

VALUATION OF REAL ESTATE



This book is for IBBI Training For Valuation In Real Estate Includes Various Topics Such As Valuation Of Real Estate, Income Approach To Value, Market Approach To Value, Cost Approach To Value, Various Purpose Of Valuation, Report Writing, Professional Ethics And Standards, The prospects for valuers under IBBI and IBC processes...

**FOR IBBI
TRAINING**

Preface and Forward....

It is with my immense pleasure that I am representing this Book for aspirants who are preparing for IBBI registered valuers Examination for Valuation of real estate. This book covers basic understanding of valuation subject, by which one shall easily catch key conceptual understanding about valuation.

Many aspirants have expectations towards a book which can be read in a very short time. And so, it becomes easy in understanding. This book is specially designed in such a manner that a reader can understand key features with an ease and minimum effort. And so, minimum words with specific & required elaboration are kept in mind while preparing the book. The language is kept simple, lucid and easy. The key strategy to pass IBBI exam is not hard work but smart work. And so, attention has been put in making the book that aspirant can complete work with this aspect.

IBBI exams are MCQ type where one has not to elaborate in depth about a topic. But, Basic understanding for topic with knowledge, logics, memories, concept, and reasoning is vital. There are basically four pillars of memories & they are interest, observations, understanding, and repetitions. Thus, for this, your interest is very essential, because interest shall make your observations very clear. After observations, understanding becomes very clear. Understanding shall help to memorize. This is initial registration in brain which can permanently be stored with repetition. After permanent memory you can apply to logics.

Moreover, reader should also enhance memory techniques like associations, acronyms, logics, story preparations, pag words systems etc. This shall reduce reader's effort at a drastic level.

In this context, it is advisable to all readers to make their own notes. For this purpose, notes based on SQRR system of working in which reader should always find 5W & 1 H (why, where, when, what- which, who and how) which are basic questions types to create MCQs. And so, here notes should be made in this context finding these six attributes.

As far as exam & MCQs are concerned, if one is in the need to take calculated risk, use of theory of elimination in MCQs. It means, when it is not possible to find right answer, find perfectly wrong answer from options given in the answers. And try to reach nearly probable right answer. This shall be useful for taking risk if required to pass the exam.

Thus, this material can be used as ready reference notes while doing revisions. Moreover, reader should make end hours notes in the blank pages given at last, which shall be useful to revise key points in last hours. It is use of short term memory ideology and quick reference before sitting in the exam. In notes, key focus should be made on techniques of memories. It can be anticipated that same material could be used in class room study training program. So, aspirants can understand it in class, make their own notes and repeat it at their home study time with effective notes. And same should be revised in last hours notes. Thus it shall be wonderful, enjoyable experience....

Moreover, the message for aspirants is that IBBI is not only the exam which checks person capacity to adopt new study, but also it is the exam to check your ability to balance personal, social, professional, family life with new challenging tasks. And so, one starts feel that the task is unwanted burden in one's life.

But, dear aspirant, please take this with sportsman's spirit because after completing this exams, one shall be full of knowledge, energy & shall feel confident in their professional life. By which, one shall be able to make him or herself well prepared. It shall enhance ability for ongoing carrier towards

professional practice and also to take precise decisions in professional life. Moreover, you shall see that a student has awoken within you, and, it is still alive, which was sleeping since a long. So, thrust yourself, awake your student, and also awake your own self, make yourself well prepared. This shall keep one in the mode for enjoyment of entire experience. It is for sure that you shall really find a change within you and also, in your life. And start endeavoring to new way of working

All the best... ..



Brijesh N. Panchal

ACKNOWLEDGEMENT

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I am also grateful to my family, my wife Tina, daughter Shloka and parents Natubhai & Kantaben who gave this wonderful opportunity to pursue study & who were bearing extra burden in life management, giving peaceful enverionment and all supports. Without their support, it was not possible to even think off new studies and to complete this task.

I wish to record my sincere thanks to book and references and to my knowledge sources as mentioned in bibliography. Moreover, I also appreciate all of my valuer friends who supported me, rendered their suggestions on topics, and also, all the participants across India. I am thankful to Nidhi Goyal from Mumbai and Jay Kapadia from Ahmedabad who have participated in the training and gave their valuable time to go through the script and have given their valuable suggestions as proof readers.

Disclaimer

This material has been prepared from various sources based on own belief, judgments etc. for candidates appearing for IBBI exams. It is an additional supports to aspirants. The material is made with due care but, no liabilities is undertaken for any legal/ or professional actions on whom who relies on this. The material shall survive as study reference only. Although enough care has been put while preparing this book, but there might be some improvement needs remained in within, so, reader is requested to please bring that in to notice. Any further suggestions for improvement are invited to shubhlaxmivaluers@gmail.com

Brijesh N. Panchal

PVAI
VPO

Insolvency and Bankruptcy Board of India

31st December, 2018

Subject: Valuation Examination for Asset Class- Land and Building

In pursuance of the rule 5 (3) of the Companies (Registered Valuers and Valuation) Rules, 2017, the Insolvency and Bankruptcy Board of India, being the Authority, hereby publishes the syllabus, format and frequency of the 'Valuation Examination' for the asset class: **Land and Building**.

Principles of Economics

• Microeconomics – 4 Marks..

Consumption: Indifference Curve, Consumer's Surplus, Elasticity

- Price Mechanism: Determinants of Price Mechanism, Individual and Market Demand Schedules, Law of Demand & its Conditions, Exceptions and Limitations of Law of Demand, Individual and Market Supply Schedules, Conditions and Limitations, Highest, Lowest and Equilibrium Price, Importance of Time Element

- Pricing of Products under different market conditions: Perfect and Imperfect Competition, Monopoly

- Factors of Production and their pricing: Land, Labour, Capital, Entrepreneur and other factors - Theory of Rent

- Capital and Interest: Types of Capital, Gross Interest, Net Interest - Organisation and Profit: Functions of Entrepreneur, Meaning of Profit and Theories of Profit

• Macroeconomics – 4 Marks..

Functions & Role of Money

- Inflation: Types of Inflation, Causes, Effects, Inflationary Gap, Control of Inflation, Monetary, Fiscal and Direct Measures

- Deflation: Causes, Effects, Deflationary Gap, Measures to Control Deflation, Deficit Financing

- Savings and Investment: Savings and Types of Savings, Determinants of Savings, Investment, Types of Investment, Determinants of Investment, Relationship between Savings and Investment

- Components of Economy: Primary Sector, Secondary Sector, Tertiary Sector, Informal Sector in Urban Economy, Parasitic Components in Urban Economy

- Concepts of GDP and GNP, Capital Formation Parallel Economy

- Definition of Parallel Economy, Causes and Effects of Parallel Economy on use of Land and its Valuation - Its impact on Real Estate Market

- Construction Industry and Parallel Economy

Parallel Economy –2 Marks..

Definition of Parallel Economy, Causes and Effects of Parallel Economy on use of Land and its Valuation - Its impact on Real Estate Market

- Construction Industry and Parallel Economy

Book Keeping and Accountancy –3 Marks..

Meaning and objects of Book Keeping, Double Entry Book Keeping

- Books of Prime Entry and Subsidiary Books: Cash Book, Bank Book, Journal, Ledger, Purchase and Sale Books, Debit and Credit Notes Register, Writing of Books, Posting and Closing of Accounts - Trading Account, Profit and Loss Account, Income and Expenditure Account

- Preliminary Analysis of Financial Statements

- Cost, Costing and Elements of Cost, Fixed Expenses, Variable Expenses, Break

-Even Point

Law - General – 10 Marks..

Indian Legal System: Salient Features of the Indian Constitution, Fundamental Rights, Directive Principles of the State Policy

- Government: Executive, Legislature and Judiciary

- Laws of Contract: Formation of a Contract, Parties, Void, Voidable and Unenforceable Contract, Contingent Contract, Misrepresentation and Fraud and Effect thereof, Termination of Contract, Remedies for Breach, Performance of Contract, Indemnity and Guarantee, Law of Agency

- Tort: General Principles of Tort, Tort affecting Valuation. - Law of Arbitration and Conciliation: Salient Features

- Auction: Authority of Auctioneer, Duties of Vendor, Purchaser and Public, Mis-description and Misrepresentation, Advertisements, Particulars and Catalogues, Statements on the Rostrum, Conduct of Sale, Reservation of Price and Right to Bid, Bidding Agreements. Memorandum of the Sale. The Deposit, Rights of Auctioneer against Vendor and Purchaser

- Laws of Evidence: Burden of Proof, Presumptions, Conclusive Proof, Salient Features of the Insolvency and Bankruptcy Code, 2016 concerning Valuation

- Salient Features of the Companies (Registered Valuers and Valuation) Rules, 2017

- Salient Features of the Securitization and Reconstruction of the Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act, 2002) concerning Valuation

- Section 5(n) of the Banking Regulation Act, 1949 on “Secured Loan or Advance”
 - The Companies Act 2013: Section 192(2), 230 (1), 230 (2), 230 (3), 231, 232, 247 and 281(1)
-

Introduction to Statistics- 2 Marks..

- Data Classifications and Processing, Graphical Representation of Data, Frequency Distributions
 - Measures of Central Tendency, Dispersion and Skewness
 - Elementary Theory of Probability and Probability Distributions, Sampling and Sampling Distributions, Estimation
 - Simple Test of Significance, Regression and Co-relation, Multiple Correlation Coefficient
 - Time Series
 - Index Numbers
-

Environmental Issues in Valuation -4 Marks..

- Environment and Valuation
 - Differences between the Market Price and the Negative Value Consequent on Environmental Impact - Environmental Issues of Air Pollution, Water Pollution, Environmental Factors and their effects, Measures to Restore the Damage, Cost to Cure
 - Outlines of Environmental Legislations: The Indian Forest Act, 1927, The Water (Prevention and Control of Pollution) Act, 1974, The Air (Prevention and Control of Pollution) Act,1981, The Environment (Protection) Act,1986
 - Laws related to Industrial Health and Safety
-

Professional Ethics and Standards 2 Marks..

- Model Code of Conduct as notified by MCA under the Companies (Registered valuers and valuation) Rules 2017
 - Ethical considerations under terms of engagements
-

Law-Real Estate 8 Marks..

- Land Acquisition
 - The Right to Fair Compensation and Transparency in the Land Acquisition, Rehabilitation and Resettlement Act, 2013
 - General Building Rules and Regulations
-

- Rent Control Laws: Sections pertaining to Occupancy Rights of Tenants, Freezing of Rent and Protection against Eviction of Tenant and its effect on value of property
 - Right of Way and Section 52
 - Licenses under the Indian Easements Act, 1882
 - Salient features of the Real Estate (Regulation and Development) Act, 2016 and Real Estate Regulating Authorities established under the Act • The Transfer of Property Act, 1882
 - Transfer of Immovable Property: Sale, Mortgage, Gift, Exchange, Assignment, Charge, Lien, Tenancies/SubTenancies
 - Lease of Immovable Property, Lease granted by Private and Statutory Bodies
 - Impact of each on Valuation - Sections: 3, 5, 6, 7, 25, 53 and 53A of the Transfer of Property Act, 1882 • Laws Relating to Inheritance/Succession
 - Mohammedan: Muslim Personal Law
 - The Hindu Succession Act, 1956, the Hindu Succession (Amendment) Act, 2005 (39 of 2005)
 - The Indian Succession Act, 1925: Law of succession for person other than Hindu and Mohammedan - Will & Testament, Succession Certificate
-

Valuation of Real Estate 14 Marks..

- Cost, Price and Value
 - Types of Value
 - Basic elements of Value
 - Marketability, Utility, Scarcity, and Transferability
 - Factors affecting Value - Physical, Economic, Legal and Social
 - Highest and Best Use, Value in Use, Value in Exchange
 - Real Property: Rights and Interests in Real Estate, Types of ownerships and Types of occupancy in Real Estate
 - Annuities, Capitalization, Rate of Capitalization, Years' Purchase, Sinking Fund, Redemption of Capital, Reversionary Value
 - Construction and use of Valuation Tables
 - Urban Infrastructure and its influence on Value of Real Estate
 - Real Estate Market and its characteristics, Investment in Real Estate, Factors influencing Demand and Supply Schedule in Real Estate - Concepts of Green Building
-

• Income Approach to Value 8 Marks..

- Relation between Income and Value
- Valuation of Property affected by the Rent Control Act, Licensed property under the Easement Act, 1882 and Leasehold properties under the Transfer of Property Act, 1882

- Derivation of Yield Rate from Market Derived Data
- Remunerative Rate of Interest and Accumulative Rate of Interest
- Types of rent: Outgoings, Income, Yield, Years' Purchase
- Determination of Market Rent and Standard Rent
- Lease: lessor and lessee: Types of Lease, Lease provisions and Covenants
- Valuation of Lessor's Interest, Lessee's Interest including SubLease in Leased Property. Premature Termination of Lease or Surrender of Lease
- Real Estate as an Investment, Yield from Real Estate vis-à-vis other forms of Investments
- Sound Investment Comparison - Investment Decisions: Discounted Cash Flow Techniques, Internal Rate of Return (IRR) and Net Present Value (NPV)
- Profit Method: Valuation of Special Properties: Hotels, Cinema, Mall, Petrol Pump, Hill resorts.

Market Approach to Value 8 Marks..

- Types of Market, Demand and Supply Curve, Buyer's and Seller's Bell Curve for Overall Sales Performance
- Market Survey & Data Collection, Sources of Sale Transactions
- Comparison of Sale Instances
- Factors of comparison and weightages for adjustment in value Hedonic Model and Adjustment Grid Model under Sales comparison Method
- Land characteristics and its effect on Land Values
- Hypothetical Plotting Scheme for value of large size land
- Residue Technique and other development methods
- Valuation for Joint Venture Development of property

Cost Approach to Value 8 Marks..

- Methods of Cost Estimates for Buildings
 - Life of Building: Economic/Physical/Legal
 - Factors affecting life of the building
 - Total Life, Age, Estimating Future Life
 - Various methods of Computation of Depreciation, Functional, Technological and Economic Obsolescence
 - Reproduction Cost/Replacement cost, Depreciated Replacement Cost (DRC) working, adopting DRC as Value subject to Demand and Supply aspect
-

- Land Value by Market Approach and Building Value by Cost Estimation Method for Owner Occupied Bungalows, Factories, Public Buildings

Various purposes of Valuation 4 Marks..

- Valuation of properties for purposes such as: Bank Finance, Auction Reserve, Building Insurance, Sale, Purchase, Valuation Disputes in Court, Probate, Partition, Rent Fixation, Stamp Duty, Capital Gain Tax, Lease and Mortgage of Property. Any other purposes not referred above
- Study of Valuation Standards as per the provisions of the Companies Act 2013
- Study of Indian Accounting Standards (Ind AS 16) as applicable to Valuation
- Valuer as an Expert witness in Court
- Valuers' Functions & Responsibilities, Error of Judgement and Professional Negligence

Important Case Laws on principles of valuation of Real Estate: 2 Marks..

- K.P. Varghese Vs. Income Tax Officer and Another, (1981) 131 ITR 597 (SC)
- Gold Coast Selection Trust Ltd. Vs. Humphrey (1948) 2 ALLER 379 and (1949) 17 ITR 19
- R.C. Cooper Vs. Union of India, (1970) AIR SC 564
- Hays Will Trust Vs. Hays and Others (1971) 1WLR 758
- V. C. Ramachandran Vs. CWT (1979) 126 ITR 157 Karnataka HC
- Subhakaran Chowdhary Vs. I.A.C. (Acq), (1979) 118 ITR 777 Kolkata HC (Special Value/ FMV)
- Wenger & Co. Vs. DVO (1978) 115 ITR 648 Delhi HC (Combination of Methods)
- Sorab D. Talati Vs. Joseph Michem, Appeal No. 101 Of 1949 in R.A. Application No. 805 of 1948
- CWT Vs. P.N. Sikand (1977) 107 ITR 922 (SC) - SLAO (Eluru) Vs. Jasti Rohini (1995) 1SCC 717 SC
- Shubh Ram and Others Vs. State of Haryana (2010) 1SCC 444 2 6 | Page -Jawajee Nagnathan Vs. Revenue Divisional Officer (1994) SCC (4) 595 (SC)
- Chimanlal Hargovinddas Vs. SLAO, AIR SC 1652
- Duncan Industries Ltd. Vs. State of U.P. and Other AIR 2000 SC 355
- CWT Vs. Purshottam N. Amersey and Anr., (1969) 71 ITR 180 (Bom)
- Dr. K.R. Dhairawan and Others Vs. J.H. Thakur and Others AIR 1958 SC 789

Principles of Insurance and Loss Assessment 4 Marks..

- Principles and legal concepts in relation to Insurance of buildings. The Contract of Insurance. Insurable Interests and Liability to Insure. Duties of the Insurer and the Insured
- The types of Fire Policies -Reinstatement Value and Indemnity Policies and policies for other perils, Terms and Conditions, Perils, Beneficial and Restrictive Clauses

- Value at Risk, Sum Insured and Condition of Average, Over and Under Insurance, Inflation Provisions, other contents, Depreciation, Obsolescence and Betterment
- Preparation of Claim for Damages due to Insured Perils.
- Obligations and Rights of Insurer and Insured

Report writing - Reports-Quality, Structure, Style- 3 Marks..

- Report writing for various purposes of valuation-Sale, Purchase, Purchase, Mortgage, Taxation, Insurance, Liquidation etc
- Contents of the report: Instruction of Clients, Date as on which valuation is made, date of Report and Site Inspection, Location, Ownership History, Data Collection and Analysis, Type of Construction, Valuation Method, Value Estimation, Assumptions and Limiting Conditions including Caveats and Conclusion

Case Study -8 Marks..

This section will have a case study to test the ability to apply valuation techniques. There will be a comprehension narrating a transaction based on which questions will be asked..

Note: Wherever any law, an Act of Parliament or any Rule is referred to in the syllabus, the same shall be taken as in force as on 31st December, 2018. This means that any amendment in such laws, Acts or Rules effected after 31st December, 2018 shall be ignored.

Format of Examination The format of examination is as under:

- a. The examination is conducted online (computer-based in a proctored environment) with objective multiple-choice questions;
- b. The duration of the examination is 2 hours;
- c. A candidate is required to answer all questions;
- d. A wrong answer attracts a negative mark of 25% of the marks assigned for the question;
- e. A candidate needs to secure 60% of marks for passing;. A successful candidate is awarded a certificate by the Authority;
- g. A candidate is issued a temporary mark sheet on submission of answer paper; and h. No workbook or study material is allowed or provided.
- i. A candidate may use a calculator which does not have memory.
- j. No mobile phone is allowed.

III. Frequency of Examination The frequency of Examination is as under:

- a. The Examination is available from a number of Examination Centres across the country.
- b. The examination is available on every working day.
- c. A candidate may choose the time, the date and the Examination Centre of his choice for taking the Examination. For this purpose, he needs to enrol and register at <https://valuationregistration.bsebti.com> .
- d. A candidate needs to pay an Examination fee of Rs.1500 (One thousand five hundred rupees only) online on every enrolment. Further details of the Examination, if any, will be provided subsequently.



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1. Valuation Real Estate

1.1. Coverage

- Cost, Price and Value - Types of Value - Basic elements of Value - Marketability, Utility, Scarcity, and Transferability - Factors affecting Valuation-Physical, Economic, Legal and Social - Highest and Best Use, Value in Use, Value in Exchange - Real Property: Rights and Interests in Real Estate, Types of ownerships and Types of occupancy in Real Estate - Annuities, Capitalization, Rate of Capitalization, Years Purchase, Sinking Fund, Redemption of Capital, Reversionary Value - Construction and use of Valuation Tables - Urban Infrastructure and its influence on Value of Real Estate - Real Estate Market and its characteristics, Investment in Real Estate, Factors influencing Demand and Supply Schedule in Real Estate.

14 marks.

7 hours of training.

▪ **Back ground**

▶ An advent of civilization

- Exchange of commodity (Barter System)
 - A barter system is an old method of exchange. This (Barter system history) system has been used for centuries and long before money was invented. People exchanged services and goods for other services and goods in return.
- Development of community settlements (Community development)
 - Community development seeks to empower individuals and groups of people with the skills they need to effect change within their communities. These skills are often created through the formation of social groups working for a common agenda.
- By KAUTILYA (Chanakya) 2300 years ago says
 - *“The Value of the land is what man makes of it”*
- Such description of Land values is not possible even in 10 hours lecture, Which this great thinker taught to us !!?

