets
- Three approaches to value – cost, market and income
- Valuation of plant and machinery, bases of value and the purposes for which their use is most appropriate
- Interpretation and use of the following terms:
  - gross current replacement cost
  - net current replacement cost
  - market value 'in-situ' and 'ex-situ' and 'existing use' and 'alternative use'
  - recoverable amount
  - highest and best use
- Accounting depreciation, technical depreciation, depreciation from market evidence.
- Meaning of terms - written down / book values.
- Indexation – their uses and limitations.
- Plant records and asset registers, their compilation, uses and limitations.
- Preparation of inventories.

3.0 Valuation – II

- Plant and machinery normally valued with the premises.
- Valuation of specialized machinery
- Assessment of imbalance in various production sections and cost to cure of the same

Leasing of machinery

- Leasing – a funding option
- Definition of lease
- Leasing, hiring and renting
- Finance lease
- Operating lease
- Sale and lease back
- Advantages of leasing to lessor/lessee

- Structure of lease agreement
- Tax-oriented or true lease

Obsolescence

Meaning and computation of terms – functional, technological, economic obsolescence.

Regulatory measures

- All industrial activities are subject to specific legislations and regulations, non-compliance with which may result in cessation of activity pending suit.
- Assessment of liability on account of regulatory measures and cost to cure.

Valuation for impairment loss

Valuation of tangible assets – a tool for restructuring of industrial undertaking

Earning and assets

Management of capital expenditure and its effect on value

depreciated **Study of the following literature –**

- Manual of valuation / Guidance notes in relation to valuation of plant and machinery published by professional societies.

Case laws – affecting valuation of plant and machinery

4.0 Principles of Insurance and Valuation for Insurance

Principles and legal concepts in relation to insurance of plant & machinery. The contract of insurance. Insurable interests and liability to insure. Duties of the insurer and the insured.

The insurance policy; terms and conditions, perils, beneficial and restrictive clauses.

Reinstatement value, market value, machinery break-down and boiler and pressure plant insurance policies.

Valuation principles and techniques in relation to insurance loss assessment; valuation bases, value at risk, sum insured and condition of average, inflation/escalation provisions, other contents, obsolescence and betterment.

5.0 Law

Sale of goods and agreement to sell, seller's obligations as to delivery time, title, description, fitness, quality and quantity; exclusion of obligations, sales by sample, passing of property in goods; transfer of title by non-owner, remedies for breach of contract; rights of unpaid seller against goods.

Licensing of industries and regulation of industrial activities under various laws; viz., revenue code, industrial licensing laws etc.

Salient features having direct bearing on valuation of PME of various acts such as

- Factory Act,
- Electricity Act,
- Labour Laws.

Outlines of environmental laws having direct bearing on valuation of industrial undertaking/plant and machinery.

6.0 Case studies

Case studies on valuation of plant and machinery

7.0 Report writing

The subject will cover how to write reports for various purposes for which a valuer is normally called upon for advice in general practice.

Two Week Training Programme on Valuation of Plant & Machinery

The topics to be covered will be same as given under six months programme and will be tailored accordingly.