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Features of determining the market value of retail real estate and individual trade related properties during pre-trial evaluation and forensic examination

The present article deals with the specifics of valuation of retail property and individual trade related properties on the basis of the international experience and as recommended by International Valuation Standards and RICS (The Royal Institution of Chartered Surveyors (Great Britain)) valuation standards (Red Book). The present article is justified as currently Russia lacks a standard, uniform for the valuers or legal experts, to be used for the purposes of valuation of similar subjects. At the same time, methodical literature is insufficient while there are numerous property disputes that call for pre-court valuations and expert evidence of valuation of such subjects, including numerous litigations arising out of bankruptcy or establishing cadastral value to the amount of market value.

The author reviews the existing approaches to valuation of real estate in accordance with both the international and national standards and awards professional recommendations pertaining to the use of the income approach to value retail real properties and individual trade related properties. The definitions and metrics of the above real properties' groups are described separately. Also, the author provides guidelines for inquiry of the documents and information necessary for the acquisition of the data to be used in the course of valuation and expert evidence. All pricing factors are described in detail in the present article against the examples of retail real properties and individual trade related properties (say, hotel) and explanation of their effect on the market value in case the income approach is applied is provided.

Keywords: valuation, valuation report, real estate, valuation approaches, market value, cadastral value, state cadastral valuation, property tax, bankruptcy, retail properties, individual trade related properties, forensic examination, expert opinion

Application of three methods to measure value, i.e., the cost approach, market approach and income approach, is generally accepted in the valuation methods. The economic essence of the approaches is elaborated in the International Valuation Standards (IVS) [1].

In accordance with IVS, "The goal in selecting valuation approaches and methods for an asset is to find the most appropriate method under the particular circumstances. No one method is suitable in every possible situation. The selection process should consider, at a minimum:

- the appropriate basis(es) of value and premise(s) of value, determined by the terms and purpose of the valuation assignment;
- the respective strengths and weaknesses of the possible valuation approaches and methods;
- the appropriateness of each method in view of the nature of the asset, and the approaches or methods used by participants in the relevant market;
- the availability of reliable information needed to apply the method(s)" [1].

The International Valuation Standards also set, that Valuers "are not required to use more than one method for the valuation of an asset, particularly when the valuer has a high degree of confidence in the accuracy and reliability of a single method, given the facts and circumstances of the valuation engagement".

In the Russian Federation the Federal Valuation Standards (FVS) statutorily prescribe the scope of application of the valuation approaches:

- in Section III, "Valuation Approaches", Federal Valuation Standard, "General concepts of valuation, approaches and requirements to valuation (FVS No. 1)", as approved by the Ministry of Economic Development and Trade of Russia through its Order No. 297, dated 20.05.2015 [2].
- for the real properties — in Section VII, "Valuation Approaches", Federal Valuation Standard, "Real properties valuation (FVS No. 7)", as approved by the Ministry of Economic Development and Trade of Russia through its Order No. 611, dated 25.09.2014 [3].

In accordance with FVS No. 7, "the key approaches used in the course of valuation are the market approach, income approach and cost approach. Where approaches are selected for the purpose of valuation, one should consider not only each approach possible application but also the purposes and tasks of valuation, the valuation results' intended use, assumptions, completeness and reliability of source information. Valuers substantiate the selected approaches on the basis of the above factors' analysis" [3].

The retail real estate's market value is generally measured using the market approach and the income approach in the Russian practice of valuation.

However, in the international practice target subjects, for which only the income approach is the most appropriate one as it gives the most reliable result, are separated into an individual block. Retail estate objects may be classified as such target subjects (shopping and shopping and entertainment malls),

excluding properties of the street-retail format and the so-called individual trade related properties/ITRP).