▶ Industrial revolution and land economics

- The Industrial Revolution was the transition to new manufacturing processes in Europe and the US, in the period from about 1760 to sometime between 1820 and 1840.

▪ **Various laws for valuation of property**

- ▶ Rent Control Acts of 1947
- ▶ Estate Duty Act of 1953,
- ▶ Wealth Tax Act of 1957,
- ▶ Gift Tax Act of 1958
- ▶ Income Tax Act of 1964
- ▶ Rating Laws of 1866
- ▶ Land Acquisition Act of 1894.

1.2. Valuation

- ▶ A multidisciplinary subject
- ▶ Economics, law, building construction, study of human behaviour, social customs and study of government policies.
- ▶ An “Art” and some others call it a “Science”.
- ▶ Gold Coast Selection Trust Ltd. V/s. Humphrey, justice Viscount Simon stated that “Valuation is not an exact science. Mathematical certainty is not demanded, nor indeed is it possible. It is for Commissioners to express in terms in the money value, attributed by them to the asset, their

estimate, and this is a conclusion of fact to be drawn from the evidence before them”.

- ▶ Thus valuation is not considered an exact science but an art.

1.3. Valuation – Aspects

- ▶ Legal Aspects. -ART
- ▶ Economic Aspects. -ART
- ▶ Social Aspects. -ART
- ▶ Technical Aspects -SCIENCE
- ▶ (Remember with “LEST” we say 75% - ART, 25 % - SCIENCE)

1.4. Property

- ▶ Personal Property
 - Money, cash deposited in bank, Gold and Silver Bullion, jewellery and personal belongs.
- ▶ Real property
 - Real property or Real Estate like land with or without building. Whole or part rights arising out of land and buildings are also real property.
 - Real Estate property
 - Income fetching marketable properties
 - Rented properties, Hotels, Cinemas, Malls fall under this group
 - Non Income fetching marketable properties
 - Owner occupied bungalows, flats, shops, offices, factories fall under this category
 - Non income fetching – non marketable properties
 - Temple, Church, School, College, Public buildings, Museum, Fire station and Govt. buildings fall in this category.

1.5. Different Approaches

- ▶ Income Approach
 - To value income fetching marketable properties.
- ▶ Market Approach
 - To value Non income fetching but marketable properties.
- ▶ Cost Approach
 - To value Non income fetching and non-marketable property.

1.6. Cost, Price and Value

- ▶ Cost
 - It is expressed as actual expenditure in terms of money incurred on labour and materials of the asset (property).
- ▶ Price:
 - It is an amount paid and expressed in terms of money for acquiring ownership rights or interest in the asset (property) .
 - Price normally includes profit of seller over and above cost of labour and cost of materials that has been incurred by the seller in creation or acquisition of the said asset.
- ▶ Value
 - The word 'value' is highly subjective.
 - Persons own perception of 'Better life'
 - Justice Hadley has stated that "Value is an estimate of the price as it ought to be".
 - In case of Raja Vyricherla Narayana Gajapatiraju Bahadur Garu V/s. Rev.Div. officer Vizagapatam 3, "In the case of land, its value in general can be measured by a consideration of the price that have been obtained in the past for land of similar quality and in similar position, and this is what must be meant in general by terms the market value".

1.7. Different value definition

Market Value

"Market value is an estimated amount of the interest or legal right of a person in a property, to derive existing and future benefit by putting land and building to best possible legal and potential use."

- IVS (International valuation standard) (IVSC 2017)

"Market value is estimated amount for which an asset should exchange on the date of valuation, between a willing buyer and a willing seller, in an arm's length transaction after proper marketing, where in the parties had each acted knowledgably, prudently and without compulsion"

- As valuer has to estimate the amount, he should assume hypothetical buyer and hypothetical seller both willing to transact
- Both buyer and seller must be knowledgeable.

- Role of man of ordinary prudence and not super intelligent person or speculator.
- Market should be open market.
- At arms length
 - Transaction between related buyers and sellers or between close friends should not be considered.
- “Estimated amount for which an asset should exchange”
- “After proper marketing”
- Minimum assumptions
- Reasons for adoption of certain basics
 - Subject matter of valuation
- “Interest” in property as the right of a persons to derive benefit (Existing or future)
- Putting land/land and building to Legal and Best possible (Potential) use.
- Physical characteristics of land (Soil, size) and materials used in the building (Brick, cement, steel) are not valued but right to derive benefit (existing or future benefit) by putting the property to lawful use and highest and best use, is being valued.
- More understanding elaborated in chapter 8 of this book.
 - Accommodation value
 - It is a value of the land which is not independently buildable on account of odd shape, odd size or small area or land lacking legal access road .Normally such land is useful only to adjoining plot owners along its periphery. Such plots invariably fetch less price than prevalent market price and land value greatly depends on needs of the adjoining plot owners and competition amongst them.
- Book value
 - Written down value of an asset as shown in books of account and balance sheet
- Breakup value
 - Production unit (running unit of an enterprise) is closed down and sale of each individual assets
- Distress value
 - For immediate sale by the owner who is in distress is called distress sale value

- May be in financial difficulty
- Social or health problems like need of money

- Forced sale value
 - “As is where is basis”
 - By negotiations amongst limited group of buyers or by public auction
 - Utmost urgency and with assumption of unwilling seller
 - Auction sale of non performing assets by banks

- Fair market value
 - Not much difference between the words ‘market value’ and ‘fair market value’
 - Rejection of
 - Distress sale or forced sale transaction
 - Transaction between relatives at concessional price
 - Transaction by speculators or purchasers
 - Special purpose to pay fancy price

- Going concern value
 - Running business of an industrial or commercial establishment
 - Continued use of all assets
 - Total breakup value of each individual asset of the enterprise plus good will value of the business may or may not be same as the going concern value of the enterprise.
 - Optimum value (balance potential or highest and best use of the assets) of individual assets is not reflected in sale transaction price of the running business unit which is executed on the basis of business valuation of the unit on ‘going concern value’ principles.

- Hope value
 - Expected value of the property to rise in the near future
 - Changes in government or municipal policies
 - Relaxation in coastal regulations or scrapping of u.l.c. act , Increase in f.s.i. rules etc.

- Intrinsic value [true value]
 - Actual value or true value of the property

- Apart from agreement value
- Liquidation value [auction value]
 - By putting up the property for auction sale
 - After proper advertisement.
- Monopoly value
 - Excellent situation
 - Highly developed area
 - Prime location
 - Sold at premium i.e. at fancy price.
 - Unusual and peculiar advantages.
- Mortgage value
 - Estimate of mortgage loan amount
 - Safely advanced by the mortgagee
 - Security or the collateral security offered by the mortgagor
 - Own safety margins
 - Deductions varies from 25% to 50% of market value.
- Net present value [depreciated value]
 - Present day value of the property
 - Deducting depreciation amount
- Notional value [hypothetical value]
 - Out for some special purpose
 - Like wealth tax act
 - Imagine hypothetical buyer and hypothetical seller transacting sale
 - In reality, owner of the property (assessee), does not intend to sell
- Potential value
 - Price the property with existing inferior or under utilised use
 - Highest and best use
 - FSI, TDR, GDCR
- Replacement value
 - Cost required to be incurred today
 - To create similar (identical) property at current prices

- Estimate of the cost of replacement of an old existing asset
- Reported value (appraised value)
 - By the valuer
 - Full scrutiny of the documents
 - Physical inspection
 - Study of relevant facts, circumstances
- Rounded value
 - Rounding off
- Salvage value
 - Old property after its probable services life is over
 - Still in continued use due to its physical conditions
- Scrap value (junk value)
 - Receivable for its material content in the market when it is completely useless
 - Normally 10% of cost.
- Speculative value
 - Motive of selling at profit
 - Greater importance in the near future
 - Special value
 - A value to an individual buyer or seller
 - A flat close to his work place as well as close to his children's school.
 - Willing to pay higher price
- Statutory value
 - Value of the property estimated in accordance with the provisions of the concerned statute
 - E.g.- for wealth tax
- Stigma value
 - Assumption of unwilling purchaser
 - Disliking for the said property for certain reason
 - E.g. Murder of a popular personality
 - Land is affected by radio activity

- Face value,
 - Face value, also referred to as par value or nominal value, is the value shown on the face of a security certificate, including currency. The concept most commonly applies to stocks and bonds, so it is particularly important to bond and preferred stock investors

- Economic value,
 - Economic value is the maximum amount a consumer is willing to pay for an item in a free market economy.

- Investment value,
 - Reflects the value of an asset to its owner, depending on his or her expectations and requirements.

- Nuisance value,
 - Change in value due to significance of a person or thing arising from their capacity to cause inconvenience or annoyance.

- Subjective value,
 - Subjective value exists in the minds of the potential buyers and seller. Subjective value is the price that people are willing to pay for a property, irrespective of its cost, as differentiated from objective value in which the value is associated with the cost of production or cost of creating the property.

- Objective value,
 - Objective value defends the predication of value in propositions where the logical subject is an entity in the world of objects.

- Sound value,
 - Sound value is the replacement cost of the property, less the accrued depreciation. Replacement cost means the current cost to reproduce new the identical units of property under consideration. This value usually differs from original cost because of fluctuations in the general price level.

- USE-VALUE vs. EXCHANGE-VALUE:
 - The usefulness of a commodity vs. the exchange equivalent by which the commodity is compared to other objects on the market.

- Auction value,
 - Most items sell at auction value prices, which means the price the item is being auctioned for. Generally, this amount is higher than market price, which means that the seller gets to make a profit with respect to reserved price.

- Realisable value,
 - Net realizable value (NRV) is a measure of a fixed or current asset's worth when held in inventory, in the field of accounting.
 - Net realizable value is generally equal to the selling price of the inventory goods less the selling costs (completion and disposal).

- Bogus value etc.
 - Value due to Counterfeit or fake; not genuine:
 - presentations like bogus money, bogus tasks .

1.8. Case Laws cited in this chapter

- Gold Coast Selection Trust Ltd. V/s. Humphery (1949) 17 I.T.R. 19.
 - Valuation is not a exact science
- Rustom Cavasjee Cooper V/s Union of India A.I.R.1970 S.C.564
 - Scope of the valuation

2. Valuation Table

2.1. Simple interest amount working

To work out gross amount that would accrue at the end of given period of time,

$$I = P \times R \times N$$

$$A = P + I$$

'I' is the total interest amount accrued in given period.

'P' is the principle amount deposited.

'R' is the rate of interest adopted.

'N' is the period in number of years.

'A' is the Gross Amount including principal sum and total interest.

Example

Mr X deposits sum of Rs.6,000/- at 5% simple interest rate , for 6 years period. Calculate Gross Amount receivable after 5 years period including total interest amount at simple interest basis.

Solution:

$$I = P \times R \times N$$

$$= 6000 \times \frac{5}{100} \times 6$$

$$= \text{Rs.}1,800/-$$

$$A = P + I$$

$$= 6,000 + 1,800$$

$$= 7,800/-$$

2.2. Compound Interest Amount Working

Would accrue at compound interest rate, after a given period of time

i) Total Interest factor (I) = $(1 + r)^n$

ii) Gross Amount (A) = $P \times (1 + r)^n$

'R' = Rate of compound interest

'n' = number of years

'P' = Principal Amount

'A' = Gross Amount receivable at end of given period.

Example

Mr. Y. deposits Rs.7,000/- in Bank at 5% compound interest rate for 6 years period. Calculate gross amount receivable after 6 years period including total interest amount on compound interest basis.

Solution

$$\begin{aligned}
 A &= P \times (1 + r)^n \\
 &= 7000 \times \left(1 + \frac{5}{100}\right)^6 \\
 &= 7000 \times 1.05^6 \\
 &= 7000 \times 1.34 \\
 &= \text{Rs. } 9380.6/-
 \end{aligned}$$

2.2.1. Present Value of a Rupee

✓ **The reverse mathematical process to calculate compound interest**

(Also refer Table 2 in Mirams Val. Tables)

Working out present worth of a rupee receivable after certain period at given rate of compound interest.

$$\text{Present value of a Rupee (PV)} = \frac{1}{(1+R)^n}$$

$$\text{Present worth of amount receivable PVA} = c \times \frac{1}{(1+R)^n}$$

'C' = Capital sum Receivable at future date.

'R' = Rate of interest

'n' = number of years.

Example

A person will receive back leased property worth Rs.15,00,000/- after 15 years. Calculate its present worth by adopting 5% rate of interest.

Solution

$$\begin{aligned}
 &\text{Present value of Rs. } 15,00,000 \\
 &= c \times \frac{1}{(1+R)^n} \\
 &= 15,00,000 \times \frac{1}{(1 + 0.05)^{15}} \\
 &= 15,00,000 \times 0.481 \\
 &= \text{Rs. } 7,21,500 /-
 \end{aligned}$$

Example

What is the present value of the investments to receive following amount of money, at 5% interest rate, at 6 years intervals as given below.

- i) After 6 years Rs.15,000
- ii) After 12 years Rs.35,000
- iii) After 18 years Rs.55,000

Solution

It will be necessary to compute present value in 3 parts as under :-

(i) Present value of Rs. 15,000

$$\begin{aligned}
 &= c \times \frac{1}{(1+R)^n} \\
 &= 15000 \times \frac{1}{(1 + 0.05)^6} \\
 &= 15000 \times 0.7462 \\
 &= 11193/-
 \end{aligned}$$

(ii) Present value of Rs. 35,000

$$\begin{aligned}
 &= c \times \frac{1}{(1+R)^n} \\
 &= 35000 \times \frac{1}{(1 + 0.05)^{12}} \\
 &= 35000 \times 0.5568 \\
 &= \text{Rs. } 19489.3 \text{ /-}
 \end{aligned}$$

(iii) Present value of Rs. 55,000

$$\begin{aligned}
 &= c \times \frac{1}{(1+R)^n} \\
 &= 55000 \times \frac{1}{(1 + 0.05)^{18}} \\
 &= 55000 \times 0.4155 \\
 &= \text{Rs. } 22,852/-
 \end{aligned}$$

Present value of right to receive sums in 3 stages at 5 years interval

=Rs. 11193/- + Rs. 19489.3 / + Rs. 22,852/-

=Rs. 53534.3/-

2.3. Amount of Re.1/Annum working

✓ Like recurring account

$$✓ = \frac{C.I.-1}{R} \quad \text{where,}$$

C.I. is compound rate of interest

Many a times valuer is required to work out Gross Amount that would accumulate after the given period of time,

$$= \frac{(1+R)^n-1}{R}$$

$$= c \times \frac{(1+R)^n-1}{R}$$

Accumulated sum for Re.1/year (APA)

'R' = Rate of Interest

'n' = Number of years

'C' = Capital Amount received/Year

Example

Mr.A is saving Rs.1,200/- each year and invests this yearly saving each year at 6% interest for 25 years period. What will be gross capital yield at the end of 25 years?

$$= \frac{(1+R)^n-1}{R}$$

$$= \frac{(1+0.06)^{25}-1}{0.06}$$

$$= \frac{6.85-1}{0.06}$$

$$= 54.864$$

$$\text{Gross capital sum} = C \times \text{APA} = 1,200 \times 54.8644 = \text{Rs. } 65837.41/-$$

Example

From the salary of a person, Rs.1000/- per month is deducted and said sum is invested in deposit fund scheme annually at 7% interest. Calculate gross amount accumulated under the scheme after 20 years service. There are no withdrawals from the fund during this period.

Solution

$$\begin{aligned} &= \frac{(1+R)^n - 1}{R} \\ &= \frac{(1 + 0.07)^{20} - 1}{0.07} \\ &= \frac{3.869 - 1}{0.07} \\ &= 40.995 \end{aligned}$$

$$\text{Gross capital sum} = C \times APA = 1000 \times 12 \times 40.995 = \text{Rs. } 4,91,940/-$$

2.3.1. Annual Sinking Fund Working

- ✓ Like EMI calculation
- ✓ Inverse of previous ie. Recurring account

$$\checkmark = \frac{R}{C.I. - 1}$$

where, C.I. is compound rate of interest

Fund amount that has to be set aside annually by building owner, at given rate of interest, for the period which is equal to past age of the building.

$$ASF = \frac{R}{(1+R)^n - 1}$$

$$\text{Gross S.F.} = C \times \frac{R}{(1 + R)^n - 1}$$

Example

What shall be Gross Sinking Fund required to be set aside every year to recoup total amount of Rs.8,00,000/- at the end of 60 years life of building at 4% rate of compound interest.

Solution

$$\begin{aligned}
 &= \frac{R}{(1+R)^n - 1} \\
 &= \frac{0.04}{(1 + 0.04)^{60} - 1} \\
 &= \frac{0.04}{10.519 - 1} \\
 &= 0.0042
 \end{aligned}$$

$$\begin{aligned}
 \text{Gross sinking fund} &= C \times \text{ASF} \\
 &= 8,00,000 \times 0.0042 \\
 &= \text{Rs. } 3360/- \text{ per year}
 \end{aligned}$$

If we apply the formula given in previous para 2.30, using 3360/year as annual saving ,you will notice that this sum of Rs.3360/- per year accumulates to the gross capital sum of Rs.8,00,000/- at 4% rate of interest after 60 years period.

Example

A person has to repay loan amount of Rs.8,00,000/- after 20 years. What amount should that person set aside every month to enable it to repay loan with 4% interest ?

$$\begin{aligned}
 &= \frac{R}{(1+R)^n - 1} \\
 &= \frac{0.04}{(1 + 0.04)^{20} - 1} \\
 &= \frac{0.04}{2.19 - 1} \\
 &= 0.0336
 \end{aligned}$$

$$\begin{aligned}
 \text{Gross sinking fund} &= C \times \text{ASF} \\
 &= 8,00,000 \times 0.0336 \\
 &= \text{Rs. } 26880/- \text{ per year} \\
 &= 2240/- \text{ per month}
 \end{aligned}$$

2.4. Present value of an amount of Re.1/year (Single rate basis)

$$\blacktriangleright \frac{1-P.V.}{R}$$

Where P.V. is present value i.e inverse of compound rate of interest

- Present worth of future annual income flow for given period of time
- Present market worth of the asset generating such income
- Income flow is normally a perpetual income
- only remunerative rate of interest for the perpetual income as single rate working
- To separately work out present value of Re.1 receivable after 1st year, P.V. of Re.1 receivable after 2nd year up to Re.1 receivable after given number of years and total up all these sum

$$(i) \quad \text{Present value of Re.1/year (Y.P.)} = \frac{1 - \left(\frac{1}{(1+R)^n}\right)}{R}$$

$$(ii) \quad \text{Value of asset} = C \times \text{Y.P.}$$

Rate of interest = "R"

Numbers of years = "n"

Capital income (Annuity) received each year = "C"

Years Purchase = "Y.P"

Example

A office yields net rental income (Annuity) of Rs.60,000/- per year. If this income ceases after 40 years (Future life of building), what is present value of this property at 7% rate of interest.

$$Y.P. = \frac{1 - \left(\frac{1}{(1+R)^n}\right)}{R}$$

$$Y.P. = \frac{1 - \left(\frac{1}{(1+0.07)^{40}}\right)}{0.07}$$

$$= 13.332$$

$$\text{Value of the property} = C \times \text{Y.P} = 60000 \times 13.332 = 799920/-$$

Example

What is the present value of an Annuity which would continue yielding income of Rs.20,000/month for 15 years period at 6% rate of interest.

$$Y.P. = \frac{1 - \left(\frac{1}{(1+R)^n}\right)}{R}$$

$$Y.P. = \frac{1 - \left(\frac{1}{(1+0.06)^{15}}\right)}{0.06}$$

$$= 9.71$$

$$\text{Present Value of the property} = 20000 \times 12 \times 9.71$$

$$= 23,30,400/-$$

2.5. Present value of an amount of Re.1/year (Duel Rate basis)

- ▶ To provide for recoupment of capital sum invested
- ▶ Addition to annual yield income from the asset
- ▶ One rate is remunerative interest (yield) rate for capital sum invested
- ▶ Remunerative interest rate is higher
- ▶ Second rate is interest rate for recoupment of capital invested for period after which annual income is likely to cease
 - Recoupment of capital has to be made
 - Nothing but to provide for setting aside Sinking Fund amount each year
 - Present value of Re.1 per year (Y.P.) = $\frac{1}{R+S}$

$$\text{Sinking fund (S)} = \frac{r}{(1+r)^n - 1}$$

$$\text{Value of Asset} = c \times Y.P.$$

Remunerative Interest Rate = "R"

Interest rate for recoupment of capital = "r"

Numbers of year = "n"

Capital income received each year = "C"

Years Purchase = "Y.P."

