Subject: Professional Practice-II
Topic: Valuation
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Valuation

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Introduction

Valuation is the technique of estimation or determining the fair price or value of property such as building, a factory, other engineering structures of various types, land etc.

By valuation the present value of a property is defined. The present value of property may be decided by its selling price, or income or rent it may fetch.

The value of property depends on its structure, life, maintenance, location, bank interest, etc.

Purpose of valuation?

Buying or selling property

When it is required to buy or sell a property, its valuation is required.

Taxation

To assess the tax of property its valuation is required. Taxes may be municipal tax, wealth tax, property tax, etc., and all taxes are fixed on the valuation of the property.

Rent fixation

In order to determine the rent of a property, valuation is required. Rent is usually fixed on certain percentage of valuation (6% to 10% of the valuation).

Contd.

Compulsory acquisition

whenever a property is acquired by law compensation is paid to the owner. To determine the amount of compensation valuation of property is required.

Insurance

For the purpose of taking out an insurance policy of the property, the owner desires to know the replacement value of the property . In this case , the value of land is excluded or omitted.

Security of loans or mortgage

when the loans are taken against the security of the property, its valuation is required.

Contd.

Speculations

When a purchase is intended for sale of the property and make some profit, a short period valuation is necessary for that purpose and this is known as speculative value. Generally speculative value is lesser than the market value.

Court fees

When a case has to be filed with respect to a real estate, it becomes necessary to affix stamp of suitable amount. This amount is worked out after arriving at the value of the property under dispute.

Gift tax

When a property is gifted, valuation of the gifted property is necessary to pay gift tax to the government by the person whom the property has been gifted

Contd.

Betterment charges

when the property comes under some town planning scheme of the area, its value increases and consequently, the owner of the property is required to pay additional tax, known as the betterment charges. It becomes, therefore necessary for the property to know the value of his property before and after completion of town planning schemes.

Balance sheet

Sometimes, a company requires valuation of its premises for the purpose of showing them in the balance sheet.

Types of valuation

Book value:

It is an original investment shown in the account books of a company on its assets including properties and machineries, less any allowance for the period passed.

Scrape value:

Scrape value is the value of the dismantled material. That means after dismantle we will get the steel, brick, timber etc. In general the scrape value is about 10 % of total cost of construction.

Scrape value = sale of useable material – cost of dismantling and removal of the rubbish material.

Salvage Value:

It is the value of the utility period without being dismantled. we can sale it as a second handle.

Depreciation

It is defined as the gradual decrease in the value of a property because of constant wear, tear and decay etc.

The rate of depreciation depends upon the longevity of utility period neglect of maintenance etc. of a property.

Method of Depreciation Calculation

1.Straight Line Method

2.Constant percentage method

3.Sinking fund method

Obsolescence

The value of property or structures become less by its becoming out of date in style, in structure in design, etc. and this is termed as Obsolescence.

Sinking fund

It is the fund which is built up for the sole purpose of replacement or reconstruction of a property when it loses its utility either at the end of its useful life or becoming obsolete.

The fund is regularly deposited in a bank or with an insurance agency so that on the expiry of period of utility of the building, sufficient amount is available for its replacement.

The calculation of Sinking Fund depends upon the life of a building as well as upon the rate of interest and it is generally calculated on 9/10 of the cost of construction as the owner will get 10% as scrape value of the building when the life of the building is over.

Valuation of land

- Valuation of land is done by one of the three methods as and where applicable.
- 1. Comparative method
- 2. Belting method
- 3. Hypothetical building schemes

Mortgage

- A mortgage is a loan in which property or real estate is used as collateral. The borrower enters into an agreement with the lender (usually a bank) wherein the borrower receives cash upfront then makes payments over a set time span until he pays back the lender in full.

A leasehold property

The leaseholder is known as lessee and holds the physical possession(under) of the property for the definite period under terms and condition specified in the lease document.

The different types of leases:

- Building lease
- Occupation lease
- Sub-lease
- Life lease
- Perpetual lease

Annuity

Is the annual periodic payments for repayments of the capital amount invested by a party. Annuity is either paid at the beginning or at end of each period of installment.

Fixation of rent

The rent of building is fixed upon the basis of certain percentage of annual interest on the capital cost and all possible annual expenditure on outgoings.

The capital cost includes the cost of construction of the building, the cost of sanitary and water supply work and the cost of electric installation and alteration if any.

The cost of construction also includes the expenditures on the following: a) raising, leveling and dressing of site b) construction of compound wall, fences and gates c) storm water drainage d) approach roads and other roads within the compound.

Gross income

Gross income is the total income and includes all receipts from various sources the outgoing and the operational and collection charges are not deducted.

Net income or net return

This is the saving or the amount left after deducting all outgoings, operational and collection expenses from the gross income or total receipt.

Net income = Gross income – Out goings

Out-going

Expenses incurred to maintain the property by undertaking periodical repairs. It also includes taxes levied by the Govt. or local body on that property. Sinking fund, insurance, etc.

Year’s purchase(Y.P.)

The capitalize value which needs to be paid once for all to receive a net annual income of Re 1 by way of interest at the prevailing rate of interest in perpetuity (i.e. for an indefinite period) or for a fixed no. of days.

Cost

The term cost is used to indicate the actual amount incurred in producing a commodity.

Cost means the original cost of construction and can be known after accounting all day-to-day expenditure from the very planning stage till the construction is completed.

The expenditures or charges represented directly in the commodity produced are called the **prime costs.**

Other expenditures or charges like rent, management, services, salaries, depreciation, etc. represented indirectly in the production of the commodity are called the **supplementary costs.**

Standard rent

Rent which would be permissible under the law to be charged from a tenant.

Market rent

It is the rent that a willing landlord might reasonably expect to receive, and a willing tenant might reasonably expect to pay for tenancy, in comparison with rent levels for similar properties in similar areas at that time.

Thank You