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Model for the market valuation of public, “quasi-market” properties, using the valuation of a museum building as an example

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Abstract

One of the less explored areas in the profession of property valuation is the assessment of the market value of publicly owned or used properties (such as roads, public utilities, parks or prisons). In particular, the “quasi-market” segment, which partly operates according to market mechanisms, is the most challenging point. Hospitals, theatres and museums are examples of such “quasi-market” public properties. Such projects have some market revenues; however, these are not enough to provide a return on the invested capital. Advanced methods of decision-support and analysis have been developed regarding public investments, and the modern technical literature studies the measurement of consumers’ willingness to pay (WTP) intensively. Building on these foundations and using a museum as an example, the author proposes a framework which follows the logic of market valuation and facilitates the Market Value appraisal of “quasi-market” properties based on uniform principles.

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1. Introduction

The discipline of property valuation mainly deals with the value appraisal of market players’ various assets. The different standards, specifications and methods typically focus on appraising the so-called Market Value. According
to the definition developed by TEGoVA†, “Market Value is the estimated amount for which the property should be exchanged on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.” This definition assumes a functional, active market, as well as sellers and buyers in the segment of the property examined. Several well-functioning methods have been developed based on this definition, which are used by professionals regarding “market” assets without any problems. However, difficulties arise when there is no market context at all, or it is highly specific. Such is the case for a wide range of public properties: there is no active market for public utilities, roads, bridges or churches, while the market is very limited, for example, with regard to prisons, museums or educational buildings. Of course, there are some public properties that are marketable in a certain market segment: administrative buildings can be placed on the office market, while doctors’ surgeries can be put to the test in the retail market. This article deals with the issue of the valuation of “quasi-market” properties, which are the most difficult to manage from a property valuation aspect. In order to facilitate understanding, a museum building will be used as an example. This case study has been chosen because the construction, restructuring and operation of museums go way beyond the technical issues of the property industry; art historians, museum educators and the whole of society all express their opinions regarding these facilities [1].

In the first part of the article, the authors present the project appraisal solutions normally used in public decision-making and, in the second part, the procedures developed based on user experience. In the third part, these approaches are contrasted and critically analysed, while the fourth part of the article proposes a theoretical framework for the market value appraisal of the museum used as an example, by combining the above concepts. This framework can be extended to appraising the Market Value of all public, “quasi-market” properties.

2. Valuation methods used in public decision-support

In the United States, the question whether the value of a public facility (or railway line, if applicable) can be different based on whether it is appraised for public or business purposes was already a subject of dispute in 1915. Butler [2] enumerates the arguments still often used today, which assign lower end user prices to public goals (opening up markets, jobs, travel) and the reasons that the community may not want to pay the actual costs of the rail tracks – still, in this article of 1915, the author clearly argues that the public also has to pay the actual market value of an investment (through the price of train tickets). It is important to note that this collection of arguments assumes the presence of private investors and corporations and is based on their expectation on returns.

Investment criteria and expected return in the public sector, however, are inevitably different from those of the private sector. In the event of a public investment, risks are also different, since the financial surcharges that private investments have to recover virtually do not arise in this case. In the public sector in the UK, a fixed expected return is applied in corporate decision-supporting calculations (the 6% value that was used in 1997 has been reduced to 3.5%). It is assumed that the expectation on returns is equal to the financing costs, which is absolutely not true in the private sector [3]. However, Brealey argues that the cost of capital should still be recorded on a market basis, as a kind of “opportunity cost”. He claims that the only difference in the appraisal is the fact that, with regard to public enterprises, the profit before taxes has to be entered in the cash flow, unlike in the practice of appraisals intended for market players, since taxes also accrue to the government.

Since 1998, the introduction of railway services in Japan is always preceded by a mandatory Cost-Benefit Analysis (CBA) [4]. The analysis is prepared from the perspective of both the user and the – usually private – investor, as well as the environment; it measures the NPV, CBR and economic IRR, calculated based on a fixed yield for the entire time frame of the project. User preferences are assessed with a detailed opinion poll carried out every five years. The value of travel time as an input to CBA was defined differently for each metropolis; in Tokyo, for example, the value/cost of one minute of travel time was JPY 47 in 2010.

† TEGoVA: The European Group of Valuation Associations; European Valuation Standard, 2016 Edition
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