Example

A person is taking a land on 50 years lease and on the plot he is building a building yielding net income of Rs. 30,000/year. After 25 years, he decided to sale the property. Calculate present sell value of the property if expected yield on investment is 9% and rate of redemption of capital is 4%.

Solution

$$Y. P. = \frac{1}{R+S}$$

Unexpired lease period 50-25 = 25 years

$$\begin{aligned} \text{Sinking fund (S)} &= \frac{r}{(1+r)^n - 1} \\ &= \frac{0.04}{(1+0.04)^{25} - 1} \\ &= 0.024 \end{aligned}$$

$$Y. P. = \frac{1}{R+S}$$

$$Y. P. = \frac{1}{0.090+0.024} = 8.77$$

Present value of the property = 30,000 x 8.77
= 2,63,100/-

Example

What is your advice on buying price of fully developed rental property yielding net rent of Rs.80,000/year. Expected rate of return is 9% and future life of building is 60 years. Adopt rate of recoupment of capital at 4%.

Solution

$$Y. P. = \frac{1}{R+S}$$

$$\begin{aligned} \text{Sinking fund (S)} &= \frac{r}{(1+r)^n - 1} \\ &= \frac{0.04}{(1+0.04)^{60} - 1} \\ &= 0.0042 \end{aligned}$$

$$Y. P. = \frac{1}{R+S}$$

$$Y. P. = \frac{1}{0.09+0.0042} = 10.615$$

Present value of the property = 80,000 x 10.615=
= 8,49,260/-

✓ **Summery to remember**

.1. Simple interest amount working

$$I = P \times R \times N$$

$$A = P + I$$

.2. Compound Interest Amount Working

$$(I) = (1 + r)^n$$

$$= P \times (1 + r)^n$$

.2.1. Present Value of a Rupee

The Inverse of compound interest

$$PV = \frac{1}{(1+R)^n}$$

.3. Amount of Re.1/Annum working

Like recurring account

$$= \frac{C.I.-1}{R}$$

where, C.I. is compound rate of interest

.3.1. Annual Sinking Fund Working

Like EMI calculation Inverse of previous ie. Recurring account

$$= \frac{R}{C.I.-1}$$

where, C.I. is compound rate of interest

.4. Present value of an amount of Re.1/year (Single rate basis)

$$\frac{1 - P.V.}{R}$$

Where P.V. is present value i.e inverse of compound rate of interest

.5. Present value of an amount of Re.1/year (Duel Rate basis)

$$= \frac{1}{R + S}$$

3. Valuation Income Approach & Various purposes of Valuation

Syllabus

- ▶ Relation between Income and Value
- ▶ Valuation of Property affected by the Rent Control Act, Licensed property under the Easement Act, 1882 and Leasehold properties under the Transfer of Property Act, 1882.
- ▶ Derivation of Yield Rate from Market Derived Data.
- ▶ Remunerative Rate of Interest and Accumulative Rate of Interest
- ▶ Types of rent: Outgoings, Income, Yield, Years' Purchase
- ▶ Determination of Market Rent and Standard Rent
- ▶ Lease: lessor and lessee: Types of Lease, Lease provisions and Covenants.
- ▶ Valuation of Lessor's Interest, Lessee's Interest including Sub-Lease in Leased Property. Premature Termination of Lease or Surrender of Lease.
- ▶ Real Estate as an Investment, Yield from Real Estate vis-à-vis other forms of Investments- Sound Investment Comparison.
- ▶ Investment Decisions: Discounted Cash Flow Techniques-Internal Rate of Return (IRR) and Net Present Value (NPV)
- ▶ Profit Method: Valuation of Special Properties: Hotels, Cinema, Mall, Petrol Pump, Hill resorts
- ▶ Theory of investment and return on investment in assets like land, land with building or plant and machinery
- ▶ Use of net income and rate of return expected by the asset holder.
- ▶ Value' is not intrinsic to or inherent in any thing,
- ▶ 8 marks
- ▶ 4 Hours training

Various purposes of Valuation:

- ▶ Valuation of properties for purposes such as: Bank Finance, Auction Reserve, Building Insurance, Sale, Purchase, Valuation Disputes in Court, Probate, Partition, Rent Fixation, Stamp Duty, Capital Gain Tax, Lease and Mortgage of Property. Any other purposes not referred above.
- ▶ Asset Valuation under the SARFAESI Act 2002, the LARAR Act 2013, the Companies Act 2013, the Insolvency and Bankruptcy Code, 2016
- ▶ -Concept of Transferable Development Rights (TDR), Concept of Time Share Interest in Real Property. Valuation of TDR,
- ▶ Time Share Interest and Easement Rights.
- ▶ - Study of Indian Accounting Standards (Ind AS) as applicable to Valuation of Real Estate.
- ▶ - Study of International Valuation Standards (IVS) as applicable to Valuation of Real Estate
- ▶ Valuer as an Expert witness in Court.
- ▶ Valuers' Functions & Responsibilities, Error of Judgement and Professional Negligence
- ▶ Code of Conduct for valuers and Professional Ethics for valuers
- ▶ 6 Marks
- ▶ 3 hours

3.1. Introduction

- ▶ Theory of investment and return on investment in assets like land, land with building or plant and machinery
- ▶ Use of net income and rate of return expected by the asset holder.
- ▶ Value' is not intrinsic to or inherent in any thing,
- ▶ 'Interest' in a property
- ▶ Legal right to Derive Benefits
- ▶ No value property as a physical asset (land, brick and mortar etc.)
- ▶ Right to Derive benefit
- ▶ The form of 'Income'

3.2. Income Approach to Valuation:

- ▶ Income from a property
- ▶ Net income
- ▶ Interest yielded
- ▶ In mathematical form, capital value =net income x multiplier y.p.,y.p. depends on the rate of interest expected to be yielded ,y.p. is the summation of the present worth of series of income of re.1/-

3.3. The Main Steps in Income Capitalisation method :

- ▶ To collect data from market and other sources like records of Registrar of documents
- ▶ To inspect property to be valued
- ▶ To find out fair and maintainable gross rent receivable
- ▶ To deduct various permissible outgoings
- ▶ To select proper rate of capitalisation by study of Real Estate Market
- ▶ To find out applicability/Non applicability of Rent Control Act
- ▶ To capitalize net receivable income
- ▶ To deduct for major outstanding liability

3.4. Principle methods :

- ▶ Rental Method also known as Yield Method or Return on Investment Method
- ▶ Discounted cash flow technique (D.C.F. Method).
- ▶ Profit Method also known as Capitalization of earnings method.

3.5. Annuity:

- ▶ Net Annual Payment

3.6. Capitalization:

- ▶ Amount required to be invested by a person

3.7. Rate of Capitalization :

- ▶ An investor is willing to invest
- ▶ Remunerative rate of interest

3.8. Rate of Redemption of Capital:

- ▶ Income is a terminable income
- ▶ Accumulative rate of interest
- ▶ For recoupment of capital invested
- ▶ Short term leases
- ▶ Income is terminable
- ▶ Recoupment therefore requires highest and assured security
- ▶ Recoupment for sinking fund
- ▶ Low as 3% to 3-1/2%
- ▶ Rate of capitalization of 8% to 9%

3.9. Quality of Sound Investment like Govt. Security

- ▶ Has effect on the value of the property in the real estate market.
- ▶ Gilt edged securities
- ▶ Basic qualities:
 - Security of capital.
 - Easy liquidity of capital.
 - Guaranteed income.
 - Regularity of income.
 - Ease of collection of income.
- ▶ 3 types of securities
 - Short Term Security : Maturity is less than 5 years period.
 - Medium Term Security: Maturity is 6 years to 15 years period.
 - Long Term Security : Maturity after 15 years to 25 years and more.

3.10. Special features :

- ▶ It gives 100% safety of capital investment
- ▶ It gives lower rate of return
- ▶ Recoupment of the capital invested
- ▶ Liquidity of capital is high
- ▶ Ease of purchase and sale of the security
- ▶ No burden on management
- ▶ Raise loan easily without heavy cost
- ▶ Income tax and other fiscal benefits
- ▶ No scope for capital appreciation
- ▶ Can be divided in desired lots without any difficulty

- ▶ Disadvantage of this security is that it does not give any hedge against inflation

3.11. Immovable Property as Sound Investment :

- ▶ Safety of capital invested
- ▶ Rate of return on investment is 2% to 3%
- ▶ Income from property in form of rent may be regular or irregular
- ▶ Certainty of getting back capital
- ▶ Cannot be easily liquidated
- ▶ Cost of transfer is very high
- ▶ Management burden
- ▶ Loan cannot be easily raised
- ▶ Income tax benefits are minimum
- ▶ Hedge against inflation
- ▶ Good chance of capital appreciation
- ▶ Divisibility of holdings
- ▶ Purchase and sale of property is cumbersome.

3.12. Theory of Investment:

- ▶ Sorab Talati V/s. Joseph Michem¹
 - 1.5% more return than the average yield rate on long term Govt.
 - 2.5% return more than the average yield on long term Govt. security

Year	Bank Rate	Av.Yield G-sec	Yield on Bank F.D (3/5Yrs).
1935	3.5 %	3 %	3 %
1957	4 %	3 %	3 %
1965	6%	6.10 %	7%
1971	6 %	4.77/5.53 %	6.50 %
1974	9%	5.00/5.74 %	7.75 %
1981	10 %	6.44/7.49 %	10 %
1991	11 % / 12 %	10.86/12.04 %	12 %
1997	12 % / 9 %	9.00/14.20 %	12 / 13 %
1998	11 % / 9 %	9.00/13.17 %	11.50 / 12 %
1999	8 %	10.00/13.46 %	10.5 / 11.5 %
2001	7.50/6.50 %	10.58/11.89 %	9.50/ 10 %
2002	6.25 %	7.41/10.86 %	8.00/ 8.50 %
2004	6.00 %	5.44/7.72 %	5.25 / 5.50 %
2007	6.00 %	8.01/8.13 %	8.25 %
2010	6.00 %	7.80/ 7.84 %	7.0 %

3.13. Interest Yields of G-Sec and Bank FD :

From (Velusami)

3.14. Theory of Investment :

- ▶ Rate of return to be adopted on cost of investments in land and building
- ▶ Residential premises
- ▶ As low as 4% to 6% of value

3.15. Valuation of Lease hold properties :

- ▶ Lessor: the owner of the land or land with building,
- ▶ Lessee: the tenant of the property owned by and belonging to Lessor.
- ▶ Sub-lessee: under lease agreement, a right is given by Lessor to the Lessee to permit sub-letting

3.16. Types of Leases :

- ▶ (a) Building Lease.
- ▶ (b) Occupational Lease.
- ▶ (c) Sub Lease.
- ▶ (d) Lease for Life.
- ▶ *Building Lease:*
 - ..1. Lease period may be 40 years, 60 years, 99 years or even 999 years.
 - ..2. 99 years and more period is called long term lease or lease in perpetuity.
 - ..3. *Occupational Lease:* normally short 3 years, 5 years or 10 years.
- ▶ *Sub Leases:* for 99 years
- ▶ *Lease for Life*

3.17. Types of Rent :

- ▶ *Ground Rent:* by the land owner (Lessor) to the tenant (Lessee) for use of land
- ▶ *Rack Rent:* actual full rental value (Gross Rent) receivable from the property
- ▶ *Virtual Rent:* virtual gross rental value to the lessor receivable from the lessee , premium from the lessee in advance ,advance rental for the property

- ▶ *Head Rent: rent paid by sub-lessee to head lessee*
- ▶ *Profit Rent: higher rent than “head rent”.*
- ▶ *Contractual Rent: mutually agreed between the landlord and the tenant under the tenancy contract*
- ▶ *Standard Rent: regulate relationship between landlord and tenant. However since independence of India , for protection to tenants against exploitation , freezing of rent and protection against ejection*
- ▶ *Market Rent: highest rent that is receivable for the property*
- ▶ *Concessional Rent: below ruling rent in the locality*
- ▶ *Monopoly Rent: by charging monopoly rent to the occupant*

3.18. Valuation of Leasehold Properties: Valuation of interest of Lessor and Lessee in a property

- ▶ *Value of Lessor’s interest*
 - ..1. *Capitalised value of lease rent payable*
 - ..2. *Present value of the right of reversion of land/land with building*
- ▶ *Market value of the rights of the Lessor*
 - ..1. *Value of Lessee’s interest*
 - ..2. *Capitalised value of profit rental*
 - ..3. *Profit rental or utility value*

Example

A person is leasing his 2,000 sq.mts. land to Lessee in 2015 for 99 years period on monthly rent of Rs.10,000/month. This lease is renewable for further 99 years period on same terms. The person constructed a building and rented 5 nos of flats in 2016 on rental of Rs.15000/month. Repairs and other outgoings of the property are 30% of house rent income. Calculate value of Lessor’s interest in land and also calculate value of Lessee’s interest in the property. Prevalent rate of return in the market is 7%.

Solution

(a) Gross Annual Income of ground rent to Lessor:
 $\text{Rs.}10,000 \times 12 = \text{Rs.}1,20,000/-$ per year.

As rate of return is 7%,

Value of Lessor's interest = $\text{Rs.} 12,00,000 \times 100/7 = \text{Rs.} 17,14,285/-$ (a)

(b) Value of lessee's interest in property is as under:

Gross Annual House rent income

$\text{Rs.}15,000 \times 12 \times 5 = \text{Rs.}9,00,000$

Less : Outgoings :

Ground Rent $\text{Rs.}10,000 \times 12 = \text{Rs.}1,20,000$

Property tax & Repairs

30% of 900000 = $\text{Rs.}3,00,000$

= $\text{Rs.}4,20,000$

Net Annual Return

= $9,00,000 - 4,20,000 = \text{Rs.}5,80,000/ \text{yr.}$

Subsistence of lease is subjected to compliance of various terms, conditions and covenants of lease. Hence investment in purchasing Lessee's interest is little risky. We should therefore capitalize net yield at 1% higher return say at 8%.

Value of Lessee's interest in property:

$\text{Rs.}5,80,000 \times 100/8 = \text{Rs.}2,66,666/-$

Say $\text{Rs.}72,50,000/-$ (b)

3.19. Concept of Reversionary Value of Land

- ▶ In cases of terminable interest,
- ▶ Lessor gives land to lessee for development
- ▶ Take back the possession of land in original condition after lease expiry
- ▶ Lessor acquires or holds two rights
 - First right is to get back his own land on expiry of lease.
 - Second right is to get full ownership of building constructed

Example

Mr. X leased 15000 sq.mts. land in 2014 to Lessee for 99 years period by charging lease rent of $\text{Rs.}100000/\text{month}$. Lessee constructed the building yielding total rent of $\text{Rs.}55000/\text{month}$. Lease is renewable for further period of

99 years on same terms. Calculate value of the Lessee's interest in the property and also value the Lessor's interest in property, as on March 2015, if Rent Act is applicable. Property taxes and other expenses for house are 50% of Gross Rent. Adopt expected rate of return at 8%.

Solution :

(a) Value of Lessor's interest = Capitalised value of ground rent income in perpetuity.

Gross Annual Rental income = Rs. 10000 x 12 = Rs. 12,00,000/-

Value of Lessor's interest: $1,20,000 \times 100/8 = \text{Rs.}1,50,00,000/-$

Say Rs.1,50,00,000/- ... (a)

(b) Value of lessee's interest = Capitalized value of net house rent income.

Gross Annual house rent income = Rs.55000 x 12 = Rs.6,60,000/-

Less :

Outgoings.

Lease rent/year = Rs.1,20,000/-

Other outgoings 50% of G.Rent.Rs.1,20,000/- = Rs.60,000/-

Net annual income = Rs.6,00,000/-

As Lessee's rental income is subjected to risk of irregular rental income and also risk of likely forfeiture of the lease, 1% higher rate of capitalization is adopted.

Value of Lessee's interest = $6,00,000 \times 100/9 = \text{Rs.}66,66,000/-$ (b)

Example

Mr. B leased 30000 sq.mts. plot to Lessee in 2015 for 99 years period , at lease rent of Rs.1,50,000/month. No initial premium is taken. Lease is renewable for 99 years further period on same terms. Expected rate of return is 8%. Freehold land rate in locality is Rs.4,000/sq.mt. and no building is put up on the plot by the Lessee. Calculate value of Lessor's interest in land and value of Lessee's interest in land as in year 2010.

Solution:

(a) Value of Lessor's interest

= $1,50,000 \times 12 \times 100/8$

= Rs.2,25,00,000/-(a)

(b) Value of lessee's interest

= Freehold value — Value of Lessor's interest.

= $30,000 \times 4,000 - 2,25,00,000$

= Rs. 12,00,00,000 — 2,25,00,000

= Rs.9,75,00,000/- (b)

3.20. Valuation of Rented Properties :

- ▶ Lessors and Lessees interest in the property

3.21. Various Outgoings

- ▶ Property Taxes
- ▶ Land Revenue
- ▶ Ground Rent
- ▶ General Repairs
- ▶ House Insurance
- ▶ Upkeep and Services
- ▶ Collection and Management Charges
- ▶ Vacancies & Bad debts
- ▶ Sinking Fund

3.22. Type of Life of Building :

- ▶ Economic Life :service life or planned life
- ▶ Physical Life :actual survival life span
- ▶ Life due to Obsolescence : out of date , residential building in an industrial zone , Environment, user and other factors

3.23. Cost of accrued structural repairs :major structural repairs for safe and tenatable condition,not include minor repairs and maintenance work like new waterproofing, outside plaster, replacement of structural members of M.T. roof or steel roof, structural repairs of R.C.C. frame members.

3.24. Assignment Premium : leasehold properties transfer charges are payable to Lessor

3.25. Unpaid taxes, water bills or Government land revenue

Example

A building has G + 3 upper floors. There are 6 tenants per floor. Ground floor tenants pay rent of Rs. 10000/month for each flat. Upper first floor, second floor and third floor tenants, pay rent of Rs.10500/month per flat, Rs.11000/month per flat and Rs.11500/month per flat respectively. Property taxes are Rs.56,000 per 6 month. N.A. tax is Rs.10000/year. Building Insurance premium is Rs.17000/year. Sweeper salary is Rs.3000/month. Common light bill is Rs.1600/month. Calculate market value of the property if building is 30 years old and expected rate of return on investment is 7%. There are no accrued major repairs to building and Rent Act is applicable. Collection & Management charges are 45000/-

Solution:

Gross Annual Rent:

$(Rs.10000 + Rs.10500 + Rs.11000 + Rs.11500) \times 6 \times 12 = 30,96,000/-$

Less: Outgoings:

Property taxes Rs.56,000 x 2	Rs.1,12,000
N.A. Tax per year	Rs. 10,000
Insurance premium	Rs. 17000
General Repairs 8% of G.R. (assumed)	Rs. 2,47,680
But in exams it shall be given	
Sweeper salary Rs. 3000 x 12	Rs. 36,000
Common light Rs.1600 x 12 Rs	Rs. 19200
Collection & Management	Rs. 45,000
Total Outgoings =	Rs. 4,86,880

Net Annual Rent = 30,96,000 — 4,86,880
= Rs. 26,09,120/-

Capitalizing yield at in perpetuity we get :

Value of property = Rs. 26,09,120 x 100/7
= Rs. 3,72,73,100/-

Say Rs. 3,72,73,100/-

Example

Value fully rented, fully developed building has G + 2 upper floors. There are 4 tenants/each floor. Ground floor tenants pay rent of Rs.16000/month/flat. First and second floor each tenant pays rent of Rs.16800/month per flat. Property taxes are Rs.192000/6 months. N.A. tax is Rs.18000/year. Building insurance premium is Rs.20000/year. Sweeper salary is Rs.6000/- per month. Electric light bill for common areas is Rs.3200/month. Calculate market value of the property, if building is 25 years old and expected rate of return is 9%. There are no accrued major repairs to building and Rent Act is applicable. General Repairs 6 % of G.R Collection & management 3% of G.R

Solution:

Gross Annual Rent: $(16000 + 16800 + 16800) \times 4 \times 12 = \text{Rs.}23,80,800$

Less: Outgoings.