In accordance with RICS valuation practice guidance — applications (VPGAs), "certain properties are normally bought and sold on the basis of their trading potential. Examples include hotels, pubs and bars, restaurants, night clubs, casinos, cinemas and theatres, and various other forms of leisure property. The essential characteristics of this type of property is that it has been designed or adapted for a specific use, and the resulting lack of flexibility usually means that the value of the property interest is intrinsically linked to the returns that the owner can generate from that use" [4].

In other words, the value of such properties reflects their trading potential. This contrasts with generic properties which may be occupied in different purposes, for example as office premises, industrial, warehouse or street retail properties [5].

Such properties often display unique architectural and space-planning characteristics which can be hardly taken into account when the cost approach is applied, and the transactions with such properties are rare and do not have an open nature (such properties are often sold and bought in the business composition rather than as a separate and free of encumbrances asset), thus implementation of the market approach raises certain difficulties. The market approach may identify a market range within which the market value may vary but does not allow to conclude about the particular value. At the same time using the income approach brings complete and reliable information about all pricing factors which have effect on the market value of similar properties.

Currently in Russia there is no separate and uniform for all valuers or forensic experts standard of valuation of such properties and methodical literature is scarce. At the same time property disputes are numerous which call for pre-court valuation and forensic examination of the value of such properties, including numerous litigations pertaining to bankruptcy or establishing cadastral value to the amount of the market value.

For the purpose of measuring the market value of such properties it is necessary to obtain from the client (and in case of court expert examination, file a petition for request) the documents, which contain the qualitative and quantitative metrics of the target properties which will be used in the course of computations within the income approach (developing the cash flows).

For example, where the shopping centre or shopping and entertainment mall is valued, the following documents need to be analyzed:

1) extract from Unified State Register of Taxpayers (EGRN) issued with respect to the building;

2) extract from EGRN issued with respect to the land plot within which the building is located (if the land plot is leased in, the lease contract);

3) building technical certificate issued by Technical Inventory Bureau (BTI), including an extract from the technical certificate, floor plan, breakdown of premises;

4) building cadastral certificate (where available);

5) information about the general technical condition of the properties, including information about all performed and scheduled repair works, about the dates of the recent major repairs and running repairs;

6) building operating costs broken down by months for the recent calendar year, including expenses reported in items as follows:

- property tax;
- land tax or land lease rent;
- insurance;
- security services;
- utility fees;
- cleaning services;
- other (if any);

7) lease contracts if the building or a part thereof is leased out (with the structure identified: VAT accounting/not accounting, maintenance and operating expenses, accounting within the marginal rate).

Information contained in the above documents is required for the valuer and the forensic expert to perform computations within the income approach (Table 1).

To value market value of the individual trade relate properties, for example, of the hotel, other pricing factors, such as stars rate existing and their number (from 1 to 5), the number and type¹ of the rooms, rates, income structure², hotel occupancy (it may vary depending on the season), operating and maintenance expenses, etc., must be considered.

1 No uniform classification of the room type exists, the most known types are as follows: standard, de lux, suite, de lux suite, presidential suite, etc.

2 In addition to room inventory, hotels may obtain additional income from other departments: room service, restaurants, bars, conference halls, dry-cleaner/laundry services, etc.

Table 1

No.	Document title	Information contained in the document which must be noted and considered in the course of valuation or forensic examination
1	Extract from EGRN issued with respect to the building	The document is composed of several parts: 1. Part which contains information about technical characteristics. This part includes such information as the year built, walling material, number of stores, basement store, if any, functional purpose, total area. 2. Part which contains information about the registered titles. In addition to information about the owner of the subject, this part provides information about the registered encumbrances which must be recorded in the course of valuation or forensic examination. For example, the subject may be leased out for a long term. In such case information about such lease encumbrance will be cited in an extract since the lease with the term exceeding 11 months is subject to statutory registration. Where the subject is leased out, either in part or as a whole, at the uncommon rental rate, this fact needs to be taken into consideration to measure the actual value of gross income
2	Land extract from EGRN issued with respect to the plot within which the building is located (if the land plot is leased in, the lease contract)	Similar to Clause 1

