

PERSPECTIVES PAPER

MARKET VALUE: AN ESTABLISHED BASIS OF VALUE

November 2021

Market Value: An Established Basis of Value

The IVSC issues Perspectives Papers from time to time, which focus on pertinent valuation topics and emerging issues. Perspectives Papers serve a number of purposes: they initiate and foster debate on valuation topics as they relate to the International Valuation Standards (IVS); they provide contextual information on a topic from the perspective of the standard setter; and they support the valuation community in their application of IVS through guidance and case studies.

Perspectives Papers are complementary to the IVS and do not replace or supersede the standards. Valuers have a responsibility to read and follow the standards when carrying out valuations.

By: Alexander Aronsohn and members of the IVSC Tangible Assets Board

The IVSC has issued this Perspectives Paper as the second in a series designed to initiate discussion and debate on the topic of market value. Share your thoughts and perspectives with us through [LinkedIn](#)

Introduction

In our first perspectives paper, Challenges to Market Value, the IVSC Tangible Assets Board (TAB) explored a number of topics pertaining to Market Value, which is one of the most common basis of value used in valuations. Topics discussed included: Price versus value, relating various forms of market evidence to a basis of value, the availability of market information in a pandemic world, prudential value and its comparison to Market Value, and value in volatile listed markets were among a number of the topics considered.

A number of pieces of feedback was received in relation to this paper.

The overarching feedback from valuation professionals is that whilst the Market Value basis of value is generally sound from a valuers' perspective, the concept is frequently misunderstood and misinterpreted by a range of valuation stakeholders, as outlined in the first Perspective Paper in this series. This second Perspective Paper seeks to further explore this topic and feedback in more detail, including discussions on:

- Price, Cost, Value and Worth
- How do we define what the 'market' is and how does this impact on Market Value?
- What is the Market Value conceptual framework?

- Is Market Value backward looking?
- Are the 'peaks' and 'troughs' truly captured when using a Market Value premise?
- How does the valuer utilise assumptions and special assumptions with Market Value?

We now take a further look at what the TAB makes of these topics in uncertain times.



Price, Cost, Value and Worth ... let's take a recap!

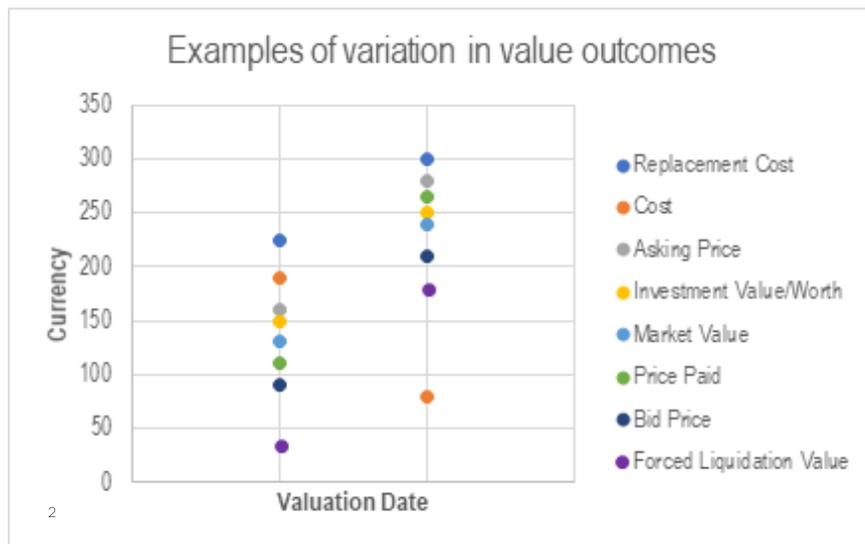
In the previous perspective paper, the TAB put forward definitions for price and value amongst others. Subsequent to that paper, the following refined definitions have been included within IVS (Effective 31st January 2022):

- **Cost(s) (noun):** The consideration or expenditure required to acquire or create an Asset.
- **Price:** The monetary or other consideration asked, offered or paid for an Asset, which may be different from the Value
- **Value (noun):** The opinion resulting from a valuation process that is compliant with IVS. It is an estimate of either the most probable monetary consideration for an interest in an asset or the economic benefits of holding an interest in an asset on a stated basis of value.
- **Investment Value/Worth:** The value of an asset to the owner or a prospective owner given individual investment or operational objectives (may also be known as worth).