Property taxes Rs.192000 x 2 = Rs.3,84,000

N.A. tax per year = Rs. 18000

Insurance premium = Rs. 20000

General Repairs 6 % of G.R. = Rs.1,42,848

Sweeper salary Rs. 6000 x 12 = Rs. 72,000

Common light 3200 x 12 = Rs. 38,400

Collection & management 3% of G.R. = Rs. 71,424

Total outgoings = Rs. 7,46,672

Net Annual Rent = $23,80,800 - 7,46,672$

= 16,34,128 Rs.

Capitalising yield at 9% in perpetuity, we get,

Value of the property : $16,34,128 \times 100/9 = \text{Rs.}1,81,56,977/-$

Say Rs. 1,81,56,977/-

Example

A is sold for Rs.700,000/-. On market evidence it is learnt that total rent income from house is Rs.84,000/year. Property taxes are Rs.20,000/6 months. Other expenses are 20% of Gross Rent. Calculate rate of return available to the purchaser landlord.

Solution : Gross Annual Return : Rs.84,000

Less : Outgoings.

Property tax Rs. 20,000 x 2 = Rs.40,000

Other outgoings 20 % of 84,000 =Rs. 16,800

Total = Rs.56,800

Net yield per year = $84,000 - 56,800 = \text{Rs.} 27,200$

$$\text{Rate of return} = \frac{\text{Net yeild}}{\text{Investment}} \times 100$$

$$= 27,200 / 7,00,000 \times 100 = 3.88 \%$$

Example

A shop was rented out in 2000 at Rs.30000/month. Court reduced rent and fixed standard rent at Rs.1500 per month. Value today , if the society maintenance charges are fixed at Rs.22800 for 3 months as under.

Property Taxes	Rs. 12000
Society Maintenance	Rs. 1800
Sinking Fund	Rs. 600
Insurance	Rs. 300
Water Charges	Rs. 900
Car Parking charge	Rs. 1200
Non occupancy charge	Rs. 3000 Rs.
Capitalising net yield at 10%	

Solution:

Gross Annual Return G.R.= Rs.15000 x 12
= Rs.18,0000

Less : Outgoings.

Property tax. 12000x4	= Rs.48000
Maintenance 1800x 4	= Rs. 7200
Sinking Fund 600x4	= Rs. 2400
Insurance 300x4	= Rs. 1200
Water charges 900x4	= Rs. 3600
Parking charges 1200x4	= Rs. 4800
Non occupancy charges 3000 x 4	= Rs. 12000

Total =Rs.93600

Collection and management 3% of G.R. = Rs. 5400

Internal repairs 5% of G.R. = Rs. 9000

Total = Rs.105600

Net Yield/Year = Rs.86,400/-

Capitalising net yield at 10% in perpetuity, we get,

Value of the flat = Rs.86,400/- x 100/10

= Rs.8,64,000/-

3.26. Types of situations where in rental method is used:

A) Land is fully developed and building on plot is fully tenanted.

- ▶ Only Rental Method is applicable.

b) Land is fully developed but building is partly let out and partly owner occupied.

- ▶ Rented portion to be valued by rental method and owner occupied portion by market approach.

c) Land is partially developed with surplus available F.S.I. Rented building is in one side of the plot,

- ▶ Rented portion by Rental Method. Surplus F.S.I. to be valued by comparing with rate of open plot prevalent in the locality. Separate building in plot is possible to consume F.S.I.

d) Land is partially developed with surplus available F.S.I. But only vertical development is possible over rented building.

- ▶ Rented portion by rental method. Surplus F.S.I. to be valued after deducting cost of strengthening building or extra cost of structural frame work provided from outside.

e) Land is only partially developed but rented ground floor structures in the plot occupy entire plot.

- ▶ Rental Method may or may not be used depending upon market trend. Balance potential to be valued by Development Method. This is the case where total demolition of rented building existing in the plot is necessary for optimum use of land.

Example

A luxurious bungalow is built by an entrepreneur in his home town, a very small village having population of hardly 9,000 persons. Area of plot is 4000 Sq.Mts. Bungalow builtup floor area is 400 Sq.Mts. on ground floor and 400 Sq.Mts. on 1st floor. Total cost of land and bungalow in year 2010 was Rs.6 lacs and Rs.44 lacs respectively. Value the property as on 2018 if no one in village has capacity to pay even 10 lacs for the property and small rented premises are available in village at rate of Rs.10/SM/Month.

Solution:

There is no paying capacity of buyers in the village. We can therefore value property by rental method. Assume two tenants . One paying net rent of Rs.4000/Month for ground floor and second one paying Rs. 2000/Month for 1 floor.

Gross Annual Receivable Rent = $(4000 + 2000) \times 12$

= Rs.72,000/-

Capitalising net rent at 6%, in perpetuity, we get, Value of property = $72,000 \times \frac{100}{6}$ = Rs.12,00,000/-

It will be seen that property having a cost of Rs 50 Lacs in 2010 had value of only Rs. 12 lacs after eight years.

Even owner/occupied or vacant flats in urban area can also be valued by rental method instead of sales comparison method. However we will have to first arrive at fair rental value of flat with the help of sales comparison method.

3.27. Limitations of Rental Method :

- ▶ No single method of valuation is perfect
- ▶ Rental Method greatly depends on selection of proper and accurate rate of capitalisation.
- ▶ Even 1% variation in the selected rate of return , may change values by 8 to 10%.

3.28. Case laws cited in this chapter

1. Sorab Talati V/s Joseph Michem (Appeal No.101 of 1949) Mumbai H.C.
 - ✓ Rate of return (1.5.% on long term government
 - ✓ Security and 2.5% more on average yeild)
2. R.C.Cooper V/s Union of India (AIR 1970 SC-564) Supreme Court
 - ✓ Scope of property to value
3. C.W.T. V/s P.N.Sikand (1977) (107 ITR 922) Supreme Court.
 - ▶ For lease hold property (50% unearned increase of land has to go to lessor)

3.29. Investment appraisal

▶ Measure of investment:

3.30. Few appraisal techniques.

1. Net present value (NPV)- By DCF Method
2. Internal rate of return (IRR)
3. Accounting rate of return
4. Payback
5. Cost benefit ratio

3.31. Discount Cash Flow (DCF)

- Net cash flow during each period, i.e., Estimated cash inflow or outflow.
- Discount factors for each period - this can be
 - calculated by using the Expression
 - $C \times \frac{1}{(1+r)^N}$

Where, r = rate of return per period (expressed as a decimal), and
 N = number of periods.

Multiplication of the anticipated future cash flow by the appropriate discount

Factor gives the present value.

Example

Mr. A agrees to sell a property to Mr. B for rs. 10,00,000. Mr. B however, asked For some concessions in payment by allowing him to pay in installments. The first Installment of 20% was made immediately. The other installments were to be made In equal amounts every two months. Discuss the benefits that Mr. B obtained from his friend Mr. A by requesting him to accept this scheme of payment assuming that Interest rate in the market is 12 per cent per annum.

Solution

The easiest way to do this problem is to bring all payments to present value.

Instal lment No.	Amount	R per month	n	$\frac{1}{(1 + R)^n}$	Present value (Rs.)
1	200000	0.01	0	1	200000
2	200000	0.01	2	0.980	196,000
3	200000	0.01	4	0.96	192,000
4	200000	0.01	6	0.94	1,88,000
5	200000	0.01	8	0.92	1,84,000
					960000

Instead of paying an amount of Rs. 1000000 at a time, Mr. B gets the opportunity of paying in installments. The present value of which is Rs. 960000. He is therefore, benefits by an the amount of $500000 - 960000 = 40000/-$
 Ans is Rs.40,000/-

Example

In the following investment proposal the enterpreneur would like to know the minimum sale price X. You are requested to advise him.

Cost of readymade house Rs. 40,00,000

Improvements Rs.30,00,000

Rent per year for consecutive 5 years (payable at the end of each year) Rs. 600,000

Sale price at the end of 5 years Rs. X

Tax to be paid at the time of sale Rs. 1,00,000

Target rate Rs. 12%

Time (years)	Details	Cash flow(C) (-)_outgoing (+) Incoming	R	N years	Discount factor $\frac{1}{(1 + R)^n}$	Present value $P = C \times D$ (Rs.)
0	Cost of house	-40,00,000	0.12	0	1	-40,00,000
0	Improvements	-30,00,000	0.12	0	1	-30,00,000
1	Rent year 1	+6,00,000	0.12	1	0.89286	+5,35,700
2	Rent year 2	+6,00,000	0.12	2	0.79719	+4,78,320
3	Rent year 3	+6,00,000	.12	3	0.71178	+4,27,070
4	Rent year 4	+6,00,000	0.12	4	0.63552	+3,81,320
5	Rent year 5	+6,00,000	0.12	5	0.56743	+3,40,460
5	Sale value	+X	0.12	5	0.56743	0.56743 X
5	Capital Gain Tax	-1,00,000	0.12	5	0.56743	-56,740

The minimum sale price X of the house will be obtained when the total present value P as calculated above is zero so that a 12 % target rate is maintained.

So

$$-4893870 + 0.56743 X = 0$$

$$\text{Or } X = 86,24,623/-$$

Say 86,24,623/-

3.32. Internal rate of return (IRR)

- Obtained from an investment. To be calculated so that all future discounted receipts and discounted payments are equal.

3.33. Nature and characteristics of yields:

- To generate a cash flow in the future
 - ▶ Internal rate of return:
 - Rate used in discounted cash flow (DCF) analysis

- ▶ All risks
 - Rental income remains the same throughout the life of the asset and other factors such as inflation, growth and risk are ignored
- ▶ **Equivalent yield:**
 - A variation of the all risks yield capitalizing the term rent at a lower rate of interest than that used for the reversionary rent.
- ▶ **Gross redemption yield:**
 - An equivalent yeild. Applied to government stocks {gilts} which provide a fixed income, are redeemable at par or a fixed amount on expiry.

3.34. Inflation and growth

- ▶ The rapidly changing economic parameters, changing laws, continuous inflation and various other factors contribute to the necessities
- ▶ General economic forces
- ▶ Factors of supply, demand, alternate possible lettings, physical attributes of the property, lease terms, liabilities for outgoings, etc
- ▶ By the supply and demand factors and the yields obtained on similar investments.
- ▶ To provide a hedge against inflation.
- ▶ Due to inflation rather than due to real growth.
- ▶ Investor is able to reestablish the real purchasing power of the income.
- ▶ The investor sells the property, new investor will determine the value having regard to the income rather than keeping pace with inflation only

3.35. Valuation of special types of properties

3.35.1. Valuation for easements

- Non exclusive use of a portion
- A specific purpose or enjoyment of a certain rights as the 'dominant tenement'
- Type of easements:
 - 'Self-imposed'
 - 'Legal'

- Characteristics of easements:
 - The dominant and servient easements must co-exist. Cannot be one without the other may be granted by the deed, easement by existing conditions and usage. A personal right cannot be claimed it must be definite and beneficially enjoyable.
- **Creation and Extinguishment of Easements**
 - Can be created or extinguished by owners or their representatives
 - Can be by grant as per agreement

Example

Mr. X and Mr. Y are owner of two adjacent plots of land with building on them having a common boundary. However, the municiple has constucted a garden in some portion on Mr. X's plot which can be used by Mr. X and a few other neighbours. The estimated value of the above properties belonging to X and Y are Rs. 12,00,00,000 and Rs. 11,00,00,000 respectively. Because of the common use of this facility, which has caused some nuisance to Mr. X has decided to sell the property. About three months ago, before the construction, the fair market value for the propeties was estimated Rs 10,00,00,000 and Rs. 8,00,00,000 for Mr. X's and Mr. Y's property. Estimate the diminishing in Mr.X's property due to the easement rights given by him to his neighbor.

Solution

Increase in Mr. X's property
 $= \text{Rs.}12,00,00,000 - \text{Rs.}10,00,00,000 = \text{Rs. } 2,00,00,000$
 Percentage increase over prices three months ago =
 $= 2,00,00,000 / 10,00,00,000 \times 100 = 20\%$

Increase in Mr. Y's property
 $= \text{Rs.}11,00,00,000 - \text{Rs.}8,00,00,000 = \text{Rs. } 30,00,00,000$
 Percentage increase over prices three months ago =
 $= 30,00,00,000 / 8,00,00,000 \times 100 = 37.5\%$

Assuming that increase in percentage value of both properties should be same because of the tube well and ignoring increase due to other factors it can be assumed that decrease in value of Mr. X's property due to granting of easement right = $37.5\% - 20\% = 17.5\%$

Diminshing in Mr. X's Property due to easement
 $= 17.5\% \text{ of Rs } 10,00,00,000 = \text{Rs. } 1,75,00,000$

Ans: Rs. 1,75,00,000

3.35.2. Hotel and restaurant industry

- ▶ Salient points to be noted:
- ▶ Location of the premises.
- ▶ Characteristics of furniture, fittings and miscellaneous equipment.
- ▶ Type of management and its efficiency.
- ▶ Type of services provided.
- ▶ Quality of rooms, as also the general construction of the premises.
- ▶ Quality of food that is served.
- ▶ General standard of cleanliness.

Example

An investor has purchased a land 20 years ago for Rs. 2,00,00,000 constructed a hotel five years ago, spending Rs. 4,00,00,000 for building, furnishing, decoration, etc. And runs the same himself. The hotel has 120 single Rooms and 80 double rooms besides all the other facilities such as a good and clean dining room which serves liquor and provides other necessary comforts. The Vacancy percentage on the rooms is approximately 75% calculated on an annual Basis. The room rent averages Rs. 6000 per day for a single room and rs. 10000 per Day for double room depending upon the season. Maintenance costs for the hotel Portion are estimated to be 10% of the gross rent collected. The government has Imposed a luxury tax on room rent at 20%. The restaurant runs for 365 days of the year and it has been estimated that After accounting for good, Liquor and paying off the dining room employees, the Profit aft. paying all taxes (except income tax), accounting for depreciation, repair, maintenance, etc. Works out to Rs. 500 per every person who either stays at the hotel or enters the dining room. Additional people not staying at the hotel but Entering the restaurant is estimated to be 250 daily. There is an income from other sources such as advertisements, commission, Etc. of Rs. 6,00,00,000 per annum to the business. Calculate the value of the property.

Solution

Gross income from 120 single rooms per day
 $= 120 \times 6000 \times 0.75 = 540000$

Gross income from 80 double rooms per day
 $= 80 \times 10000 \times 0.75 = 600000$

Gross Income from all rooms per day = Rs. 1140000

Gross income from all rooms per annum
 $= 1140000 \times 365 = 41,61,00,000$

Less luxury tax to be paid to Government @ 20%(-)
 $= \text{Rs. } 8,32,20,000$

Remains = Rs.33,28,80,000
Less maintenance cost on hotel portion
@ 10% of gross Income of rent(-)=Rs.4,16,10,000

Income from hotel portion per annum
=29,12,70,000 (a)

Number of clients staying at the hotel daily:
In single rooms = $0.75 \times 120 = 90$
In double rooms = $0.75 \times 80 \times 2 = 120$
Others entering the restaurant = 250
Total number of people using the restaurant daily
= 460

Profit to restaurant daily = $230 \times 500 = \text{Rs. } 2,30,000$
Profit to restaurant per annum = $365 \times 5,750$
= Rs. 8,39,50,000 (B)
Income from other sources per annum
= Rs. 6,00,00,000 (C)

The net profit is as follows: .

(A) From room rent = Rs. 29,12,70,000
(B) From restaurant business = Rs. 8,39,50,000
(C) From other sources. = Rs. 6,00,00,000
Total net profit = Rs. 43,52,20,000

On analyzing the components of the net profit we could allocate different ratios of tangible to intangible profit for each component or perhaps could even consider a ratio on the total net profit. This is left up to the judgement of the valuer. In this case the ratios have been fixed as follows for the reasons given.

(a) Room rent On a basic investment of Rs. 2,00,00,000 and Rs. 4,00,00,000 made 10 years and 5 years ago for rooms, a return of Rs. 29,12,78,000 seems high at current rates. Therefore, there must certainly be an element of goodwill for the business, i.e., the rooms are of a high standard and maintenance, service, etc. are of good quality. Therefore, tangible to intangible profit ratio is assumed at 66.67 to 33.33%.

(b) Restaurant business, This, too, seems to have a high degree of management efficiency but because food and drink items have to be purchased the intangible profit percentage is not likely to be as high as in the former case. The ratio assumed in this case will be at 75 to 25%.

(c) Advertisement and commission

For this the ratio of tangible and intangible is taken as 40 to 60%

Talking to Rate of return it is taken as shown further in the table.

Component	Total net profit	Type	%	Amount	Yield	Value
Room rent	29,12,78,000	Tangi.	66.67	194195042	100/10	1941950426
		Intangi	33.33	9708295740	100/12	80902464500
Restaurant	20,98,750	Tangi.	75	62962500	100/11	572386363
		Intangi	25	20987500	100/13	17758653
Other income	6,00,00,000	Tangi	40	24000000	100/13	184615384
		Intangi	60	36000000	100/15	240000000
Total	435228000					83859175328

Ans is Rs. 83,85,91,75,328/-

Say 83,85,92,00,000/-

Example

An owner of a multiplex receives Rs 1,00,000 daily as rent for allowing its use. He pays insurance premium at Rs. 13,00,000 per annum, and his collection and management charges are estimated @ 6 % of gross income. Depreciation is to be allowed @ 10% of the gross income. All other charges are paid by the contractor who runs the show. Calculate the value of Multiplex to the owner. Insurance premium = Rs 13,00,000

Solution

Gross rent to the owner = $1,00,000 \times 365$
= Rs. 3,65,00,000

Insurance premium = Rs 13,00,000

Collection and management charges @ 6% of
Rs. 3,65,00,000 = Rs. 21,90,000

Less owner's risk and entrepreneurship @ 15% of
Rs. 3,65,00,000 = Rs. 54,75,000

Net profit = Rs.2,75,35,000

Divide the net earnings in tangible and intangible earnings in the ratio of 70%,
30%

Tangible = Rs. 2,01,84,500

Intangible = Rs. 82,60,500/-

Capitalize tangible profits @ 12 % and Intangible @ 15 % for perpetuity

$$= \left(\left(\frac{100}{12} \right) \times 2,01,84,500 \right) + \left(\left(\frac{100}{15} \right) \times 82,60,500 \right)$$

= **Rs. 28,45,28,300/-**

3.35.3. Valuation for Time Share Property

Time Share Concept

Evolved in France

Providing cheaper hotel accommodation for Regular visiting people/tourist, Selling hotel room on temporary ownership right basis (or) fixed time period, occupancy basis, Stay for - Specific number of days without paying charges.

Time share Right - Saleable in the manner to third party

- Time Share ownership
- Right to occupy on lease ownership
- Part time Ownership

- ▶ Lease Ownership
 - Time Share period - Number of years is fixed (Example 20 years)
 - Purchaser gets right to use specific number of days After time share rights, it reverts back to Developer.
 - Time share ownership Rights can be saleable
- ▶ Valuation of Time Share Rights
 - Comparable sale Method
 - Rental Income Method

3.35.4. Valuation as a going concern and determination of goodwill

- Expected to continue in operation and have a 'going concern value',
- Includes a value apportioned to both tangible and intangible assets.
- The profit method of valuation is adopted.

3.35.5. Market value of goodwill:

- The privilege granted by the seller of a business to a purchaser of trading as his recognized successor
- The possession of a ready-formed connection with customers considered as a separate element in the saleable value of a business.
- The extent that it is transferable. Attached to personal qualities, reputations, brand names or similar items.
- Through a valuation process where an alternative use of the premises is adopted.

- Financial adjustments to normalize treatment , such items as capital, bad debts, depreciation, valuation of stock, etc. And to exclude non-recurring Items.
- The value of services provided to the business by the proprietors and/or members of their families.
- The value of fixed assets owned by and/or employed in the business.
- Normally be reflected in a balance sheet. In addition to the fixed assets,
- Financial assets and also intangibles amongst which may be included goodwill.
- Business as a continuing operation.

3.35.6. Mehods of valuing Good will

Source : (Swayamjit)

1. Years' Purchase of Average Profit Method:

Under this method, average profit of the last few years is multiplied by one or more number of years in order to ascertain the value of goodwill of the firm. How many years' profit should be taken for calculating average and the said average should be multiplied by how many number of years — both depend on the opinions of the parties concerned. The average profit which is multiplied by the number of years for ascertaining the value of goodwill is known as Years Purchase. It is also called Purchase of Past Profit Method or Average Profit Basis Method.