End of Table 1

No.	Document title	Information contained in the document which must be noted and considered in the course of valuation or forensic examination
3	BTI technical certificate issued with respect to the building, including an extract from the technical certificate, floor plate, breakdown of premises	The document contains information about the total area of the subject, footprint area. Using the floor plan, breakdown of premises and the data acquired in the course of surveillance (object's surveillance), gross leasable area, or GLA, may be measured. Meanwhile to forecast cash flows from lease rents pertaining to shopping centres and shopping and entertainment malls, it should be remembered that not the gross area of the building or GBA is the income source. The building has common premises (for example, atrium, entry elements), and also vertically arranged communications (for example, elevators, ventilation trunks), which are not included into the leasable area. The average indicator of the share occupied by GLA in GBA (excluding parking area) is less than 70 % in the shopping centres of A class
4	Building cadastral certificate (if any)	Similar to Clause 3
5	Information about the general technical condition of the real property, including information about all performed maintenance works, dates of the recently performed major and operating repairs	Where information is available that the building requires the repair works or that any defects must be eliminated, the respective expenses must be accounted for to forecast cash flow
6	Expenses from operation of the building, broken down by months, for the recent calendar year, including expenses as follows: • property tax; • land lease rent; • insurance; • security services; • utilities; • cleaning services; • other (if any)	These expenses must be analyzed and taken into account whilst making forecast of cash flow. Where single or abnormal items of expenses are identified, those need to be normalized. Where expenses differ from the average market values, a departure reason must be identified. Possibly this is due to objective reasons and will have effect on the subject's market value. For example, due to the building's design features winter supply of heating and summer conditioning consumes more power than is required for other buildings. In such case expenses will be higher and the building value, less
7	Lease contracts, if the building is leased out either as a whole or in part (with the structure to be specified: with/without VAT, maintenance costs and operating expenses — accounting using the marginal rate)	Where the shopping centres or shopping and entertainment malls are to be valued, a key role is played by the occupancy rate and the lessees' structure. The larger the subject is, the larger its lessees' pool and aggregate information which is contained in the rent roll with the lease conditions specified with respect to each lessee — the most important object for analysis when the valuation works are performed within the income approach. Whilst performing the analysis, the following matters as below must be in the focus, specifically: Building's occupancy by the lessees (where it is below the average market indicator, the reasons must be determined. For example, the reason may be that the subject has been recently commissioned and thus is not occupied by the lessees as a whole; also, the reason may be that the concept, or transport accessibility, or flow of visitors are poor); Amount of rent rates (if the rates do not correlate with the average market values, the reasons of such deviation must be analyzed). Here one should take into account that in the modern shopping centres the rate is determined by many factors: the lessee's type, area leased in, location in the building, etc. The real property market's analysts currently observe the average lease rates (for the shopping centres and shopping and entertainment malls in Moscow) ³ (Table 2). Lease terms (short-term/long-term, accounting of VAT in the rate, utilities included in the rate, accounting of additional interest from the turnover, and etc.)

Table 2

Nature of the occupancy	Range of basic rent rates, RUB/m ² /year*	Percent of SC
Hypermarket (> 7,000 m ²)	0...8,000	1.5...4
DIY (> 5,000 m ²)	0...6,000	4...6
Supermarket (1,000...2,000 m ²)	8,000...18,000	4...6
Supermarket (450...900 m ²)	18,000...35,000	6...6
Household product (< 1,500 m ²)	0...10,000	6...10
Household appliances and electronics (1,200...1,800 m ²)	6,000...15,000	2.5...5
Sporting goods (1,200...1,800 m ²)	6,000...12,000	6...8

