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VALUATION OF AN OPEN PLOT BY HYPOTHETICAL DEVELOPMENT METHOD

[1]Prasad Dilip Brahme, [2]Dr.Nitin Bharadiya, [3]Dr. P.L. Naktode
[1]MTech (Valuation Land & Building) Student, [2]Associate Professor, [3]Professor & Head of Department
[1] Department of Civil Engineering,
[1]Sandip University, Nashik, India

Abstract: Hypothetical method of Valuation is adopted for valuation of properties which have latent potential for development and for valuation of those properties whose net value can be increased by capital expenditure. Such properties which have the latent potential for development are called “Development Properties” and the Valuation for such properties is done based on “Hypothetical Method or “Development Method” This method is adopted only in special cases of specific purpose also this method of valuation is an effective tool which provides the right value for the stakeholders to make accurate & appropriate financial decisions.

Index Terms **- Valuation, residual value, development potential, legal aspects, technical aspects.**

I. INTRODUCTION

1.1 General

The hypothetical development method of land valuation is indirect method of deriving land rates by residual technique and by direct comparison of open land sales. This technique involves preparation of hypothetical building project scheme first.Then works out of sale value of property design and planned under hypothetical building scheme. After deducting for profits, cost of construction, management expenses and other outgoings involved in the implementation of project from the total sale proceeds, net values are worked out. This net value balance is taken out as value of land component and land rate is derived there from on the basis of area of the plot.

Definitions:

Market value - Market value is an estimated amount for which asset can be exchange on the date of valuation between willing buyer and willing seller in arm’s length transaction after proper marketing wherein both the parties act knowledgeably, prudently & without compulsion

Forced sale value / Distress value - A Forced sale value is the estimated amount that a would receive If the asset is sold out with less compensation without proper marketing condition and unwilling seller. Generally, We take Forced sale value is 70% of Fair market value of the property.

Reliazable value - The realizable value is the value of an asset that can be realized upon the sale of the asset, less and reasonable estimate of the costs associated with the eventual sale or disposal of the asset. The realizable value is taken 90-85% of the present fair market value of the property.

1.2 Various aspects in valuations :

1.2.1 Legal aspects -

Any known legal impediments on transfer, any restrictive covenants, easement right, details regarding zoning and other relevant DCRs, N. A. permission details etc. Effect of any planning proposal or acquisition proceedings. Details of pending financial liability if any, affecting value of the property. There is no any reservation on the property area and no any pending financial liability on the property. Some area will be going under road widening, the FSI is for Residential 1.1

Following are some Legal factors affecting value of the property:-

1. Social legislation like – The Rent Control Act 1948
2. Land reform legislation like: The Urban land (Ceiling andregulation) Act 1976.
3. Ecological restriction like Coastal Regulations.

1.2.2 Social aspects -

Availability of infrastructural, civic and social facilities. like Transportation, water supply, sewerage disposal, communication, electricity, religious facility, education and health care, market, local bus terminal & many more.

1.2.3 - Economic aspect -

Type of locality, description with respect to demand and supply, population trend in that locality and other relevant matters. The property situated at Middle class locality, Demand for this type of property is high, young population is near locality. Density of population is moderate, economic condition of the people in that area is good.

1.3 Need of Study

A client who owns a development property like a large piece of urban land and wants to sell it. He would like to know the reserve price or the Percentage of ownership in the developed property after development.
A developer client would like to know whether the Property Development in a development property like a Land for developing an apartment complex is viable or not and at what cost he can purchase the land.
In case of development projects where project appraisal is required for business decisions to find out the best development model among mutually exclusive development models to yield maximum returns.
Assessment of Transferable Development Rights (TDR) provided by the local bodies in major cities.

1.4 Problem Statement

The residual method is based on the concept that the value of a property with development potential is derived from the value of the property after development minus the cost of undertaking that development, including a profit for the developer.
In equation form that is
gross development value (GDV) - total development costs (including profit) = residual land value

1.5 Objectives of study

The main objectives of this study are

1. To determine the valuation of open plot by Development method of valuation
2. To cross verify the valuation by open plot by development method & valuation by market approach
3. To study the effectiveness of development method over the other conventional practices
4. To check the feasibility or viability of the any proposed projects for the investor

II. LITERATURE REVIEW

Josef Kupec & Petr Dlask (2020) This paper comments on assumptions and the technique how it is particularly suitable for property under construction and land valuation & its sensitivity. In real estate valuation it is necessary to understand the economic potential of the property. The residual value is in many cases the only possible way how to determinate market value of the undeveloped land or property under construction which is important for investors, banks or auditors. The methodology of calculation for residual method is described in several valuation standard. These standards are usually very general so they can be applied in different markets. The residual method of valuation is very sensitive to changes in key inputs. Small changes in variables such as sales volumes or build costs will have a disproportionate effect on residual value. The article is focused on the sensitivity of the residual method to changes in key inputs. Sensitivity analysis is tested on a model suitable especially for commercial real estate valuation and reflect current market conditions.
Boshoff, D.G.B. (2011) The paper provides assurance to valuers, as well as other built environment practitioners of the credibility of the method, with a practical example.The professional valuers often experience difficulties to perform accurate valuations due to a lack of comparable information. Reliance have to be made to alternative methods in order to quantify the value of a property. One such an approach is the development approach. There are however a lot of criticism and resistance in using the approach, which is sometimes due to valuers not understanding the method, or the variables involved, but also due to the sensitivity of the approach. The study considers theory as well as some legal cases pertaining to the use of the method, and explains it by way of a practical case study in order to show the basic method, where it is used, and the main shortcoming of the method for which valuers must be wary. The paper finds that the development approach is an acceptable method of valuation, even though full information on development variables are not available, and shows what to treat with caution in order to obtain an accurate result