The most important item to take away from these definitions is that the concept of Market Value is one of many Bases of Value. Consequently, Market Value may differ, perhaps materially, from each of Cost, Price and Worth.

What critically defines Value is the basis of value adopted for any given valuation. All other things being equal, an asset could be considered on a number of bases of value as at the same valuation date, for example Replacement Cost, Market Value, Investment Value or Forced Liquidation Value, to name but a few. Whilst all of these are 'value' outcomes, they would each yield different valuation results.

A hypothetical example of this potential variation can be represented in the following diagram, reflecting that the price and value of an asset can depend upon the bases of value used:



In accordance with IVS 104 Bases of Value:

...requires a valuer to select the appropriate basis (or bases) of value and follow all applicable requirements associated with that basis of value ...

This is mandatory when valuing any asset. Too often valuers make a silent assumption that their client understands the variety of bases of value that exist and agree with the selection made by the valuer. It is important the valuer advises the client as to why a specific basis of value was selected as appropriate for the assignment.

Moreover, it is critical that valuers analyse the plethora of information available in the market to ensure that it is considered appropriately having context to the basis of value being considered as part of the valuation.

As stated in the paper written by Laura Gabrielle and Nick French on ‘Pricing to market property valuation methods – a practical review’:

...distinction between “price”, “value” and “worth” is of paramount importance. But sadly, not every valuation user understands the distinction. Likewise, many clients think that value and worth are the same thing. Or that value is an inherent number below which the property will never be sold. Valuation, and property valuation, is beset with misunderstandings. It is therefore important that valuers are precise in the language that they use in valuation reports and that the valuation process is clear as is the choice of valuation approach, method and model.

To recap, Market Value, though being a globally established basis of value, is only one of a number of bases of value. While different pricing information that is represented in the market may help establish Market Value (for example, set a floor or ceiling), such pricing information may not necessarily accord with the premise of Market Value for a variety of different reasons.



How do we define what the ‘market’ is and how does this impact on Market Value?

The market is the environment in which goods and services trade between buyers and sellers through a price mechanism. The concept of a market implies that goods or services may be traded among buyers and sellers freely, only constrained by the laws that govern that jurisdiction. Each party will respond to supply-demand relationships and other price-setting factors as well as to their own understanding of the relative utility of the goods or services as well as their individual needs and desires.

