

# Evaluation Methods of the Real Estate Goods

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The theme represents a synthesis of the evaluation methods of a real estate good. The used evaluation method but especially their results have a special significance to the company but also a decisive role for the crediting officer as the financing decision is influenced by the reached values.

**Keywords:** real estate good, market, evaluation, direct comparison method, cost approach, income approach.

**JEL Classification:** G32, G33, C39

## 1. Introduction

In the contemporary era, building evaluation gained significant importance, with a great influence for those who own a business. Thus, judicial persons who own a building are imposed at a level that is established through the decision of the Local Council.

This tax varies between 0,25% and 1,5% of the inventory value for the buildings that are part of the patrimony, for which the judicial persons have made at least one reevaluation during the last three years prior to the reference year of taxation. Companies that made no building reevaluation during the last three years prior to the reference year of taxation make the subject of a level of taxation between 5% and 10%.

Also, the choice of the most adequate approach or evaluation method depends on the consideration of the following: the adopted value type, determined by the evaluation objective, the availability of the entrance data and of the evaluation information, the approaches or the methods used by the participants on the relevant market.

In order to reach an as possible as accurate preview on the value, one can use, one, two or three approaches, especially if there are not sufficient entry data for the evaluation, as to reach a viable value by using a single approach.

Building evaluation is also needful to crediting officers as, lately they have put pressures in order to raise the value, thus pleasing the client and raising the market share of the bank, in turn, in the actual economic framework, risk departments make pressures to lower the evaluated value, aiming at protecting the bank and not willing to give risky credits during the actual lack of liquidities.

Big companies feel the pressure to make ordered evaluations for financing thirsty important investors. The solution emerges from the nature of the profession, by choosing the adequate methods of the situation, according to standards. In case we choose the market comparison method, it is very useful for the active markets, but it can represent a failure when transactions are quasi-blocked. In turn, the costs method can be once again useful, especially for new developments.

## 2. Evaluation premises

The casuistic consists of the evaluation of a real estate good located in Galati, represented by a field and the building on it, the surface is 250 sqm (251 according to the measurements) and the construction on this building, with a height regime of S+P+1F+ Attic, with the following surfaces: the basement has a useful surface of 65,45 sqm and the total surface is 125,7 sqm, the ground level has a useful surface of 103,48 sqm and a total surface of 132,4 sqm, the first floor has a useful surface of

105,23 sqm and a total surface of 132,4 sqm and, the last, the useful surface of the attic is 107,46 sqm, respectively a total surface of 140,25 sqm.

The evaluation objective consists of the market value estimation in order to continue the activity of the real estate good at the data of evaluation, January 15<sup>th</sup> 2015, to inform the Creditors' General Council. To reach this objective, we started from the evaluation mission indicated by the client and from the particular situation of the company willing to receive a credit as it is at a standstill. In the case of this evaluation, the company is the client and the recipient is Banca Transilvania S.A.

Considering the specific of the evaluation mission in the case of the present approach, one considered aspects of the International Valuation Standards: IVS 230 Rights on real estate property.

### **3. Property description**

The structure of the building consists of ferroconcrete and GFC masonry and PVC joinery with double pane glasses, Lindab house top on timber support. The finish consists of floor tiles and crockery in the bathrooms and the hallways, wood flooring in the rooms, the walls are covered in washable paint, floor tiles in the trading space at the ground floor. The heating equipment with own gas thermal power stations and steel heaters, air conditioning system. The basement finish is: concrete floor, rough-cast concrete wall, and the attic has double pane glasses.

Subdivisions: Basement – depositing space; Ground floor – commercial space, coffee shop; First floor – Bowling area; Attic – living area, no information regarding reconversion authorizations was provided.

The area the building is located is a mixed one, designed for trading activities. No environmental problems were identified during the visit. Field topography: plain, rectangular shape.

As for the use of the analyzed property, it was rented as a commercial space and recreational activities space. The paid rent is estimated at 1500 euro/month, but, in the near future, the contracts will be renegotiated.

#### **3.1. The analysis of the market it operates on**

In order to evaluate the real estate property located in Galati, the real estate market specific to commercial spaces from Galati was analyzed.

First of all, one analyzed the demand which can be defined as the number of properties with the same features for which the desire or renting will is expressed, at different prices, on a certain market, during a period of time, as the volume of the demand determines the attractiveness of a property.

The field of street trading spaces is featured by the high availability of the offer, due to the incapacity of tenants of financially supporting the leasing contracts. Though the tenants' interest remained constant for this type of properties, the tenants' flow that occupy, respectively set free the commercial spaces provides a high uncertainty degree for this field. The most active tenants remain the supermarkets, which take advantage of the consumers' buying behavior.

Also, the demand, representing the number of properties with the same features that are available for selling or renting at different prices on a certain market at a certain moment in time. The upper limit of the commercial spaces' rent has faced a visible decrease, due to the owners' will of maintaining the tenants that faced problems regarding their specific market. Big commercial chains, both big box and specialized shops (clothing, shoes), desire to aggressively extend at national level, to take advantage of the reduction of the occupation costs and commercial spaces adequate to their specific requirements.

The balance between the demand and the offer on the field of commercial properties of shopping centers has reflected in the stability of rents, as they vary between 35 and 50 Euros/sqm/month for the small spaces and from 6 to 12 Euro/sqm/month for the anchor type tenants according to the analyses.

For 2014-2015, I foresee the continuous extension of the hypermarkets chains (Kaufland, Cora) and the proximity, supermarket type shops. Thus, rents in the shopping centers will remain the same, but low decreases can be expected in the case of rents for street spaces, if the internal demand doesn't face any improvements.