Profit Basis Method:

$$\text{Average Profit} = \frac{\text{Total Profits for all the years}}{\text{Number of Years}}$$

Value of Goodwill = Average Profit x Years' Purchase

Illustration 1:

Majumdar & Co. decides to purchase the business of Banerjee & Co. on 31.12.2003. Profits of Banerjee & Co. for the last 6 years were: 1998 Rs. 10,000; 1999 Rs. 8,000; 2000 Rs. 12,000; 2001 Rs. 16,000, 2002 Rs. 25,000 and 2003 Rs. 31,000.

The following additional information about Banerjee & Co. were also supplied:

(a) A casual income of Rs. 3,000 was included in the profit of 2000 which can never be expected in future.

(b) Profit of 2001 was reduced by Rs. 1,000 as a result of an extraordinary loss by fire.

(c) After acquisition of the business, Majumdar & Co. has to pay insurance premium amounting to Rs. 1,000 which was not paid by Banerjee & Co.

(d) S. Majumdar, the proprietor of Majumdar & Co., was employed in a firm at a monthly salary of Rs. 1,000 p.m. The business of Banerjee & Co. was managed by a salaried manager who was paid a monthly salary of Rs. 4,000. Now, Mr. Majumdar decides to manage the firm after replacing the manager.

Compute the value of Goodwill on the basis of 3 years' purchase of the average profit for the last 4 years.

Solution:

Computation of Goodwill

	Rs.	Rs.
Profit of 2000	12,000	
Less: Casual Income	<u>3,000</u>	
		9,000
Profit of 2001	16,000	
Add: Abnormal Loss	<u>1,000</u>	
		17,000
Profit of 2002		25,000
Profit of 2003		31,000
		<u>82,000</u>
Average Profit = (Rs. 82,000 ÷ 4)		20,500
Less: Insurance Premium		<u>1,000</u>
		19,500
Add: Manager's Salary (Rs. 400 × 12)		<u>4,800</u>
		24,300
Less: Majumdar's Salary (Rs. 1,000 × 12)		<u>12,000</u>
Expected Net Average Profit:		<u>12,300</u>

∴ Value of Goodwill = Rs. 12,300 × 3 = Rs. 36,900

Method. Under this method, each and every year's profit should be multiplied by the respective number of weights, e.g. 1, 2, 3 etc., in order to find out the value of product which is again to be divided by the total number of weights for ascertaining the weighted average profit. Therefore, the weighted average profit is multiplied by the years' purchase in order to ascertain the value of goodwill. This method is particularly applicable where the trend of profit is rising.

$$\text{Weighted Average Profit} = \frac{\text{Total Profits for all the years}}{\text{Number of years}}$$

$$\text{Value of Goodwill} = \text{Weighted Average Profit} \times \text{Years Purchase}$$

Illustration 2:

XYZ Co. Ltd. intends to purchase the business of ABC Co. Ltd. Goodwill for this purpose is agreed to be valued at 3 years' purchase of the weighted average profits of the past four years.

The appropriate weights to be used:

1998 — 1; 1999 — 2; 2000 — 3; 2001-4.

The profits for these years were:

	Rs.
1998	30,900
1999	45,400
2000	35,700
2001	48,000

The following information were available:

(a) On 1.9.1999 a major repair was made in respect of a Plant at a cost of Rs. 8,000 and this was charged to revenue. The said sum is agreed to be capitalized for Goodwill calculation subject to adjustment of depreciation of 10% p.a. on Diminishing Balance Method.

(b) The Closing Stock for the year 2000 was overvalued by Rs. 3,000.

(c) To cover the Management cost an annual charge of Rs. 10,000 should be

Solution:

Adjusted Annual Profits:

	1998 Rs.	1999 Rs.	2000 Rs.	2001 Rs.
Add: Profits	30,900	45,400	35,700	48,000
Repair for Plant (being a capital expenditure) charged to revenue	—	(+ 8,000)	—	—
	<u>30,900</u>	<u>53,400</u>	<u>35,700</u>	<u>48,000</u>
Less: Depreciation, not provided for @ 10% on Rs. 8,000 on Diminishing Balance Method	—	(-) 800	(-) 720	(-) 648
	<u>30,900</u>	<u>52,600</u>	<u>34,980</u>	<u>47,352</u>
Less: Overvaluation of Stock	—	—	(-) 3,000	(+ 3,000)
	<u>30,900</u>	<u>52,600</u>	<u>31,980</u>	<u>50,352</u>
Less: Management Cost	(-) 10,000	(-) 10,000	(-) 10,000	(-) 10,000
	<u>20,900</u>	<u>42,600</u>	<u>21,980</u>	<u>40,352</u>

Weighted Average Profit

Years	Profits Rs.	Weights Rs.	Product Rs.
1998	20,900	1	20,900
1999	42,600	2	85,200
2000	21,980	3	65,940
2001	40,352	4	1,61,408
		<u>10</u>	<u>3,33,448</u>

Weighted Average of 4 years' profit = $\frac{\text{Rs. } 3,33,448}{10}$
= Rs. 33,345 (approx.)

Value of Goodwill = Rs. 33,345 × 3 = Rs. 1,00,035
or, say, Rs. 1,00,000

3. Capitalisation Method:

Under this method, the value of the entire business is determined on the basis of normal profit. Goodwill is taken as the difference between the Value of the Business minus Net Tangible Assets.

Under this method, the following steps should be taken into consideration for ascertaining the amount of goodwill:

- (i) Expected Average Net Profit should be ascertained;
- (ii) Capitalised value of profit is to be calculated on the basis of normal rate of return;
- (iii) Net Tangible Assets (i.e. Total Tangible Assets – Current Liabilities) should also be calculated;
- (iv) To deduct (iii) from (ii) in order to ascertain the value of Goodwill.

Capitalised Value of Profit = Profit (Adjusted)/Normal Rate of Return x 100

Value of Goodwill = Capitalised Value of Profit – Net Tangible Assets

Illustration 3:

The following is the Balance Sheet of P. Ltd. as at 31.12.2009:

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital:		Goodwill	20,000
20,000 Equity Shares of Rs. 10 each	2,00,000	Building at Cost	80,000
Profit and Loss Account	40,000	Plant & Machinery at Cost	50,000
Depreciation Fund:		Sundry Debtors	30,000
Building	5,000	Less: Reserve for Bad Debts	3,000
Plant and Machinery	3,000		27,000
	8,000	Stock-in-Trade	43,000
Sundry Creditors	22,000	Cash at Bank	50,000
Bills Payable	4,000	Discount on Issue of Shares	10,000
Provision for Taxation	6,000		
	<u>2,80,000</u>		<u>2,80,000</u>

The profits of the past four years (before providing for taxation) were:

2006 — Rs. 20,000; 2007 — Rs. 30,000; 2008 — Rs. 36,000 and 2009 — Rs. 40,000.

Compute the value of Goodwill of the company assuming that the normal rate of return for this type of company is 10%. Income Tax is payable @ 50% on the above profits.

Solution:

<i>Computation of Capital Employed/Net Tangible Assets</i>	Rs.
Building (Rs. 80,000 – Rs. 5,000)	75,000
Plant and Machinery (Rs. 50,000 – Rs. 3,000)	47,000
Sundry Debtors (Rs. 30,000 – Rs. 3,000)	27,000
Stock-in-Trade	43,000
Cash at Bank	50,000
	<u>2,42,000</u>

Less: Current Liabilities:

Average Profit:	Rs.
4 years' total Profit = Rs. 20,000 + Rs. 30,000 + Rs. 36,000 + Rs. 40,000	
= Rs. 1,26,000	
<i>Less: Income tax @ 50%</i> = Rs. <u>63,000</u>	
4 years' Adjusted Profit = 63,000	
∴ Average Profit = Rs. 63,000 ÷ 4 = Rs. 15,750	
Capitalised Value of Profit = $\frac{(Rs. 15,750 \times 100)}{10}$	1,57,500
<i>Less: Net Tangible Assets</i>	<u>2,10,000</u>
∴ Value of Goodwill	<u>Nil</u>

Illustration 4:

From the following Balance Sheet and other necessary information of P. Ltd. for the year ended 31.12.2001, compute the value of Goodwill by the application of Capitalisation Method:

<i>Liabilities</i>	Rs.	<i>Assets</i>	Rs.
Share Capital: 20,000 Equity Shares of Rs. 100 each, fully paid	2,00,000	Goodwill	40,000
Bank Overdraft	40,000	Land and Building	1,00,000
Sundry Creditors	80,000	Plant and Machinery at cost less Depreciation	1,00,000
Provision for Taxation	50,000	Stock-in-Trade	80,000
Profit and Loss Appropriation A/c	70,000	Book-Debts less Provision for Bad Debts	1,20,000
	<u>4,40,000</u>		<u>4,40,000</u>

The company commenced operation in 1997 with a paid-up capital of Rs. 2,00,000.

Profits earned before providing for taxation have been:

1997 — Rs. 90,000; 1998 — Rs. 95,000; 1999 — Rs. 1,05,000; 2000 — Rs. 80,000; 2001 — Rs. 1,10,000.

Assume that Income-Tax @ 50% has been payable on these profits. Dividends have been distributed from the profits of the first three years @ 10% and for those of the next two years @ 15% on the Paid-up Capital.

Solution:

$$\text{Average rate of dividend} = \frac{(10 \times 3) + (15 \times 2)}{5} = 12\%$$

Calculation of Profit

Year	Profit (before Tax) Rs.	Tax @ 50% Rs.	Profit (after Tax) Rs.
1997	90,000	45,000	45,000
1998	95,000	47,500	47,500
1999	1,05,000	52,500	52,500
2000	80,000	40,000	40,000
2001	1,10,000	55,000	55,000
			2,40,000

+ 5 = Rs. 48,000

$$\therefore \text{Capitalised Value of Profit} = \frac{\text{Rs. } 48,000}{12} \times 100 = 4,00,000$$

$$\text{Net Tangible Assets} = (\text{Rs. } 4,00,000 - \text{Rs. } 1,70,000) = \text{Rs. } 2,30,000$$

$$\text{Value of Goodwill} = \text{Rs. } 1,70,000 (\text{Rs. } 4,00,000 - \text{Rs. } 2,30,000).$$

4. Annuity Method:

Under this method, Super-profit (excess of actual profit over normal profit) is being considered as the value of annuity over a certain number of years and, for this purpose, compound interest is calculated at a certain respective percentage. The present value of the said annuity will be the value of goodwill.

Value of Goodwill,

$$V = \frac{a}{i} \left(1 - \frac{1}{(1+i)^n} \right)$$

Where

V = Present value of Annuity

a = Annual Super Profit

n = Number of Years

I = Rate of Interest

Illustration 5:

From the following particulars, compute the value of goodwill under Annuity Method:

Super-Profit Rs. 10,000

Number of years over which Super-Profit is to be paid 5

Rate Per cent p.a. 5%

Computation of Goodwill:

Solution:

$$V = \frac{a}{i} \left(1 - \frac{1}{(1+i)^n}\right) = \frac{\text{Rs. } 10,000}{0.05} \left(1 - \frac{1}{(1+0.05)^5}\right)$$

where a = Rs. 10,000
i = 5% or, 0.05
n = 5

$$= \text{Rs. } 43,260 \text{ or, say, Rs. } 43,300.$$

5. Super-Profit Method:

Super-profit represents the difference between the average profit earned by the business and the normal profit (on the basis of normal rate of return for representative firms in the industry) i.e., the firm's anticipated excess earnings. As such, if there is no anticipated excess earning over normal earnings, there will be no goodwill.

This method for calculating goodwill depends on:

- (i) Normal rate of return of the representative firms;
- (ii) Value of capital employed/Average capital employed; and
- (iii) Estimated future profit, i.e. the average profit of the last few years.

Super-Profit = Average Profit (Adjusted) – Normal Profit

Value of Goodwill = Super-Profit x Years' Purchase

The students should remember that the number of years' purchase of goodwill differs from firm to firm and industry to industry. One or two years' purchase should be taken into consideration if the retiring partner of a business was the main source of success. It should also be remembered that three to five years' purchase is usually taken. Of course, a large number of years' purchase may be considered if the super-profit itself is found to be large. If there is a declining trend in super-profit, one or two years' purchase may be considered.

The following steps should carefully be followed for calculating the value of Goodwill under Super- Profit Method:

- (a) Ascertain the amount of Capital Employed/Average Capital Employed;
- (b) Ascertain the amount of Normal Profit (i.e. Percentage of Normal Rate of Return on Capital/Average Capital Employed);
- (c) Ascertain the Actual Maintainable Profit;

(d) Ascertain the difference between Actual Maintainable Profit minus Normal Profit. If Actual Maintainable Profit is more than the Normal Profit, the excess is called Super-Profit and, in the opposite case, this is no Super-Profit;

(e) Value of Goodwill = Super-Profit x Year's Purchase.

Illustration 6:

The following particulars are available in respect of the business carried on by Mr. R. N. Mitra:

				Rs.
(1)	Capital invested			50,000
(2)	Trading results:			
	2006	Profit	12,200
	2007	Profit	15,000
	2008	Loss	2,000
	2009	Profit	21,000
(3)	Market rate of interest on investment			8%
(4)	Rate of risk return on capital invested in business			2%
(5)	Remuneration from alternative employment of the proprietor, if not engaged in business			3,600 per annum

Compute the value of Goodwill of the business on the basis of 3 years' purchase of super-profit taking average of last four years.

Solution:

		Rs.
	Average Profit = $\frac{\text{Rs. 12,200} + \text{Rs. 15,000} - \text{Rs. 2,000} + \text{Rs. 21,000}}{4}$	11,550
Less:	Proprietor's Remuneration	3,600
		<u>7,950</u>
Less:	Normal Rate of Capital Employed 8% + 2% = 10% on Rs. 50,000	5,000
	Super-Profit	<u><u>2,950</u></u>

∴ Value of Goodwill is 3 years' purchase of Super-profit

Goodwill = Rs. 2,950 × 3 = Rs. 8,850.

Illustration 7:

The following is the Balance Sheet of Mithu Ltd. as on 31.12.2009:

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Share Capital:		Goodwill	20,000
10,000 Equity Shares of Rs. 10 each	1,00,000	Plant and Machinery	40,000
General Reserve	15,000	Land and Building	45,000
6% Debentures (Rs. 100 each)	25,000	Investment	20,000
Profit and Loss Account:		Stock	25,000
Balance as on 1.1.09	Rs. 5,000	Debtors	20,000
Profit for the year	Rs. 40,000	Cash and Bank	25,000
	45,000	Discount on Issue of Debentures	5,000
Creditors	10,000		
Provision for Taxation	5,000		
	<u>2,00,000</u>		<u>2,00,000</u>



Plant and Machinery Rs. 50,000; Land and Building Rs. 40,000; Investments Rs. 25,000; Profit includes Rs. 1,000 income from Investment. Calculate the value of Goodwill on the basis of 3 years' purchase of Super-profit. Normal rate of return

Solution:

<i>Average Capital employed:</i>		Rs.
Present Value of Assets:		
Plant and Machinery		50,000
Land and Building		40,000
Stock		25,000
Debtors		20,000
Cash at Bank		25,000
		<u>1,60,000</u>
<i>Less: Current Liabilities:</i>		
Sundry Creditors	10,000	
Prov. for Taxation	<u>5,000</u>	
		<u>15,000</u>
		1,45,000
<i>Less: $\frac{1}{2}$ of current year's Profit:</i>		
Profit	Rs. 40,000	
<i>Less: Income from non-trading assets</i>	<u>Rs. 1,000</u>	
	Rs. 39,000	
<i>Less: Income-tax, say, 50%</i>	<u>Rs. 19,500</u>	
	Rs. 19,500	
		9,750
		<u>1,35,250</u>
Average Capital employed		
Normal Profit = (Rs. 1,35,250 \times $\frac{12}{100}$) = Rs. 16,230		

Actual Profit:

		Rs.
	Profit for the year	40,000
<i>Less:</i>	Income from non-trading assets, i.e. Investment	<u>1,000</u>
		39,000
<i>Add:</i>	Interest on Debentures	<u>1,500</u>
		40,500
<i>Less:</i>	Depreciation to be provided for increased value of P & M Rs. 10,000 (Rs. 50,000 – Rs. 40,000) Dep., say, @ 5%	<u>500</u>
		40,000
<i>Add:</i>	Depreciation on decreased value of L & B Rs. 5,000, Dep., say, 10%	<u>500</u>
		40,500
<i>Less:</i>	Income-tax, say, 50%	<u>20,250</u>
		20,250
<i>Less:</i>	Normal Profit	<u>16,230</u>
	Super-Profit	<u>4,020</u>

\therefore Value of Goodwill Rs. 4,020 \times 3 = Rs. 12,060 or, say, Rs. 12,000

Illustration 8:

From the following information, compute the Goodwill of the firm XYZ Co. Ltd. on the basis of four years' purchase of the average Super-Profit on a 10% yield basis:

XYZ Co. Ltd.
Balance Sheet as at 31st December

	2006 Rs.	2007 Rs.	2008 Rs.
Capital and Liabilities:			
10,000 Equity Shares of Rs. 100 each fully paid	10,00,000	10,00,000	10,00,000
Creditors	3,00,000	4,00,000	5,00,000
General Reserve	5,00,000	6,00,000	7,00,000
Profit and Loss Account	70,000	80,000	1,20,000
	<u>18,70,000</u>	<u>20,80,000</u>	<u>23,20,000</u>
Property and Assets:			
Goodwill	5,00,000	4,00,000	3,00,000
Factory, Building and Machinery (Less: Depreciation)	9,00,000	10,00,000	10,00,000
Stock-in-Trade	4,00,000	5,00,000	6,00,000
Debtors	10,000	80,000	2,20,000
Cash and Bank	60,000	1,00,000	2,00,000
	<u>18,70,000</u>	<u>20,80,000</u>	<u>23,20,000</u>

The following assets have been undervalued, their real worth to the business being:

	2006 Rs.	2007 Rs.	2008 Rs.
Factory, Building and Machinery	10,00,000	11,00,000	12,00,000
Stock-in-Trade	6,00,000	7,00,000	8,00,000
Net Profit — after writing-off depreciation and making provision for Taxation and General Reserve (including opening balance)	4,10,000	5,10,000	6,10,000

As per the Articles of Association of this private company, its Directors have declared and paid dividends to its members in the month of December each year

out of the profit of the related year. The cost of the Goodwill to the company was Rs. 5, 00,000. Capital employed at the beginning of the year 2006 was Rs. 19, 30,000 including the cost of Goodwill and balance in Profit and Loss Account at the same time was Rs. 60,000.

Solution:

Capital Employed:

	2006 Rs.	2007 Rs.	2008 Rs.
Goodwill (as it has to be paid for)	5,00,000	4,00,000	3,00,000
Factory, Building and Machinery (as revalued)	10,00,000	11,00,000	12,00,000
Stock-in-Trade	6,00,000	7,00,000	8,00,000
Debtors	10,000	80,000	2,20,000
Cash and Bank	60,000	1,00,000	2,00,000
	<u>21,70,000</u>	<u>23,80,000</u>	<u>27,20,000</u>
Less : Creditors	<u>3,00,000</u>	<u>4,00,000</u>	<u>5,00,000</u>
Capital Employed (closing)	<u>18,70,000</u>	<u>19,80,000</u>	<u>22,20,000</u>
Capital Employed (opening)	<u>19,30,000</u>	<u>18,70,000</u>	<u>19,80,000</u>
	<u><u>38,00,000</u></u>	<u><u>38,50,000</u></u>	<u><u>42,00,000</u></u>
Average Capital employed	19,00,000	19,25,000	21,00,000
∴ Normal Profit @ 10% on Capital Employed	1,90,000	1,92,500	2,10,000
Profit as given	<u>4,10,000</u>	<u>5,10,000</u>	<u>6,10,000</u>
Less: Opening balance	(-) 60,000	(-) 70,000	(-) 80,000
	<u>3,50,000</u>	<u>4,40,000</u>	<u>5,30,000</u>
Add: Undervaluation of Closing Stock	(+) 2,00,000	(+) 2,00,000	(+) 2,00,000
	<u>5,50,000</u>	<u>6,40,000</u>	<u>7,30,000</u>
Less: Undervaluation of Opening Stock	—	(-) 2,00,000	(-) 2,00,000
	<u>5,50,000</u>	<u>4,40,000</u>	<u>5,30,000</u>
Amounts written-off to Goodwill	—	(+) 1,00,000	(+) 1,00,000
	<u>5,50,000</u>	<u>5,40,000</u>	<u>6,30,000</u>
Add back: Amounts transferred to Gen. Reserve	(+) 1,00,000	(+) 1,00,000	(+) 1,00,000
Adjusted Profit :	<u>6,50,000</u>	<u>6,40,000</u>	<u>7,30,000</u>
Less: Normal Profit	1,90,000	1,92,500	2,10,000
Super-Profit :	<u>4,60,000</u>	<u>4,47,500</u>	<u>5,20,000</u>

$$\therefore \text{Average Super-Profit} = \frac{4,60,000 + \text{Rs. } 4,47,500 + \text{Rs. } 5,20,000}{3} = \text{Rs. } 4,75,833$$

Value of Goodwill will be four years' purchase of Average Super-Profit, i.e. Rs. 4,75,833 x 4 = Rs. 19,03,332, or, say, Rs. 19,00,000.