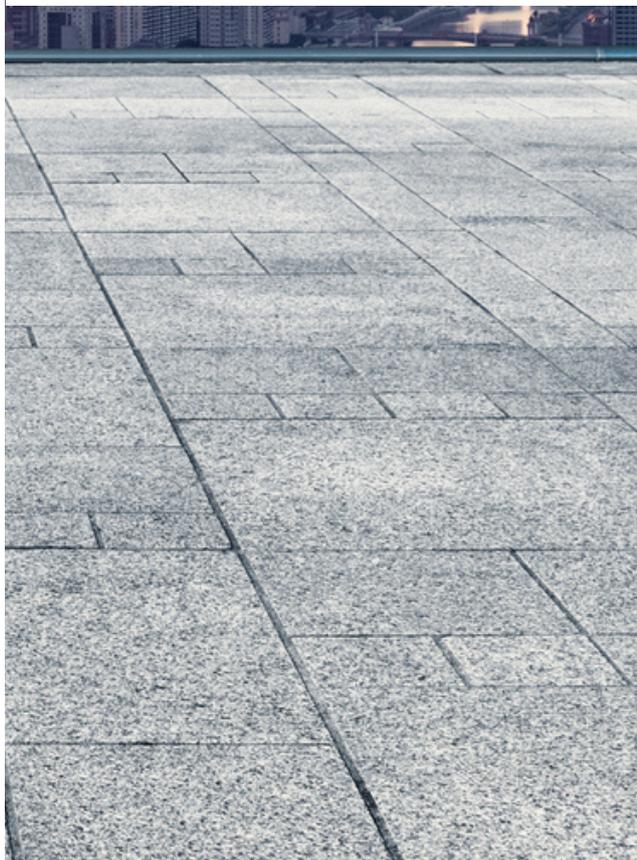
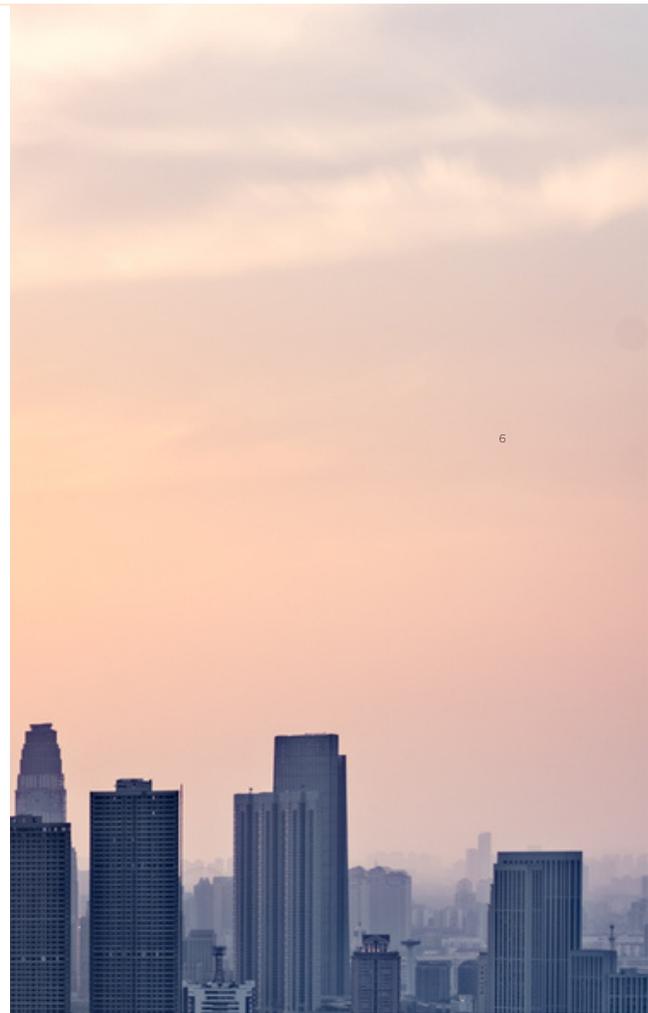
The market is defined in the Market Value basis of value as being:

30.3. The concept of Market Value presumes a price negotiated in an open and competitive market where the participants are acting freely. The market for an asset could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of market participants. The market in which the asset is presumed exposed for sale is the one in which the asset notionally being exchanged is normally exchanged.

In order to determine the “estimated amount for which an asset or liability should exchange on the valuation date”, it is critical to understand the nature of the market in which the asset trades. This is because the “estimated amount” that can be obtained will largely depend upon the number of buyers and sellers in the market, and the ability of those buyers and sellers to have access to that open and competitive market. The market could be categorised or described by various criteria which might include one or more of the following:

- The goods or services that are traded, often known as an asset class
- Geography, which may include local through to international borders
- Legal, licencing, regulatory or capital requirements

When considering an open and competitive market, it should be noted that the size of markets can also be categorised according to a number of factors such as the volume of trade and price of the assets traded. In some instances, the market may consist of a limited number of participants, but it is still an open and competitive market. For some asset classes, participants may be able to purchase certain interests in an asset (i.e., an equity interest via a public stock exchange), but they may be precluded from purchasing an asset outright because of licencing or regulatory restrictions. In all cases, valuers must consider the relevant market in which the asset is traded and the bidders for the asset, so they do not overestimate or underestimate Market Value.