The information sources used in the analysis of the specific market are: transactions, offers, data bases: the internet, auctions, clients, institutions. But, compared to this sources, there are some reserves: reduced inspection possibilities of traded real estate properties, high existence probability of some "atypical" elements, incomplete and partially verifiable data.

#### 4. Data analysis

##### 4.1. Direct comparison approach

The direct comparison is one of the most used techniques to evaluate the surface and the most preferred method when comparable sales are available. The objective of the direct comparison approach is to select the comparable sales or offers on the market and then to adjust the differences that cannot be removed through the selection process.

Comparison elements include property rights, legal restrictions, financing conditions, sales condition (motivation), market conditions (sale date), location, physical features, available utilities, mapping and the best use. Variables that are seen as comparison elements are the physical features of the building, namely its size and shape, its façade opening, the topography, location, the view and the utilities included.

In order to estimate the market value through the comparison, we analyzed the market to find similar properties, we gathered data on: sales, rents, offers, thus identifying the differences between them and the field to be evaluated, and we finally shaped the conclusions on the most reasonable and probable market value of the field to be evaluated.

To estimate the market value of the real estate property through this method, we used information from transactions, surface offers in the area, as well as data provided by a series of real estate agents and existing information in the specialized publications.

To determine the market value of the surface through the direct comparison method, we analyzed the specific market and we chose 3 corresponding comparables.

**Table no. 1. Direct comparison method**

Short description	Comparable 1	Comparable 2	Comparable 3
location	Morilor n. 10 Street, Galați	Unirii nr. 11 Street, Galați	George Coșbuc nr. 5Bld, Galați
Surface (sqm)	270	290	310
Street facade (ml)	14	16	11
Offer price (euro)	<b>64.800</b>	<b>65.250</b>	<b>66.650</b>

As a result, the market value of the surface, estimated through the comparison method is 63.400 Euro, corresponding to 205 Euro/sqm. In the case of the shopping center represented by comparable 1, the tenant will pay 240 Euro/sqm, it has the following structure: basement, ground floor, first floor and attic, and for a shopping space of 310 sqm located in the George Cosbuc Blvd, namely 3<sup>rd</sup> comparable, 66.650 euro will be paid for the same structure like the previous building. The offer of comparable 2 is 65.250 euro, corresponding to 225 euro/sqm for a 290 sqm surface, with basement and ground floor only.

The real estate property that is evaluated and located in Galați, has a surface of 250 sqm, and the price of each square meter is 205 euro, which can be easily paid from the incomes resulted from the services made for clients.

Thus, by evaluating through the direct comparison method, a market value of the field of 63.400 euro was reached, corresponding to 205 euro/sqm. As a result, the surface of the rented space is sufficient for the depositing, service and chill out activities.

##### 4.2. Cost approach

The cost approach is a comparative approach of the property value as a substitute for the purchase of a certain property, the possibility of building another property equivalent to the original one or a property which would have the same use and without delay costs.

The estimation of the market value of the real estate good through the cost approach supposes the summing up of: the market value of the surface (estimated through the market comparison approach), respective of the market value of the building (estimated through the cost approach). By using the cost approach to estimate the value, the market value of the analyzed property is 65.000 euro.

#### 4.3. Income approach

The income approach is a comparative approach of the value of each income generating propriety, which considers the information regarding the incomes and expenditures associated to the evaluated propriety and estimates its value by converting the income into value. The income approach estimates the actual value of the future benefits gained from the ownership of the propriety title.

To estimate the profitableness degree of the real estate propriety, one needs to analyze the specific market and extract, interpret and assimilate the information regarding the comparable proprieties' transactions. Through this type of analysis, one is to estimate as accurate as possible, the possible rent and the corresponding capitalization rate, such as the value to be as basic as possible.

The Discounted Cash Flow method is used when the property generates, in an explicit foreseen period, an unequal annual net cash flow. This method is based on the ability of the company's activity to generate positive cash-flows.

To estimate the market value of the analyzed property, we used the Income Capitalization method. As a result, the market value of the analyzed property (land + building) estimated through the Income approach is 62.000 Euro.

#### 4.4. Results reconciling

**Table no.. 2. Results centralization**

Cost approach	65.000 Euro
Income approach	62.000 Euro
Comparison approach	63.400 Euro

The income approach - the value that we have reached by using this method was used to verify the value reached through the income method

The comparison approach - as there are no transactions or offers of similar properties on the specific market (with similar surface and use), and the information on the existing comparables is not sufficient to accurately use this method, we used the comparison method to verify the result that was reached through the income approach.

The income approach - considering that the analyzed property generates incomes from space leasing, and the information on the rents that can be purchased and the corresponding costs are relevant, we chose the income capitalization method to estimate the market value of the property.

#### Conclusions

After applying the three evaluation methods we reach three different results with close values, so that the income that can be gained by choosing any method excepting the income one, can be only positive.

Even if the cost approach generated the highest value from the calculus, the society won't choose to sell the space, as the money that can be gained is not satisfying its needs. As for the comparison approach, though the sum from the calculus is higher than the one associated to the income based approach, this option is neither considered by the company that requested the evaluation, especially due to the fact that the existing differences between the values are not very high.

By confirming all the information that is displayed above, I conclude that the best choice remains the one of leasing the space as the rent generates secure and constant values for the society. Thus, the resulting amount that can be capitalized and the company can use these values after a certain period of time in order to reach the proposed objective.

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