6. Capitalisation of Super-Profit Method:

Under the method, we are to consider super-profit in place of ordinary profit against the normal rate of return.

The same is calculated as:

Value of Goodwill = Super-Profit/Normal Rates of Returns x 100

$$\text{Value of Goodwill} = \frac{\text{Super - profit}}{\text{Normal Rates of Returns}} \times 100$$

Illustration 9:

X Ltd. Presented the following information:

Normal Rate of Return @ 10%

Capital Employed Rs. 3,00,000

Profit for last 5 years are Rs. 20,000; Rs. 25,000; Rs. 45,000; Rs. 30,000 and Rs. 50,000

Compute the value of goodwill.

Solution :

$$\text{Normal Profit @ 10\% on Capital Employed} = \text{Rs. } 3,00,000 \times \frac{10}{100} = \text{Rs. } 30,000$$

$$\begin{aligned} \text{Average Profit} &= \left(\frac{\text{Rs. } 20,000 + \text{Rs. } 25,000 + \text{Rs. } 45,000 + \text{Rs. } 30,000 + \text{Rs. } 50,000}{5} \right) \\ &= \text{Rs. } 34,000 \end{aligned}$$

$$\begin{aligned} \therefore \text{Super-Profit} &= \text{Average Profit} - \text{Normal Profit} \\ &= \text{Rs. } 34,000 - \text{Rs. } 30,000 \\ &= \text{Rs. } 4,000. \end{aligned}$$

$$\begin{aligned} \therefore \text{Value of Goodwill} &= \frac{\text{Super-Profit}}{\text{Normal Rate of Returns}} \times 100 \\ &= \frac{\text{Rs. } 4,000}{10} \times 100 \\ &= \text{Rs. } 40,000 \end{aligned}$$

7. Sliding Scale Valuation Method:

Under this method, the distribution of profit which is related to super-profit may vary from year to year. In other words, in order to find out the value of goodwill, sliding scale valuation may be considered relating to super-profits of an enterprise.

Illustration 10:

Compute the value of Goodwill on the basis of Sliding Scale Method.

Amount of Super-Profit estimated at Rs. 12,000.

Sliding Scale:

First Rs. 6,000 for 3 years' purchase

Next Rs. 4,000 for 2 years' purchase

Balance Rs. 2,000 for 1 year's purchase

Solution :

Computation of Goodwill

			Profit
First	Rs. 6,000	3 years	18,000
Next	Rs. 4,000	2 years	8,000
Balance	Rs. 2,000	1 year	2,000
Value of Goodwill			28,000

from [http://www.yourarticlelibrary.com/accounting/goodwill/methods-of-
valuing-goodwill-of-a-company-7-methods/58717](http://www.yourarticlelibrary.com/accounting/goodwill/methods-of-
valuing-goodwill-of-a-company-7-methods/58717)>

3.35.7. Adverse possession

- Ganda singh vs. Ram narain singh (A.I.R. 1959 punjab, 147).
- This was a case of claim of adverse possession where the court held that a person who claims adverse possession must show -
- On what date he came into possession?
- What was the nature of possession?
- Whether the factum of his possession was known to the legal claimants?
- How long his possession continued? He must also show whether his possession was open and undisturbed to 12 years period.
- The law will not help wrong doer if he obtained possession of another's property in clandestine manner
- Has concealed the knowledge of his possession
- From the person who is rightful owner.

Adverse possession vs prescriptive easement

- Adverse possession results in ownership of the land in question, a prescriptive easement only grants the right to use the land for a specific purpose—the original land owner retains title to the land in question.

3.35.8. Transfer of development rights:

- Was initially developed in the united states of America for land preservation,
- Environmental conservation and protection of Historical and cultural buildings.
- Transferring the building potential from one plot known as the originating plot to some other site, known as the receiving plot
- First started in india in the city of bombay under development control regulations of 1991.
- Eligible for the award of TDR in the form of FSI (or FAR) to the extent and on the conditions set out in the said regulation.
- FSI in the form of a development right certificate (DRC)
- Issued by the commissioner of the local authority,

- FSI credit of built up area to which the owner is entitled is mentioned in the certificate
- When the total area is sold out by the owner, the DRC will be cancelled and it will have nil value.

3.35.9. Development Rights (D.R.)

- Affected by reservation and development rights on remaining adjacent portion of the said plot
- It could be utilized on the same plot from which TDR is generated.
- Originating plot and the receiving plot are not different but the same.

3.35.10. Types of T.D.R.

- ▶ General T.D.R.
 - ▶ Free surrender of plot reserved for public purposes
 - ▶ Like garden, school, playground, etc. is called general T.D.R.
- ▶ Road T.D.R.
 - ▶ Plot or portion of plot affected by new D.P. Road or road widening.
- ▶ Slum T.D.R.
 - ▶ Carrying out redevelopment work of 'slum area' plot
- ▶ Heritage T.D.R.
 - ▶ 'Heritage' building exists and when F.S.I. of such plot is underutilized and when such owner is prevented to use such unutilized F.S.I.
- ▶ **Norms for use of T.D.R.**
 - ▶ No T.D.R.: City proper
 - ▶ T.D.R is usable only on those receiving plots
 - ▶ F.S.I. Of originating plot is converted into permissible F.S.I in receiving zone
 - ▶ Originating T.D.R. Is from residential zone, it can not be used on plot In industrial or commercial zone and vice versa.

- ▶ General T.D.R on receiving plot should not exceed 40% of total area of receiving plot.
- ▶ Road T.D.R should not exceed 40% of plot area.

▶ **Effects of transfer of development rights on land value in Bombay**

- ▶ Has come to be a blessing in the form of extra permissible built up area
- ▶ Permissible FSI is 1, due to purchase of TDR, FSI on the receiving plot has become upto 2.00.
- ▶ The DRC has become a trading commodity.
- ▶ The valuer has to keep in view the other factors which also affect the value of TDR
- ▶ TDR value has to be the value of receiving plot only.
 - ▶ 20 % share in value to receiving plot owner (royalty value)
 - ▶ 35% share in value to originating plot owner(compensation value)
 - ▶ 45% share in value to developer cum investor(profit value)

Example

A plot owner at “fort” surrendered the plot to a local authority and obtained TDR for 3900 sq.mt. plot FSI of the plot is 1.33 and the plot is in residential zone TDR is usable northwards at Andheri where prevalent land rate is Rs. 7,00,000 per sq.mt. and FSI is 1.00 Land rate is Rs. 15,60,000 per sq.mt. Find value of TDR received by the originating plot owner.

Solution

Land value of Rs 7,00,000 per sq.mt. (receiving plot locality) is taken as base and shares are proposed as under:

20% Receiving plot owner= Rs. 1,40,000 per sq.mt.

55% originating plot owner=Rs.3,85,000 per sq.mt.

25 %Developer share =Rs. 175000 per sq.mt.

Value of TDR to owner = 3900 x 1.33 x 385000

=1,99,69,95,000/-

3.35.11. Corporate valuation

- ▶ Corporate value is the value of its net assets,
- ▶ Value of each asset separately,
- ▶ **Need for corporate valuation**
 - ▶ **Amalgamation and merger**
 - ▶ A merger is said to involve acquisition of assets and liabilities of one company, called the transferor or vendor company by another called transferee or the purchasing company.
 - ▶ **Sale of business and takeover:**
 - ▶ For selling the whole business or any of its division, to fix a bargaining limit. Determine the value of the portion which he intends to buy.
 - ▶ **Liquidation:**
 - ▶ To know the corporate valuation of business so as to fix a bargaining limit.
 - ▶ **Corporate health analysis:**
 - ▶ For making profit for the utilization of funds,
 - ▶ Shares Are also two types
 - ▶ Equity
 - ▶ Preference

3.35.12. Methods of Corporate Valuation

Source: (Prof. Ian H. Giddy)

What is my company worth? What are the ratios used by analysts to determine whether a stock is undervalued or overvalued? How valid is the discounted present value approach? How can one value a company as a going concern, and how does this change in the context of a potential acquisition, or when the company faces financial stress?

How a business is valued depends on the purpose, so the most interesting part of implementing these methods will be to see how they work in different contexts - such as valuing a private company, valuing an acquisition target, and valuing a company in distress. We'll learn how using the tools of valuation analysis can inform management choices.

Outline

1. **Asset-Based Methods**
2. **Using Comparables**
3. **Free Cash Flow Methods**
4. **Option-Based Valuation**
5. **Special Applications**

1. Asset-Based Methods

Asset-based methods start with the "book value" of a company's equity. This is simply the value of all the company's assets, less its debt. Whether it's tangible things like cash, current assets, working capital and shareholder's equity, or intangible qualities like management or brand name, equity is everything that a company has if it were to suddenly stop selling products and stop making money tomorrow, and pay off all its creditors.

Another measure of value is a company's current **working capital** relative to its market capitalization. Working capital is what is left after you subtract a company's current liabilities from its current assets. Working capital represents the funds that a company has ready access to for use in conducting its everyday business.

Shareholder's Equity & Book Value

Shareholder's equity is an accounting convention that includes a company's liquid assets like cash, hard assets like real estate, as well as retained earnings. This is an overall measure of how much liquidation value a company has if all of its assets were sold off.

Shareholder equity helps you value a company when you use it to figure out **book value**. Book value is literally the value of a company that can be found on the accounting ledger. To calculate book value per share, take a company's shareholder's equity and divide it by the current number of shares outstanding. If you then take the stock's current price and divide by the current book value, you have the **price-to-book ratio**.

Another use of shareholder's equity is to determine **return on equity**, or ROE. Return on equity is a measure of how much in earnings a company generates in four quarters compared to its shareholder's equity. It is measured as a percentage. For instance, if XYZ Corp. made a million dollars in the past year and has a shareholder's equity of ten million, then the ROE is 10%. Some use ROE as

a screen to find companies that can generate large profits with little in the way of capital investment.

Intangibles

Brand is the most intangible element to a company, but quite possibly the one most important to a company's ability as an ongoing concern.

The Piecemeal Company

Finally, a company can sometimes be worth more divided up rather than all in one piece.

2. Using Comparables

The most common way to value a company is to use its earnings. Earnings, also called net income or net profit, is the money that is left over after a company pays all of its bills.

Price/earnings (P/E) ratio.

A company's earnings relative to its price, most investors employ the **price/earnings (P/E) ratio**. The P/E ratio takes the stock price and divides it by the last four quarters' worth of earnings.

The Price-to-Sales Ratio

Every time a company sells a customer something, it is generating revenues. Revenues are the sales generated by a company for peddling goods or services. Whether or not a company has made money in the last year, there are always revenues. Even companies that may be temporarily losing money, have earnings depressed due to short-term circumstances (like product development or higher taxes), or are relatively new in a high-growth industry are often valued off of their revenues and not their earnings. Revenue-based valuations are achieved using the price/sales ratio, often simply abbreviated PSR.

Uses of the PSR

The PSR is often used when a company has not made money in the last year. Unless the corporation is going out of business, the PSR can tell you whether or not the concern's sales are being valued at a discount to its peers.

3. Option-Based Methods

Executives continue to grapple with issues of risk and uncertainty in evaluating investments and acquisitions. Despite the use of net present value (NPV) and other valuation techniques, executives are often forced to rely on instinct when finalizing risky investment decisions. Given the shortcomings of NPV, real options analysis has been suggested as an alternative approach, one that considers the risks associated with an investment while recognizing the ability of corporations to defer an investment until a later period or to make a partial investment instead. In short, investment decisions are often made in a way that leaves some options open.

4. Free Cash Flows Methods

Despite the fact that most individual investors are completely ignorant of **cash flow**, it is probably the most common measurement for valuing public and private companies used by investment bankers. Cash flow is literally the cash that flows through a company during the course of a quarter or the year after taking out all fixed expenses. Cash flow is normally defined as **earnings before interest, taxes, depreciation and amortization (EBITDA)**.

5. Assignment: Special Applications

What adjustments to the valuation approaches discussed above would have to be made in the following special situations?

Valuation of a company in distress

Valuation of a company facing corporate financial restructuring.

3.35.13. Valuation of entire business

- ▶ Historical cost valuation
 - ▶ Historical cost or historical costing is the concept that assets should be valued based on their purchase price or the money actually paid for the assets.

- ▶ Current cost valuation
 - ▶ Current cost accounting is a valuation method whereby assets and goods used in production are valued at their actual or estimated current market prices at the time the production takes place (it is sometimes described as “replacement cost accounting”)
- ▶ Economic valuation
 - ▶ Economic value is the maximum amount a consumer is willing to pay for an item in a free market economy.
- ▶ Asset valuation
 - ▶ This again consists of:
 - Valuation of tangible fixed assets
 - Valuation of intangible assets
 - Valuation of current assets, loans and advances

3.36. Town planning

▶ General principles

- Various local and state governments
- These schemes set certain standards and guidelines which require growth of township and urban development areas in a certain planned manner.

▶ Concept of freeze value

- The value on the date on which the declaration Of intention of implementing the town planning scheme is made.

▶ General procedures followed in planning schemes

- **The resolution** : to prepare a planning scheme for the particular area, define the boundaries or the areas which are proposed to be brought
- **Draft scheme**: all interested parties should have access to it

- **Consideration of the draft scheme**
- **Approval**

▶ **Planning provisions and valuation**

- Interim development
- Zoning of land
- Change in the planning scheme
- Continuance of existing non-conforming development
- Injurious affection
- Recovery of betterment

▶ **Terms used in town planning schemes**

- **Original plot** : by the owner originally and generally bearing one municipal number.
- **Reconstituted plot** : reconstituted and rendered suitable for building purpose in conformity with the general scheme
- **Final plot** : finally demarcated plot in the town planning scheme. It may be the original plot, may have undergone alteration by inclusion or exclusion of land from adjacent plots.
- **Original value** : value of the original plot on the date of notification,
 - forms the basis of any compensation as the freeze value.
- **Semifinal value** : value of the plot due to its improvement
- **Final value** : value of the plot estimated on the date of notification of final TP.

3.37. Capital Gain tax

Source: (Mohabansi)

Profit from the transfer or sale of a capital asset is chargeable to tax under the head "Capital Gain" in the year in which capital asset is sold or transferred. Capital asset means property of any kind i.e. movable or immovable, tangible or intangible. However the following assets cannot be treated as capital assets:-

- Raw material, stock, spares and other inventories used for the purpose of the assessee's business or profession.
- Personal Assets i.e. movable property used for personal use of the assessee or of his family members dependent on him. However personal effects does not include jewellery. In other words, though Jewellery is a movable property held for personal use, it will still be treated as capital asset.
- Agricultural land situated in rural areas
- Special Bearer Bonds, 1991 issued by the Central Government
- 6 1/2 per cent Gold Bonds, 1977 issued by the Central Government
- 7 per cent Gold Bonds, 1980 issued by the Central Government
- National Defense Gold Bonds issued by the Central Government
- Gold deposit Bonds issued under the Gold Deposit Scheme., 1999

Exempt Transfers

In certain case, though a capital asset is transferred i.e. the ownership of the asset changes, the transfer will not be subject to capital gains tax. The following transactions are not regarded as transfers i.e. such transfers do not invite any taxable capital gain:-

1. Distribution of assets in kind by a company to its shareholders on liquidation
- 2 .Distribution of capital assets in kind by an Hindu Undivided Family to its members at the time of total or partial partition
3. Transfer of capital asset under a gift or will or irrevocable trust. However, this exemption will not apply to transfers under gift or irrevocable trust of securities allotted to employees under ESOP schemes under Central Government guidelines.
4. Transfer of a capital asset by a company to its wholly owned Indian subsidiary company.

5. Transfer of a capital asset by wholly owned subsidiary company to its Indian holding company.
6. Any transfer in the scheme of amalgamation of a capital asset by an amalgamating company to the amalgamated company if the transferee company is an Indian company.
7. Any transfer of shares in an Indian company held by a foreign company to another foreign company in pursuance of scheme of amalgamation between two foreign companies in which at least 25 per cent shareholders of the amalgamating company continue to remain shareholders of the amalgamated company and such amalgamation does not attract capital gains tax in the country in which the amalgamated country is incorporated.
8. Any transfer by a shareholder, in a scheme of amalgamation, of shares held by a shareholder in the amalgamating company if the transfer is made against allotment of shares of the amalgamating company and the amalgamating company is an Indian company.
- 9) Any transfer made by a non-resident of such foreign currency convertible bonds or shares as may be specified by the Central Government to another non-resident where the transfer is made outside India.
10. Any transfer by way of conversion of bonds or debentures or deposits in any form of a company into shares or debentures of that company.
11. Any transfer of a capital asset which is a work of art or of archaeological, scientific or artistic importance to the government or to a university or to the National Art Gallery or any other such public museum or art gallery as may be notified by the Central Government. for example Indira Gandhi National Center of Art.
12. Any transfer made on or before 31/12/1998 by a person who is a member of a recognised stock exchange to a company of his membership rights in the stock exchange to company incorporated for this purpose
13. Any transfer of land by a sick industrial company under the scheme prepared by BIFR where such sick industrial company is being managed by its workers cooperative, provided such transfer is made during the period of sickness.

14 .Conversion of a partnership into a company

Where a partnership firm is succeeded by a company and in the course of which any capital asset is transferred to the company from the firm, there will not be any taxable capital gains if the following conditions are satisfied:-

- All assets and liabilities relating to the business of the firm before the succession become the assets and liabilities of the company.
- All partners of the firm become shareholders in the company in the same proportion in which their capital accounts stood in the books of the firm.
- The partners do not receive anything apart from shares in the aforesaid company for agreeing to the succession.
- The aggregate shareholding of the partners in the company does not fall below 50 per cent of the total voting power in the company for at least five years from the date of succession.

15. Conversion of sole proprietorship concern into a company

Where a sole proprietorship concern is succeeded by a company in the course of which any capital asset is transferred to the company from the sole proprietorship concern, there will not be any taxable capital gains if the following conditions are satisfied:-

- All assets and liabilities relating to the business of the sole proprietorship concern before the succession become the assets and liabilities of the company.
- The sole proprietor becomes a shareholder in the company.
- The sole proprietor does not receive anything apart from shares in the aforesaid company for agreeing to the succession.
- The aggregate shareholding of the sole proprietor in the company does not fall below 50 per cent of the total voting power in the company for at least five years from the date of succession.

16. Where there is a demerger, any transfer of a capital assets by the demerged company to the resulting company will not lead to any taxable capital gains provided the resulting company is an Indian company.

17. Any transfer in a demerger, of shares held in an Indian company by the demerged foreign company to the resulting foreign company will not lead to any taxable capital gains, if the following conditions are satisfied:-

- at least 75per cent of the share holders of the demerged foreign company continue to remain shareholders of the resulting foreign company ; and
- such transfer does not attract capital gains tax in the country in which the demerge foreign company is incorporated.

18. Any transfer or issue of share by the resulting company in a scheme of demerger to the shareholder of the demerged company will not lead to a taxable capital gains if the transfer or issue is made in consideration of demerger of the undertaking.

19. Corporatization of Stock Exchanges : Where any recognised stock exchange is corporatized which leads to transfer of any capital asset to the corporate entity, there will not be any taxable capital gains if the following conditions are satisfied:-

- All assets and liabilities relating to the business of the stock exchange before the corporatization become the assets and liabilities of the company.
- The corporatization is carried out in accordance with a scheme for corporatization approved by SEBI.

Withdrawal of Exemption

In the following situations though generally the transfer is treated as non taxable transfer, the exemption will be withdrawn:-

1. (Refer Point 12 above) Where at any time before the expiry of three years from the date of transfer of membership rights in a stock exchange to the company, the transferor sells the shares in the company so that his share holding stands reduced. It will be treated as taxable transfer in the year of such sale.