While at any point in time an open and competitive market may be self-contained and be little influenced by activity in other markets, over a period of time markets will often influence each other. For example, on any given date the price of an asset in one jurisdiction may be higher than could be obtained for an identical asset in another. If any possible distorting effects caused by government trading restrictions or fiscal policies are ignored, suppliers would, over time, increase the supply of the asset to the location where it could obtain the higher price, and reduce the supply of an asset to the location where the price was lower, thus bringing about a convergence of prices.

It should be noted though that open and competitive markets rarely operate perfectly with constant equilibrium between supply and demand and an even level of activity. Frequent market imperfections include disruptions of supply, sudden increases or decreases in demand or asymmetry of knowledge between market participants. Because market participants react to these imperfections, at a given time a market is likely to be adjusting to any change that has caused disequilibrium. Since Market Value has the objective of determining “the estimated amount for which an asset or liability should exchange on the valuation date”, it has to reflect the conditions in the relevant market at that time, and not an adjusted or smoothed price based on a supposed restoration of equilibrium. As such, the definition of Market Value doesn’t change as levels of uncertainty rise and fall, what changes is the prevailing market conditions which requires the valuer to undertake a forensic examination of the market.

Whilst the Market Value basis of value gives a number of cues as to how the valuer should consider the ‘market’, it’s quite clear that the market is not:

- One where potential market participants are closed out of a transaction.
- One that unduly considers only certain types of buyers and sellers.

Despite the fact that “the market in which the asset is presumed exposed for sale is the one in which the asset notionally being exchanged is normally exchange”, the valuer should ensure that the highest and best use premise is being considered in line with IVS 104, section 30.4 of the Market Value basis of value being:

30.4. The Market Value of an asset will reflect its highest and best use (see paras 140.1-140.5). The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset’s existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.

For example, if the valuer is considering agricultural land with residential development potential that meets the highest and best use criteria then this should be reflected in the valuation.

What is the Market Value conceptual framework?

Market Value is defined in IVS as:

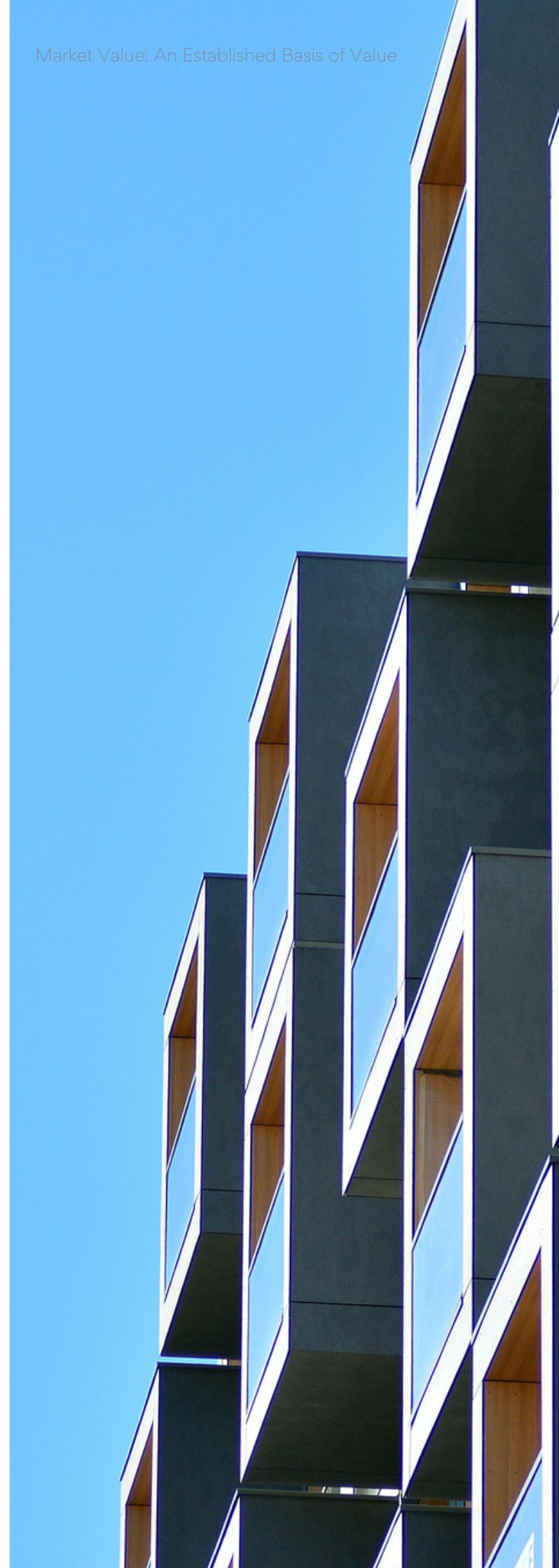
‘estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