Harish Tahilramani (2015) tells about the real estate market experience fluctuations in market values for, residential as well as commercial properties. To study variations in values of commercial properties, i.e. shops study was carried out in the Sayajigunj area of Vadodara city, Gujarat for the period 2001 to 2010. The variations in the values of shops were studied with respect to the variations in the rate of interest on investments.

Khazan Chandra (2015) tells about valuation for cost of construction by CPWD plinth area rates. The assessment of investment cost in the building is called the valuation of construction cost. This is generally required by financial institute's income tax department to compare with the investments shown by the owner in their account and sometimes for the other purpose as family disputes or other reasons. Thus the derivation of the construction cost should be as nearer as possible to the actual cost. Here the author is dealing with the valuation of investment cost for the purpose of income tax.

Abhishekh Golcha (2016) the aim of this work was to study the market value of building for bank finance purpose which is situated in urban , semi urban and rural area of Chhattisgarh, India. This study helps to bank to know the actual condition of building and simplify the bank finance amount to owner of the property. The valuation of property helps to both owner of the property and the bank to know the actual rate of the property.

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III. METHODOLOGY

3.1 General

The methodology of work is divided into following steps namely Adopting appropriate method, documents collection, verification of documents, property visit, calculations and results.

3.1.1 Adopting appropriate technique for carryout valuation

Development method or residual method is selected for carry out further valuation process

3.1.2 Document Collection

Documents required for valuation are collected which includes:

1. Copy of Collector NA order
2. Copy of approved layout
3. Copy of Registered Sale Deed of land
4. Copy of 7/12 extract

3.1.3 Documents Analysis

Verification of all documents as per the guidelines given by respective authorites is done.

3.1.4 Property Visit

It is required to verify that subject property is demarcated as per the norms & regulations or not by visiting the property physically.Property is visited and inspected thoroughly. Checking the present condition of the property, boundaries of the property

3.1.5 Analysis

Total land area =1396.64 sq.mt
Zoning = Residential zone
Permissible F.S.I. = 1.1
Permissible build up area = 1536.30 sq.mt.
Proposed build up area = 725.65 sq.mt.
No. of units = 8
Build up area per unit = 90.70 sq.mt.
Assuming build up area of 90.70 sq.mt. for one unit of row house of 2BHK, we can construct 8 units. Considering salable rate for one unit of row house prevailing in that area as Rs.33,000 Per sq.mt. of buildup area.

SALE PRICE = Salable rate x Area of one unit x Total units.
= Rs. 33,000 x 90.70 x 8
= Rs. 2,39,44,000/-

Considering sale period of 2 years, deferring the sale price by calculating presents value of it, i.e., Rs. 2,39,44,000 x 0.917
= Rs. 2,19,57,382/-

Cost of construction including each and every amenities including staircase, compound wall water tank and gate, garden etc.
= Rs. 10,000/- per sq.mt. x 725.65 sq. mt.
= Rs.72,56,500/-

Architect's fees = 3 % of construction cost,
= 0.03 x 72,56,500/-
= Rs. 2,17,695/-

Developer's profit = 20 % of sale price,
= 0.2 x 2,19,57,382
= Rs. 43,91,476/-

Cost of advertisement and Brokerage fees = 2 % of sale price,
= 0.02 x 2,19,57,382
= Rs. 4,39,147/-

Thus, net land value,
= Income - Expense
= 2,19,57,382 – (72,56,500 + 2,17,695 + 43,91,476 + 4,39,147)
= Rs. 96,52,564/- say Rs. 96,53,000/-
Fair market value = Rs. 96,53,000/-

Realizable value = 90 % of market value
= 0.90 x 96,53,000/-
= Rs. 86,87,700/-

Force sale value = 70 % of market value
= 0.70 x 96,53,000/-
= Rs. 67,57,100/-

IV. RESULT & DISCUSSION

As considered above information & visit the Present fair market value of the subject property is` 96,53,000 /- (Rupees Ninety-Six lakhs fifty-three thousand only)

Realizable Value is `86,87,700 /- (Rupees Eighty-six lakhs eighty-seven thousand seven hundred only) Forced Sale

Value is ` 67,57,100 /- (Rupees Sixty-seven lakhs fifty-seven thousand one hundred Only)

The above report is prepared as per the instruction of the owner of the property. And the documents and information provided by owner on the basis of that we visited the property and estimate the values.

V. CONCLUSION

In this case study of Development method of valuation is explained in details. This study states that complete methodology of valuation in very decent manner which is simply to understand to the valuers while doing actual work in real estate market.If we looked at the government guideline value and market value there is a huge difference due to the exponetial growth of the city and vicinity of property. As per the study done in this case study , we observed that there is a huge difference in Government value and Market value of property.

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