2. (Refer Points 4 & 5 above) Where a capital asset has been transferred by an Indian holding company to a 100per cent Indian subsidiary company or vice versa then it will not be generally treated as taxable transfer. However if the parent company transfers any shares in the subsidiary company within a period of eight years from the date of transfer of the capital asset or the transferee

company treats the capital asset as stock-in-trade within the aforesaid period of eight years, then the exemption granted earlier will be withdrawn.

3. (Refer Points 14 & 15 above) Where at any time before the expiry of five years from the date of succession, the conditions specified in points 14 or 15 as the case may be are contravened, the capital gains which were not taxed will be taxed in the hands of the company.

Capital Assets can be divided into two types:

1. Long Term Capital Assets and

2. Short Term Capital Assets.

When a long-term capital asset is transferred, it gives rise to long term capital gain or capital loss. When a short-term capital asset is transferred, it gives rise to short term capital gain or capital loss.

Short-term capital asset means a capital asset held by an assessee for less than 36 months before it is transferred. However in case of shares held in a company or any other listed securities or units of the UTI or any units of a recognised mutual fund, the period of 36 months is substituted by 12 months ie if such shares, debentures or units are held for 12 months, they become long term capital assets. In determining the period for which the capital asset has been held by the assessee the following are the important rules -

1. In case of share held in company liquidation the period subsequent to the date of liquidation will not be counted.

2. In case capital assets have become the property of the assessee in circumstances mentioned in 49(1) [See Para on Section 49 (1) below], in determining the period, the period for which the capital asset was held by the previous owner will also be counted.

3. In case of shares in an Indian company which become the property of the assessee against shares of an amalgamated company, the period for which the shares in the amalgamated company were held by the assessee will also be counted.

4. In case of rights issue of shares or other securities subscribed to by the assessee on the basis of his rights to subscribe the counting of the period shall start from the date of allotment.

5. In case of renunciation of a rights issue, for the person who has acquired the rights, the period shall be reckoned from the date of the offer of such rights by the company or institution.

6. In case of a bonus issue, allotted without payment on the basis of holding of any other financial asset, period shall be reckoned from the date of allotment of such financial asset.

7. Sometimes a company may allot shares or securities to its employees under a stock option scheme. When such shares or securities are sold by the employee, the employee will be liable to capital gains tax on the sale value less cost of acquisition / indexed cost of acquisition.

8. Where the company buys back its own shares in accordance with the provisions of section 77A of the Companies Act, 1956, the difference between the cost of acquisition / index cost of acquisition and the value of a consideration received by the shareholders will be deemed to be capital gains in the hands of the shareholders in the year of buyback.

9. Cost of acquisition of shares in the resulting company in case of a demerger shall be determined as follows:-

Cost of shares of the demerged company x Net book value of assets Net worth of demerged company before demerger and the cost of acquisition of the original shares in the demerge company shall be reduced by the amount calculated as above

Method of computing long term capital gains

In order to obtain the amount of long term capital gain on sale of a long term capital asset, from the sale proceeds the expenses on transfer are to be reduced. From the balance amount the indexed cost of acquisition and indexed cost of improvement are to be deducted to get the amount of taxable capital gains or capital loss.

Indexed cost for acquisition means the cost of acquisition of the capital asset indexed by the cost inflation index of the year of sale divided by the cost

inflation index of the year of acquisition. The central government notifies index number for each previous year having regards to the consumer price index for urban non-manual employees in each year.

For example if the asset was acquired on 31 May 1994 for Rs10,000, it is substantially improved on 30 June 1996 for Rs5,000 and it is sold on 10 December 1998 for Rs75,000, indexed cost of acquisition will be Rs13,552 ($10,000 \times 351/259$), indexed cost of improvement will be Rs5,755 ($5,000 \times 351/305$) and long term capital gains will be Rs. 55693 ($75,000 - 13,552 - 5,755$)

If the asset was acquired prior to 1/4/2000, the index of the year of acquisition will be taken to be 100.

However in respect of bonds and debentures even though they may qualify to be called long term capital assets, no indexation benefits will be available to the assessee. This is because bonds and debentures are normally issued and redeemed at par and if benefit of indexation is given, it will always give capital loss.

Option available to assessee in calculating long term capital gains on sale of listed securities.

When an assessee has made long term capital gain on sale of listed securities he has two options (He may choose that option where tax payable is lower)

Option 1:

He may compute long term capital gains as follows and pay tax @ 20 per cent thereon.

Sale proceeds

Less: Expenses on transfer

Less: Indexed cost of acquisition

Less: Indexed cost of improvement

LTCG

Tax on LTCG @ 20 per cent

Option 2:

He may compute long term capital gains as follows and pay tax @ 10per cent thereon.

Sale proceeds

Less: Expenses on transfer
Less: Cost of acquisition
Less: Cost of improvement
LTCG
Tax on LTCG @ 10 per cent

Method of computing short term capital gains

In order to obtain the amount of short term capital gains or loss, from the amount of sales proceeds deduct the expenses incurred on transfer. From the balance, deduct cost of acquisition and cost of improvement. to obtain the short term capital gains or loss. No indexation will be available in respect of short-term capital gains or capital loss. A concessional rate on income tax is chargeable on long term capital. As far as short-term capital gains is concerned it is treated as normal income and normal rates of income tax are applicable. Long term capital gains are taxable at a flat rate of 20 per cent after claiming indexation of cost or 10 per cent without claiming cost indexation.

Section 49 (1)

Cost to the previous owner and situations where the holding period of the previous owner must also be considered. The cost to the previous owner as well as the period for which the capital asset was held by the previous owner must be considered in following cases ie the cost of previous owner will be considered as cost of the current assessee for determining the profit or loss on transfer of a capital asset:-

- Acquisition of property on distribution of assets on the total or partial partition of any HUF. ie the cost of the capital asset to the HUF will be considered as cost in the hands of the assessee in determining his profit when he transfers such a capital asset. Similarly, the period for which the asset was held by the HUF will also be considered. for example An HUF acquired a flat on 30 June 1994 for Rs500,000. The HUF was partitioned on 31 May 1997 and the flat was allotted to Mr A as his share in HUF property. Mr A sells the flat for Rs. One million on 1 April 1998. In this case, on partition of HUF, if any property is allotted to any family members, there is no taxable transfer in the hands of the HUF (See exempt transfers above) Therefore, though there is a change in ownership of the flat from HUF to Mr A on 31 May 1997, there will not be any capital gains tax in the hands of HUF. When Mr A sells the flat, cost of the flat for him will be taken

to be Rs500,000 though he has not paid any price for the flat. Similarly it will be treated as if he had acquired the flat on 30 June 1994 though he became the owner only on 31 May 1997. Therefore, it will be treated as if he held the flat for 45 months. Consequently, it will give rise to long term capital gains.

- Acquisition of property under a gift or will. However, this will not apply to gift or transfer through an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under a Central Government approved employees stock option scheme. In such cases, the market value of the shares, debentures or warrants gifted or transferred to the irrevocable trust on the date of transfer will be treated as the sale proceeds for the purpose of capital gains.
- Acquisition of property by succession, inheritance or devolution.
- Acquisition of property on distribution of assets on liquidation of company.
- Acquisition of property under a revocable or irrevocable trust.
- Acquisition of property on transfer by a wholly owned Indian subsidiary company from its holding company and by a parent company to its 100 per cent Indian subsidiary company.
- Acquisition of property on any transfer in scheme of amalgamation by the amalgamated company from the amalgamating company.
- Acquisition of property by Hindu undivided family where one of the members has converted its self acquired property into a joint family property.

Cost of acquisition in case of advance money received

In computing the cost of acquisition in a case where the capital asset was on an earlier occasion subject to negotiation for its transfer and any advance or other money, whether by way of earnest money or otherwise, was received and forfeited by the assessee because the negotiation failed, such money forfeited is to be deducted from the cost of acquisition of the capital asset in computing the capital gains when the capital asset is ultimately sold. eg Mr A had acquired a capital asset on 31 May 1995 for Rs. one million. He wanted to sell the asset in 1996 and entered negotiation for this purpose. The prospective buyer gave him advance money of Rs100,000 at that time. However, the negotiations failed and Mr A forfeited the Rs100,000 advance money. Subsequently, he actually sold the asset in 1998 for Rs two million. In this case, cost of acquisition for Mr A will be Rs900,000 (Cost less money forfeited)

Cost of acquisition where debentures are converted into shares

In case debentures, debenture stocks or deposit certificates in any form of a company are converted into shares or debentures, such conversion will not be treated as a taxable transfer. However, when the shares obtained on conversion are sold, the cost of acquisition of the shares sold will be that part of the cost of debenture stock or debenture stock, debenture certificate which has been appropriated towards the shares.

Cost of acquisition of bonus shares

Cost of acquisition of bonus shares will be treated as nil. However if the bonus shares have been acquired prior to 1/4/2000, then the share market value of bonus shares as on 1/4/2000 will be treated as the cost of acquisition.

Substitution of fair market value as on 1/4/2000

Fair market value in relation to a capital asset means the price that the capital asset would ordinarily fetch on sale in the open market on the relevant date. If the assessee has acquired the asset prior to 1/4/2000, he has the option of substituting the fair share market value of the asset as on 1/4/2000 instead of actual cost of acquisition. However this option is available to the assessee only when the asset has been acquired prior to 1/4/2000.

Cost of Improvement

Cost of Improvement means any expenditure or cost incurred by the assessee for substantially improving or raising the value of the capital asset. Cost of improvement includes all expenditure of capital nature incurred by an assessee in making addition to capital asset after date of acquisition. It also includes any expenditure incurred to protect or complete the title of the capital asset or to cure such title or remove any defect from the title. Cost of improvement in relation to capital asset means:-

- Where the capital asset becomes the property of the assessee in circumstances mentioned in section 49(1), all capital expenditure incurred in making alterations in the capital asset by the assessee or previous owner.
- In case of a capital asset acquired prior to 1/4/2000, where the fair market value of the capital asset as of 1/4/2000 is substituted in place of cost of acquisition, all capital expenditure incurred assets by the assessee or the previous owner after 1/4/2000 in making any additions or alterations to capital asset. However, cost of improvement incurred prior to 1/4/2000 will be ignored in all cases.
- In any other case all capital expenditure incurred in making in additions or alterations to the capital asset by the assessee after it become his property.

Conversion of capital asset into stock-in-trade

When the assessee converts a capital asset held by him into stock-in-trade, it will be treated as taxable transfer giving rise to notional capital gains or loss. For this purpose, the fair market value of the capital asset on the date of conversion is treated as notional sale proceeds from which the cost of acquisition / indexed cost of acquisition is deducted in order to get the capital gain. Later, when this converted capital asset is sold there will be business profit or loss i.e. actual sale proceeds less notional fair market value taken, as cost will be the taxable business profit or loss. However business income as well as capita gains are chargeable to tax only in the year of actual sale to a third party.

Introduction of capital asset by a partner in a partnership firm as his capital contribution will give rise to capital gains in the hands of the partner. For this purpose, the amount credited to the partner's capital account on account of this capital asset will be treated as sales proceeds in the hands of the partner from

which the cost or indexed cost of acquisition will be reduced to get the amount of taxable capital gains or loss.

Takeover of assets by the partner on dissolution of the partnership firm

In such a case, there will be taxable capital gains in the hands of the firm. The fair market value of the capital asset on the date of dissolution of the firm will be treated as sales proceeds from which the cost of acquisition or indexed cost of acquisition, as the case may be, will be reduced to get the amount of taxable capital gains in the hands of the firm.

Compulsory acquisition of capital asset

Where there is compulsory acquisition of capital asset by the government or any government authority under law, there will be a taxable capital gain or loss in the year of such compulsory acquisition. However such capital gain will be chargeable only in the year in which the consideration is received. If the compensation is enhanced later, then the receiver of such additional amount is chargeable to capital gains in the previous year in which such additional capital gains is received.

Capital gains on transfer of self generated assets

Self-generated assets are assets which are created in the course of business and profession and for which the assessee has not incurred any substantial capital expenditure. For example patents, copyrights, goodwill, tenancy rights, etc. Generally when a self-generated asset is sold, the law provides that there will not be any capital gain. However if the following self generated capital assets are sold, there will be taxable capital gains:-

- Goodwill of a Business
- Trade Mark or Brand Name associated with a business
- Tenancy Rights
- Loom Hours
- Route Permits
- Right to manufacture or produce any process any article

Cost of acquisition on sale of the aforesaid self-generated assets will be treated nil. In other words, the entire sale proceeds less expenses on transfer will be

treated as capital gain. In case such assets have been acquired for a price from some other person, they cannot be called self-generated assets and therefore the other normal provisions of the Income Tax Act apply.

Capital gain on amount received by shareholder at the time of liquidation of the company

Out of the money received by the shareholder, a part of the amount will be treated as deemed dividend under section 2(22) (Refer chapter on "Income from Other Sources") and the remaining amount less the indexed cost of acquisition or cost of acquisition, as the case may be, is taxable as capital gains on sale of the shares.

Capital gain in respect of depreciable assets

In respect of sale of a capital asset on which depreciation has been charged, capital gain will arise only if the full value of sale price exceeds the aggregate of the following:-

- Incidental expenses on transfer
- The written down value of the block at the beginning of the previous year.
- Cost of acquisition of the asset falling in that block of assets during the previous year

The resulting figure, if gain would be short term capital gain if loss would be short term capital loss.

Capital Gains on a Slump Sale

Slump sale means the transfer of one or more undertakings by way of sale for a lumpsum consideration without assigning values to individual assets and liabilities of the undertaking. In such cases of slump sale, the undertaking itself will be treated as a capital asset. When the undertaking is sold, it will give rise to long term or short-term capital gain depending on how long the business is owned by the assessee. In such cases, the net worth of the undertaking will be treated as the cost of acquisition and the cost of improvement of the undertaking for the purpose of calculation of capital gain. No indexation will be allowed in case of long-term capital gains.

Capital Gains on Sale of Shares under Depository System

Where an assessee has any depository account and any shares are sold from the depository account, then such cost of acquisition of the shares sold will be determined on FIFO i.e. on first in first out basis. It will be assumed that the assessee is shares deposited in the account first were sold first and accordingly the cost of acquisition, date of acquisition and the period of holding will be calculated.

The CBDT has come out with a circular that any share given under the stock-lending scheme approved by SEBI in this behalf will not give rise to any taxable capital gain.

Corporatization of Stock Exchanges

In case any person transfers equity shares allotted to him as member of a recognised stock exchange in India under a SEBI approved scheme of corporatization of stock exchanges, his original cost of acquisition of membership of the stock exchange will be the cost of acquisition for computation of capital gains on those shares.

Deductions from Capital Gains

In respect of certain types of capital gains, certain deductions are made available to assessee if he satisfies the conditions mentioned in the relevant sections for this purpose. The balance amount, which is remaining after claiming the deductions, will be the amount of taxable capital gain. Let us discuss the various deductions available to the assessee.

Capital gains on transfer of residential building and land appurtenant thereto -
Section 54

The following are the conditions to be satisfied:-

- There must be a long-term capital gain on sale of a residential house property.
- The property should be a residential property.
- This exemption is available to individuals and HUF only and not to other assessees such as firms and companies.
- Investment must be made in another residential property within 1 year before or two year after the date of transfer or if the property is to be constructed, the construction is to be completed within three years from the date of transfer.

In order to claim this deduction, where the assessee has not already acquired the new house property, the amount of deduction proposed to be claimed must be temporarily deposited before the due date for filing the return of income in a "Capital Gains Account" with a nationalised bank specified by the government and the amount so deposited must be used for the purpose of making investment in new house within the allowed time. The new property must be held for at least 36 months before it is sold; otherwise the gain on transfer of the new property becomes chargeable to tax as short-term capital gain and for calculating the gain on new property, cost of acquisition of the new property will be actual cost less deductions which has been claimed in respect of the original transfer. Such a transfer will be treated as short-term capital gain for the previous year in which the new property is sold if it is sold within 36 months. If the amount deposited in the bank is not used at all or the entire amount is not so used, the unutilised balance will be taxable as long term capital gain of the previous year in which the period of three years expires.

For example

1. A sells a residential house property in Mumbai for Rs1.5 million on May 15, 1996 which was purchased by him on June 11, 1982 for Rs200,000. On June 15, 1996 he purchases House I for Rs200,000 and further he deposits in the Deposit account Rs700,000 on June 30, 1997. Out of the deposit account he acquires House II on May 10, 1998 for Rs 400,000.
2. On June 10, 1998 X sells House I for Rs400,000. Further on March 8, 1999 he sells House II for Rs800,000.
3. Out of the Deposit account, he does not purchase any other house.

3.38. Role of the valuer in society & ethics in valuation

- ▶ Often subject to scrutiny. In matters of litigation, support his references, references of sales analysis, rentals, etc. Which would always be helpful in his future work.
- ▶ **Survey and valuation for mortgage purposes or for purchase of property**
- ▶ It must be clearly- understood the degree of inspection upon
- ▶ These purposes normally fall into three categories:

- ▶ Valuation for mortgage purpose.
- ▶ A limited report on the condition of the property for mortgage purpose by the lender.
- ▶ A full structural survey report including valuation coupled with details of the condition of the property.
- ▶ First case : the borrower and the lender
- ▶ Institutions are aware of the limited scope of the report.
- ▶ Second case : determination of the value of the property will depend on the specific instructions,
- ▶ Third case : to give a complete survey report including a detailed structural survey.

3.39. Role of the valuer in Investment decisions

- ▶ Practical situations could be encountered
- ▶ To select between alternative components, designs, services or processes where investment is involved.
- ▶ To estimate and analyze economic consequences of improvement in operations.
- ▶ To select among proposed projects within the annual capital budget limit established in an organization.
- ▶ To choose between asset lease and purchase options for supporting a new product line

3.40. The Valuer as Witness

- ▶ It is the parties' role, supported by their witnesses, to present their case. A poorly presented case may result in an unfavourable award. It is the valuer witness responsibility to ensure at least that valuer's evidence is such as to create a full picture for the arbitrator.
- ▶ The valuer is engaged for professional advice and that must reflect through to the valuer's behaviour as an expert witness.
- ▶ As expert, the valuer is not an advocate for a client or cause.

4. Valuation cost approach

▶ Syllabus

- ▶ Methods of Cost Estimates for Buildings
- ▶ Life of Building: Economic/Physical/Legal.
- ▶ Factors affecting life of the building.
- ▶ Total Life, Age, Estimating Future Life
- ▶ Various methods of Computation of Depreciation, Functional, Technological and Economic Obsolescence
- ▶ Reproduction Cost / Replacement cost, Depreciated Replacement Cost (DRC) working, adopting DRC as Value subject to Demand and Supply aspect
- ▶ Land Value by Market Approach and Building Value by Cost Estimation Method for Owner Occupied Bungalows, Factories, Public Buildings.
- ▶ 6 marks
- ▶ 3 hours

4.1. Introduction

Suitable for

- ▶ Non marketable properties in real estate
- ▶ Cost of construction of the building under construction
- ▶ Valuation of the owner occupied bungalows, offered as security to the banks for mortgage

4.2. Two methods under this approach

- ▶ Book value method.
- ▶ Land and building method. (Depreciated cost method)
 - ▶ Land and building method is also known as contractors method
 - ▶ Like temple, church, museum, school and college buildings. Bungalows and factories
 - ▶ Estimating value of land and value of building separately

4.3. Land characteristics

As fixed supply commodity

- ▶ Land can now be generated in vertical form by use of F.S.I. And T.D.R. concepts

4.4. Two types of properties.

- ▶ Tangible properties.
- ▶ Intangible properties

▶ **Tangible properties are again subdivided into two parts.**

- ▶ Movable properties
 - ▶ Plant and machineries, cars, trucks, aircraft, jewellery are movable properties.
- ▶ Immovable properties
 - ▶ Land and buildings are immovable properties.

4.5. Ownership rights

- ▶ Right of possession
- ▶ Right to user and enjoy the property
- ▶ Right to alienate and destroy the property.
- ▶ Right to lease, rent, sale, transfer or assignment, gift or give away under will
- ▶ Right to develop
 - Absolute ownership of Real Estate means that the owner holds each and every right described above

4.6. The values of land depends on innumerable characteristics

- ▶ Economic Aspect
- ▶ Technical Aspects
- ▶ Legal Aspect
- ▶ Social Aspect

4.7. Land Characteristics

▶ Situation (Economic Angle)

- ▶ Situated in Central Business District area of the town, it fetches high rental and high land values

▶ Location (Social Angle)

- ▶ Plays highest role next to demand and supply aspect.
- ▶ From point of view of placement of the property
- ▶ from point of view of importance and prominence
- ▶ from point of view of availability of civic and infrastructure amenities.