3 Retail.ru. URL: <https://www.retail.ru/articles/knight-frank-itogi-2020-goda-na-rynke-torgovoy-nedvizhimosti-moskv/>

End of Table 2

Nature of the occupancy	Range of basic rent rates, RUB/m ² /year*	Percent of SC
Baby stuff (1,200...2,000 m ²)	6,000...12,000	7...9
Operators of the shopping mall		
Anchors in excess of 1,000 m ²	0...12,000	4...12
Mini-anchors 700...1,000 m ²	0...14,000	6...12
Mini-anchors 500...700 m ²	0...16,000	6...12
300...500 m ²	0...25,000	5...12
150...300 m ²	8,000...18,000	6...14
100–150 m ²	16,000...36,000	10...14
50–100 m ²	25,000...80,000	12...14
0–50 m ²	45,000...100,000	12...14
Leisure concepts		
Leisure centres (2,000–4,000 m ²)	4,000...8,000	10...14
Cinema (2,500–5,000 m ²)	0...6,000	8...12
Food service		
Food-court	45,000...120,000	12...15
Cafe	15,000...90,000	12...14
Restaurants	0...25,000	10...12

* Commercial terms are negotiable. Rent rates are specified without VAT and operating expenses⁴.

This information may be obtained after the analysis of the legal person's financial statements, where the respective asset is reported in the balance sheet, and requesting the financial results statement with the detailed breakdown of the data of all income and expenses, or the management statements of a legal person which manages the respective asset (for example, an international operator).

In accordance with RICS valuation practice guidance — applications (VPGAs), individual trade related properties are usually valued based on their potential earnings before interest, taxes, depreciation and amortization (EBITDA) using the cash flow discount method or capitalization rate applied to such EBITDA [4].

Where the computations are performed within the income approach the valuer or expert need to consider that the resultant market value includes not only the value of the building and land titles but also of plant and equipment, furniture and fixtures of the target hotel and also intangible assets, including the value of goodwill transferred. Value of the target property is obtained when value of other components is deducted from the total value.

Given examples and analysis of the specifics of the methods used to determine market value of the trade properties and trade related properties (real properties used in the entertainment and leisure activities) based on the international experience and valuation standards will improve quality of the valuation reports and expert's opinions used for the purposes of forensic studies.

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Особенности определения рыночной стоимости торговой недвижимости и недвижимости, связанной с торговлей, при предварительной оценке и судебной экспертизе

В настоящей статье автор разбирает особенности оценки торговой недвижимости и недвижимости, связанной с торговлей и используемой в сфере досуга и развлечений, опи-

раясь на международный опыт и рекомендации международных стандартов оценки и стандартов оценки RICS (The Royal Institution of Chartered Surveyors/Королевское общество сертифицированных экспертов в области недвижимости (Великобритания)) — Красная Книга (Red Book). Актуальность статьи обусловлена тем, что в настоящий момент в России нет отдельного единого для всех оценщиков или судебных экспертов стандарта по оценке подобных объектов, а методической литературы крайне мало, при этом широко распространены имущественные споры, требующие проведения досудебных оце-

нок и судебных экспертиз стоимости таких объектов, в том числе многочисленные судебные споры, связанные с банкротством или установлением кадастровой стоимости в размере рыночной. В статье автор проводит обзор существующих подходов при оценке недвижимости как по международным, так и по национальным стандартам, и дает профессиональные рекомендации по применению доходного подхода при оценке торговой недвижимости и недвижимости, связанной с торговлей. Отдельно даны определения и проанализированы особенности этих групп недвижимости. Автором также даны рекомендации по запросу документов и информации, которые требуются для сбора данных, необходимых при проведении оценки и судебной экспертизы. На основе примеров с торговой недвижимостью и недвижимостью, связанной с торговлей (на примере гостиницы), в статье детально разобраны все ценообразующие факторы, и объяснено их влияние на рыночную стоимость при реализации доходного подхода.

Ключевые слова: оценка, отчет об оценке, объект недвижимости, подходы к оценке, рыночная стоимость, кадастровая стоимость, государственная кадастровая оценка, налог на имущество, банкротство, торговая недвижимость, связанная с торговлей, судебная экспертиза, заключение эксперта

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