Whilst the basis of Market Value is commonly known, along with this definition, the conceptual framework within which it must be applied is infrequently quoted in valuation reports. Contained within IVS 104 Bases of Value, the Market Value conceptual framework includes direction on many of the aspects of the Market Value definition, including:

- What is 'the estimated amount'?
- How do you define 'a willing buyer' and 'a willing seller'?
- What is an 'arm's length transaction'?
- How do you define 'proper marketing'?
- What differentiates parties that have acted 'knowledgeably, prudently' and 'without compulsion'?

The conceptual framework can be useful for valuers when deciphering different forms of market evidence on offer when undertaking a valuation but is particularly helpful from an educational standpoint when providing guidance to clients and broader valuation stakeholders.

Careful consideration of not only the definition, but also the conceptual framework can be invaluable in every valuation incorporating the basis of Market Value. A full extract of the Market Value basis of value, including the conceptual framework, has been included as an addendum to this perspectives paper in full for ease of reference.



Is Market Value only backward looking?

In the first Perspectives Paper, we considered the criticism by some commentators that Market Value is backward looking and therefore not as relevant when markets are in flux.

It was quite clear from the feedback of the first Perspectives Paper that this criticism is unwarranted. To re-emphasise the view of the TAB, the Market Value definition considers all evidence, which may include forecasts and projections. The objective of the valuer is to ensure that they examine all evidence and relate to a point in time called the valuation date. The premise of Market Value is time specific which is essential to every valuation assignment.

If the observation by some commentators is that Market Value is backward looking, the issue is not with the definition of Market Value itself. Rather, it's likely that insufficient allowance is being made for changes in the market between the date of transactions which may be considered comparable evidence, and the valuation date.

Similarly, this doesn't mean that Market Value can't be forward looking. When forecasting cash-flows when using an income approach to value, valuers do have consideration to the future benefits market participants would expect.

Transactions themselves that occur in the market are the result of this very forward-looking thought process. Once again, the premise of Market Value is a reflection of the anticipated future benefits as of a single point in time called the valuation date. To arrive at this point in time, the forecasted future benefits and the risks associated with them are discounted by the valuer using a discount rate that is appropriate for that point in time.

It is imperative that the valuer carefully considers the relevant market evidence available (forecasts being future cash flows or benefits, sideways being current transactions or market indicators, and backwards being historical transactions where necessary), compares that appropriately to their subject asset, and makes the necessary adjustments to that comparable evidence to ensure that the subject asset is valued appropriately as at the valuation date.

Finally, it was noted that some clients may wish to use (or have updated) an existing valuation report, whose valuation date has past. Valuations may be valid for a period of time after the reported valuation date depending upon the asset class, valuation purpose and market events.

The TAB would note that technically, a valuation is only valid on the relevant valuation date, simply because market dynamics and value can change quickly

over a short period of time. Where jurisdictional allowances are made for a valuation to be utilised over an extended period of time however, we would emphasise a high level of caution with such assumptions.



Are the 'peaks' and 'troughs' truly captured when using a Market Value premise?

So if Market Value is not backward looking, are the 'peaks' and 'troughs' truly captured when using the basis of Market Value?

In this regard, the valuer needs to have specific consideration to the market evidence at the time, but in particular they need to ensure that the evidence that they are using is consistent with the definition of Market Value. This will include making sure that transaction evidence is not only occurring 'between a willing buyer and a willing seller' but that also that 'the parties had each acted knowledgeably, prudently and without compulsion' to name but a few considerations.

Not all transactions are good sign posts for Market Value. When buyers are not acting knowledgeably, prudently or without compulsion but instead are behaving with exuberance and paying unsustainable prices or sellers are accepting irrational prices out of desperation to quickly sell – these are not examples of Market Value evidence.

It is vital that valuers discern themselves between evidence and comparable evidence. Evidence that does not match the characteristics of the Market Value definition should be considered carefully by the valuer.

How does the valuer utilise assumptions and special assumptions with Market Value?

IVS 104 Section 200 states that:

200.1 In addition to stating the basis of value, it is often necessary to make an assumption or multiple assumptions to clarify either the state of the asset in the hypothetical exchange or the circumstances under which the asset is assumed to be exchanged. Such assumptions can have a significant impact on value.

200.2 These types of assumptions generally fall into one of two categories:

- (a) assumed facts that are consistent with, or could be consistent with, those existing at the date of valuation, and*
- (b) assumed facts that differ from those existing at the date of valuation.”*

Where assumed facts differ from those existing at the valuation date then these are “special assumptions” that can be “used to illustrate the effect of possible changes on the value an asset”. In some jurisdictions, these special assumptions can be referred to as Hypothetical Conditions, such as in Uniform Standards of Professional Appraisal Practice (USPAP) 2020-2021:

*Hypothetical Condition: a condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results but is used for the purpose of analysis.*¹⁰

Comment: Hypothetical conditions are contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis.

Though the use of assumptions and special assumptions may be necessary to perform a valuation, the valuer needs to exercise caution to ensure that the special assumptions used are not so far removed from the Market Value definition that it would be better to consider another basis of value that is more suitable for the purpose of the instruction. IVS 104, section 200.5 makes clear reference to this:

200.5. All assumptions and special assumptions must be reasonable under the circumstances, be supported by evidence, and be relevant having regard to the purpose for which the valuation is required.

A photograph showing two 'FOR LEASE' signs. The top sign is a long, horizontal sign with the words 'FOR LEASE' in large, bold, red capital letters on a white background. Below it, a smaller, similar sign is mounted on a post. The background shows a modern building with glass windows and some greenery.

FOR LEASE

Summary

Based on the feedback presented to the TAB following our first Perspectives Paper, the response is that Market Value is an established, resilient, and sound basis of value.

What has been highlighted as part of this series are the perceived challenges of Market Value from clients, valuation users and market commentators alike. These challenges would generally appear to be an educational void that can often be resolved by way of better communication both within valuation reports, as well as by the ongoing conversations that valuers are having with this broader valuation stakeholder group.

From here it is perhaps timely that we return to the same conclusion that was presented as part of the first perspectives paper:

Whilst all of these situations make the valuation profession challenging, it's a situation where a valuer's experience and skill set comes to the fore. There is no better professional at hand to advise on value than a valuer in these uncertain times. By utilising commonly accepted valuation standards and guidance to educate and communicate valuation matters, the valuer is a vitally important resource to their stakeholders, to act above all in the public interest.

At the same time, it is imperative that as valuation professionals we continue to listen to these valuation stakeholders to ensure that both the Market Value basis of value, and the broader International Valuation Standards that underpin valuations, continue to meet the demands of the market with adequate guidance for the resolution of these perceived challenges.

The IVSC will continue to monitor the topics in this article and would welcome your insight and feedback in order to understand what ongoing issues (if any) you or your stakeholders continue to have with the use or interpretation of Market Value in your jurisdiction.

Please forward any further feedback to the IVSC Tangible Asset Board via the following email: contact@ivsc.org

Addendum: IVS-Defined Basis of Value – Market Value

30.1. *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.*

30.2. *The definition of Market Value must be applied in accordance with the following conceptual framework:*

(a) *“The estimated amount” refers to a price expressed in terms of money payable for the asset in an arm's length market transaction. Market Value is the most probable price reasonably obtainable in the market on the valuation date in keeping with the market value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of value available only to a specific owner or purchaser.*

(b) *“An asset or liability should exchange” refers to the fact that the value of an asset or liability is an estimated amount rather than a predetermined amount or actual sale price.*

It is the price in a transaction that meets all the elements of the Market Value definition at the valuation date.

(c) *“On the valuation date” requires that the value is time-specific as of a given date. Because markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the market state and circumstances as at the valuation date, not those at any other date.*

(d) *“Between a willing buyer” refers to one who is motivated, but not compelled to buy. This buyer is neither over-eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires. The present owner is included among those who constitute “the market”.*

(e) *“And a willing seller” is neither an over-eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the asset at market terms for the best price attainable in the open market after proper marketing, whatever that price may be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner.*

(f) *“In an arm’s length transaction” is one between parties who do not have a particular or special relationship, eg, parent and subsidiary companies or landlord and tenant, that may make the price level uncharacteristic of the market or inflated. The Market Value transaction is presumed to be between unrelated parties, each acting independently.*

(g) *“After proper marketing” means that the asset has been exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the Market Value definition. The method of sale is deemed to be that most appropriate to obtain the best price in the market to which the seller has access. The length of exposure time is not a fixed period but will vary according to the type of asset and market conditions. The only criterion is that there must have been sufficient time to allow the asset to be brought to the attention of an adequate number of market participants. The exposure period occurs prior to the valuation date.*

(h) *“Where the parties had each acted knowledgeably, prudently” presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the asset, its actual and potential uses, and the state of the market as of the valuation date. Each is further presumed to use that knowledge prudently to seek the price that is most favourable for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the valuation date, not with the benefit of hindsight at some later date.*

For example, it is not necessarily imprudent for a seller to sell assets in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other exchanges in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.

(i) *“And without compulsion” establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.*

30.3. *The concept of Market Value presumes a price negotiated in an open and competitive market where the participants are acting freely. The market for an asset could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterised by a limited number of market participants. The market in which the asset is presumed exposed for sale is the one in which the asset notionally being exchanged is normally exchanged.*

30.4. *The Market Value of an asset will reflect its highest and best use (see paras 140.1-140.5). The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset’s existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.*

30.5. *The nature and source of the valuation inputs must be consistent with the basis of value, which in turn must have regard to the valuation purpose. For example, various approaches and methods may be used to arrive at an opinion of value providing they use market-derived data. The market approach will, by definition, use market-derived inputs. To indicate Market Value, the income approach should be applied, using inputs and assumptions that would be adopted by participants. To indicate Market Value using the cost approach, the cost of an asset of equal utility and the appropriate depreciation should be determined by analysis of market-based costs and depreciation.*

30.6. *The data available and the circumstances relating to the market for the asset being valued must determine which valuation method or methods are most relevant and appropriate. If based on appropriately analysed market-derived data, each approach or method used should provide an indication of Market Value.*

30.7. *Market Value does not reflect attributes of an asset that are of value to a specific owner or purchaser that are not available to other buyers in the market. Such advantages may relate to the physical, geographic, economic, or legal characteristics of an asset. Market Value requires the disregard of any such element of value because, at any given date, it is only assumed that there is a willing buyer, not a particular willing buyer.*



International Valuation Standards Council
20 St Dunstan's Hill
London
EC3R 8HL
United Kingdom
www.ivsc.org