▶ Infrastructure Amenities

- ▶ Utility Infrastructures (Services)
- ▶ Water supply system, sewerage and drainage mains, electrical and power supply systems, Tele communication links.
- ▶ Transportation Infrastructure
- ▶ Good net work of roads, proximate railway stations or bus terminals, city bus,
- ▶ Social Infrastructure
- ▶ Schools and colleges, Hospital, Nursing home, Health center, Gymnasium, Clubs, Community Hall, Temples and place of worship, Parks and playground, Banks and Post office, Swimming pool, Sports stadium, Burial ground, Cremation ground
- ▶ Commercial Infrastructure
- ▶ Shops and market, Malls and Shopping centers, Cinema and drama theatre, Trade centers

▶ **Neighbourhood**

- ▶ Surroundings of land
- ▶ Major road links ,cause great smoke and noise pollution

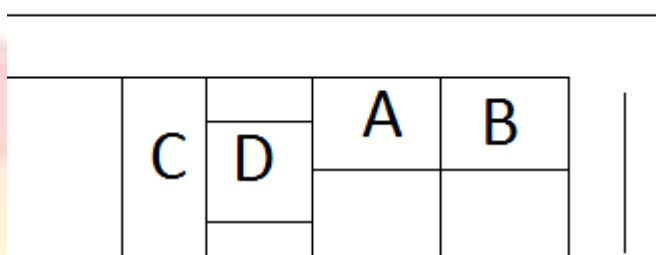
▶ **Size (Land area)**

For large size plots, generally demand is less

- ▶ Investment In Large Size Plots is Very High
- ▶ Large Size Residential User Plots, Internal Layout Roads And Certain Garden Areas (Amenity Space) Are Required To Be Kept Open And Unbuilt Upon
- ▶ requires infrastructure facilities within the layout
- ▶ In land acquisition cases
- ▶ Courts have invariably stated that ‘ the value fetched for a small plot of land can not be applied to lands covering a very large area.
- ▶ case of Collector Lakhimpur 1, Supreme Court held that –
- ▶ “The plot which is to be considered as large and the plot which could be treated as small plot, would again depend on factors such as user of plot and area where plot is situated.”
- ▶ Supreme Court has considered 60% discount on retail price land rate (small size plot rate) to arrive at whole sale price land rate (large size plot rate), in case reported at A.I.R. 1988 S.C. 943. In another case reported at A.I.R. 1982 S.C. 940., Supreme Court has considered 53% discount, to derive rate of large size plot from land rate of small size plots.

▶ **Frontage/Depth**

- ▶ Wider frontage of plot is more preferred particularly where commercial and shopping user is proposed.
- ▶ Road frontage could be divided into following four groups.
 - Plots with wide frontage.
 - Plots having medium frontage.
 - Plot with narrow frontage

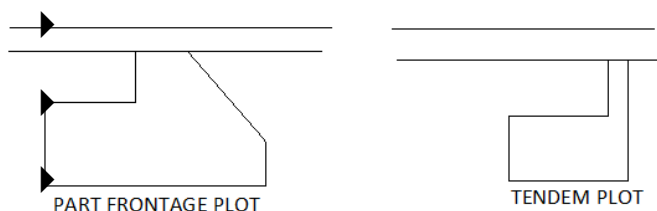


A - SINGLE FRONTAGE
 B - RETURN FRONTAGE
 C- DOUBLE FRONTAGE
 D- LAND LOCKED

- Plot with very narrow frontage or point access
- ▶ less than 15 meters width (Road Frontage), is considered narrow plot
- ▶ Plot with 20 meters to 30 meters width along the road , is considered normal or ideal width of the plot.
- ▶ Types of plots
 - Single frontage.
 - Return frontage
 - Double frontage

▶ Road Width

- ▶ “National highways”
- ▶ 60 meters or more in width



- ▶
- ▶ “state highway”
- ▶ May be 45 meters or more in width
- ▶ Inner major link road within the town connecting city and suburban areas
- ▶ May be of 30 meters to 40 meters in width.
- ▶ Inner roads within the ward are 24 meters wide
- ▶ Other roads of ward may be of 12 to 18 meters in width depending on traffic volume they are expected to carry.
- ▶ Main road may fetch 15% to 20% higher price than the rate of land in by-lane or back side parallel lane.

Accessibility

- ▶ Plot not having any legal access is known as “land locked land”
- ▶ Such plots directly deriving access are considered better plots
- ▶ On some private roads adequate street lights and road side storm water drains are not provided
- ▶ Plots with restricted frontage, creates problem of entry and exit
- ▶ Plot located at much greater distance from public road and having several plots in between and held by different owners would have lesser chance

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▶ **Land use: (zoning rules)**

A development plan under provisions of the town planning act.

- ▶ Reservations for public purposes like market, school, garden, stadium, cinema, hospital, fire station etc
- ▶ Land use and zoning of areas for residential, commercial and industrial use
- ▶ Factory building is not allowed in residential zone
- ▶ Residential building is not permitted in industrial zone
- ▶ T.D.R. is granted by the local authority to the land owners
- ▶ D.P. road is proposed passing through the plot which would divide the original plot into two parts

▶ **Shape**

- ▶ Effect on land values
- ▶ Irregular shape plots like triangular shape, curved shape or plot with several offsets and notches, fetch less rate as compared to rate of land for the regular shaped plots
- ▶ Say triangular shape plot, building with several offsets has to be planned to keep adequate open space all round the building from plot boundaries
- ▶ Plot is having small notches, such portions of plot may become unbuildable.

▶ **Orientation**

- ▶ Plot in context of wind direction is an important feature for consideration for land value assessment.
- ▶ Wind direction in north east part of India, like West Bengal, is from south east direction and hence in such region east frontage

and south frontage of plots are considered more valuable than west front plots .

▶ **Soil Conditions**

- ▶ Bearing capacity of soil is the main criteria .
- ▶ Poor bearing capacity of soil , like reclaimed land or filled ground marshy land or land with sandy soil, would fetch low land rate .
- ▶ Rocky land requires lesser foundation cost even for multistoried building due to high bearing capacity of soil.
- ▶ Black cotton soil also requires special foundation which increases foundation cost.

▶ **Topography**

- ▶ Level ground or sloping ground or uneven ground.
- ▶ Uneven topography requires special consideration by the valuer.
- ▶ A low lying plot which may require earth filling because it is lower than the road level.
- ▶ A plot on hill top would fetch higher value.
- ▶ The plot is having an entry at terrace level from the road instead of ground level , such property would obviously be considered as less preferable .

▶ **Prestige Aspect**

- ▶ In the modern times people crave for importance and prestige in the society.
- ▶ Prefer to stay in posh areas even though land values are very high.
- ▶ A great national leader or a famous film star or a well known sportsman or any such known celebrity is staying next door i.e. in immediate neighbourhood or on next adjoining plot.
- ▶ As status symbol in the society.
- ▶ Extra price to acquire 'Snob Value' or 'Pride Value'.

▶ **Vista**

- ▶ The open unobstructed view in front of the building is known as Vista.
- ▶ Rashtrapati Bhavan in New Delhi, is an excellent example of building enjoying excellent Vista.
- ▶ ‘T’ junction plots are another example.
- ▶ The building can be seen from a long distance.

▶ **View Aspect**

- ▶ Similar attribute like ‘Vista’.
- ▶ Plot overlooking public garden.
- ▶ Water front property (Directly abutting sea or river) sometimes fetch as high as 30% higher land rate .

▶ **Tenures of Land**

- ▶ Is not natural attribute of land but it is artificially created quality of land .
- ▶ “Tenure” comes from Greek word “Teno” meaning “I hold”.
- ▶ There are two types of tenures of land.
- ▶ (i) ‘Fee Simple’ or freehold land.
- ▶ (ii) Leasehold land.
- ▶ He is holding all the rights (100 % rights) that are available under Transfer of property Act.
- ▶ Freehold land ,enjoys unrestricted use of land .
- ▶ Value of land having freehold tenure will be higher than the value of land having leasehold tenure.
- ▶ i. Toka Tenure: Waste land and uncultivated land.
- ▶ ii. Foras Tenure: Waste land but these land were occasionally submerged under salt water.

- ▶ iii. Inami Tenure: 'gift' to certain persons in appreciation of their services.
- ▶ iv. Pension & Tax Tenure:
- ▶ v. Fazandari Tenure: Pension and Tax Tenure land held in perpetuity.
- ▶ vi. Quit and Ground Rent Tenure: special quit rent was charged.
- ▶ vii. Sanadi Tenure: Sanad by the government for construction of houses by charging fixed ground rent.
- ▶ **New Tenure (Navi Sharat) :**
- ▶ Land given by Government for Agricultural use at very nominal rate.
- ▶ Desired to be converted for N.A. use by the land occupant it is first required to be transferred to Old Tenure (Juni Sharat) by payment of premium for conversion of New Tenure to Old Tenure.
- ▶ Fixed on the basis of percentage of the difference between land value as freehold land and land value paid at the time of grant by the state government for new tenure land.
- ▶ **Service Inam :**
 - This land is given for specific services to be rendered to the society.
 - Land is not transferable.
- ▶ **Devsthan Inam :**
 - Land is given for maintenance of Devsthan .
 - May be Temple, Durgah etc.

- ▶ **Freehold land may grant lease of land by lease deed in favour of another person i.e. 'Lessee' for certain period.**
 - ▶ Value of leasehold land gets divided into two interests.
 - ▶ (i) Value of Lessors interest in land
 - ▶ (ii) Value of Lessee's interest in land.

- ▶ **Covenants**
 - ▶ Subjected to direct or indirect restrictions in form of covenants.
 - ▶ Created by the predecessors in title and the same are attached to land and hence they pass with the title of land.
 - ▶ Land owners create covenant in form of keeping a Garden space or unbuilt open land on certain portion of the plot .
 - ▶ In form of height restriction of building on plot.
 - ▶ To maintain orderly development in the layout or within the colony and to retain a fixed and orderly skyline, society creates a covenant .
 - ▶ Height of building not exceeding 7 meters or 10 meters.
 - ▶ Create a covenant that on leased plot only specified F.S.I. could be used , even though local authority permits much higher F.S.I.

- ▶ **State or Central Laws**
 - ▶ Which restricts or regulates development on land and sometimes regulates even holdings of land.
 - ▶ Urban Land Ceiling Act of 1976 .
 - ▶ Act restricted and put up a ceiling on ownership of 'urban land' held by land owner.
 - ▶ Limit for 'A' class cities was fixed at 500 sq.mts.
 - ▶ Limits for 'B','C' and 'D' class cities were fixed at 1000 sq.mts., 1500 sq.mts. and 2000 sq.mts. respectively.

- ▶ Rise to novel concept of two tier rating of land values ,for different land portions in the same plot.
- ▶ To be valued at market rate, whereas remaining portion of the land in the same plot, which formed an excess vacant land as per U.L.C.Act, was required to be valued at very low rate.
- ▶ Rent Control Act
- ▶ National Highway Act and Railway Act regulates development in the plot by prescribing restrictions.
- ▶ Civil Aviation Authority regulates and restricts height of buildings.
- ▶ Coastal Regulations restricts and regulates development on all lands falling within 500 meters distance from high tide line along the sea coasts.
- ▶ Clearance is required from irrigation canals and also nallah passing through the plot.
- ▶ Indian Electricity Act regulates development on land falling under power transmission lines.

- ▶ **Building Bylaws**
 - ▶ Affecting value of land are F.S.I. (Floor Space Index) provisions.
 - ▶ Town Planning Schemes prepared under the Town Planning Act

- ▶ **Status of Land**
 - ▶ Two types of status
 - Virgin status and Married status .
 - ▶ Land without improvements and land with improvements.
 - ▶ With partial or full improvements on the plot.
 - ▶ Manisingh's case 2, Punjab and Haryana Court upheld this phenomena and stated that builtup land has lesser rate than land rate of open plot of land on which purchaser has wide choice of developments.

▶ **Climatic Condition**

- ▶ Extreme climatic conditions.
- ▶ Moderate or pleasant climate .

▶ **Encumbrance**

- ▶ Mortgage .
- ▶ Form of litigation in court .
- ▶ In form of encroachments by tress-passers or slum lords who intrude by force.
- ▶ Removal of such encumbrance is very difficult even with due process of law.
- ▶ Case of litigated property final settlement of legal dispute through Court.
- ▶ Encroachment or slum hutments on plot .

▶ **Natural Forces**

- ▶ Prone to recurrence of earth-quakes.
- ▶ Land erosion due to sea.
- ▶ Less fertile due to sea water penetrating in sub soil .
- ▶ Cyclone and high tide of sea cause great damage to land and land improvements.
- ▶ ‘Tsunami’ floods in Tamilnadu eastern coast.
- ▶ Land erosion due to sea waves .

▶ **Ownership Pattern**

- ▶ By a single person or there may be several joint owners of the property.
- ▶ J.N. Bose 3, Calcutta High Court allowed 10% rebate on property value for notional sale of undivided share.
- ▶ Sale of property owned by a co-operative society, a limited company, a public trust or association of persons also suffer from

drawback of delay in decision on account of process of obtaining consensus of several persons and also due to procedural delays in completing administrative and legal formalities of sale.

▶ **Environmental Aspect**

- ▶ Obnoxious industries like chemical or cement factories, slaughter house and tanneries .
- ▶ Low value due to permanent nuisance of air pollution and health hazards.
- ▶ Value of land too close to Atomic Reactors or Atomic power station would reduce.
- ▶ Air pollution and water pollution laws .
- ▶ Garbage dumping ground of municipality .
- ▶ Yard of chemical wastes.
- ▶ Stone quarry operations causing blast noise.
- ▶ Air and noise pollution which would reduce the land value.

▶ **Stigma Effect**

- ▶ Crime or murder story
- ▶ Ghost stories
- ▶ Unpleasant usage short duration or for long duration .

▶ **‘Vastu Shashtra’ Aspect**

- ▶ Concepts and norms for an ideal land and ideal house.
- ▶ Bring peace and happiness to their family.
- ▶ Bring bad omen and disaster for their families.
- ▶ Road on east side or north side are considered good.
- ▶ South side or west side are considered poor.

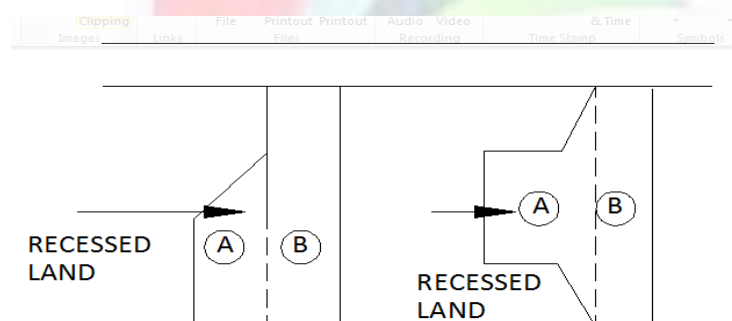
- ▶ Plot having higher ground level in south west corner as compared to the ground level of north east corner of plot is considered as ideal
- ▶ Plot in North East corner (North or East projections) is considered Good for the Growth and progress of the resident.
- ▶ South west corner is considered bad because as per vastushashtra, it would bring financial loss ,mental ill health & accidental injury to the plot owner.
- ▶ Plot extensions on North West and South east are also similarly considered poor vastu.
- ▶ Vyagramukhi (Tiger mouth) and Gaumukhi (Cow mouth)shaped plot.
- ▶ **'Feng Shui' Aspect**
 - ▶ A science of wellbeing.
 - ▶ On equilibrium of wind (feng) and water (shui) for happiness of the family .
 - ▶ Two prime energies existing in universe. Yin (female force) and yang (male force). Balance of yin-yang results in welfare and happiness.
 - ▶ 'Personal trigram' based on his birth date.
 - ▶ Each land-house has its own 'house trigram' depending upon road position.
 - ▶ Road on west has 'chen trigram' and plot with road on east has tui trigram.
 - ▶ Happiness and prosperity, 'personal trigram of owner of the house .
- ▶ **Community Aspect**
 - ▶ Parsi colony, hindu colony, brahmanwada, harijanwas, catholic society, mohmedan locality etc.
 - ▶ Restricted only to certain class of buyers of said community or religious groups.

- ▶ Proximity of church, masjid, jain temple (derasar), gurudwara is another religious factor .
- ▶ A jain buyer would be pleased to pay higher price for land if jain temple (derasar) is closeby.
- ▶ Covenant in the title document of the plot in such colonies prohibits sale of property to persons belonging to the other religious faith or cult.
- ▶ St. Anthony's society, bombay high court held that the restriction of society membership only for the roman catholics , was contrary to the 'open membership' principle under societies laws.
- ▶ Case of zorastrian radih society, supreme court held that it is legal to have society confined to persons of a particular persuasion, belief, trade, way of life or a religion.
- ▶ Public at large will continue to follow and observe such restrictions.
- ▶ Amdavad city of gujrat state, there is a law which requires government permission for sale of property to other community person.
- ▶ If hindu residing in predominantly mohmedan locality, desires to sale the property to a mohmedan, prior government permission is necessary .
- ▶ **T.D.R. Aspect**
 - ▶ 'Transfer of Development Rights'.
- ▶ **Latent Aspects**
 - ▶ They are hidden or latent.
 - ▶ Values may be indication of some future events which will enhance or reduce the value of land.
 - ▶ Large refinery complex in jamnagar, land prices in entire town suddenly rose.

4.8. THEORIES OF LAND VALUATION

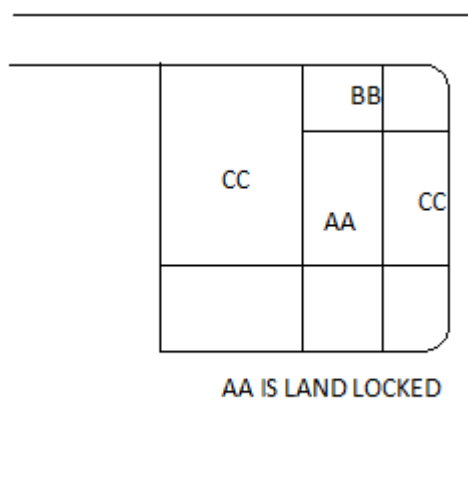
1. Recessed Land Concept.
2. Land locked land concept.
3. Belting Theory.
4. Hypothetical plotting scheme.
5. Front foot value concept.
6. T.D.R. concept.

► Recessed Land Concept



- Portion of plot fully abutting on road (shown as part 'B' of the plot in fig) is valued at 100% of prevalent land rate .
- Recessed land portion of the same plot (shown as part 'A' of the plot in fig) is valued at 3/4 rate.
- Recessed land has lesser utility than main plot.
- Introduction of FSI Concept and possibility of full utilization of land development in form of high rise constructions.
- Could be fruitfully used to develop garden, children's play area, parking facility, swimming pool purposes.

► **Land locked land concept**



Example

Mr.X of plot 'AA' desires to sale the plot having area of 1600sq.mts. Prevalent rate of land in the locality, for the plot abutting directly on the road is Rs. 20000/sq.mt. Owner of plot 'BB' (40 m x 20 m) has shown willingness to sale his plot to owner of plot 'AA'(MOU signed) at the rate of Rs.30000/sq.mt. Calculate fair sale value of land locked plot 'AA'.

Solution:

Value of plot 'B' = 800 SM @ Rs. 30000/SM.

= Rs.2,40,00,000/-

Sale value of plot 'A' and 'B' together (1600+800) 2400 SM @ Rs. 20000/SM. Rs. 4,80,00,000/-

Net value of plot 'A'

Rs.4,80,00,000/-—Rs.2,40,00,000/-

= Rs.2,40,000/-

Example

Source: (Velusami)

Owner of plot 'AA' (Fig-) desires to sale plot having area of 1600 sq.mts. Prevalent land rate along road is Rs. 20000/sq.mt. Owner of plot 'CC' has agreed in writing to give permanent right of way (12 m x 100 m) to owner of plot 'AA' by creating monthly lease and with lease rent of Rs.40000 per year. Calculate fair sale price for plot 'AA'.

Solution:

Even with right of way, the plot will lack prominence and being on inner side (It will become like tandom plot), it will fetch less price in the market. Adopting 20% discount in rate, fair value of inner plot “AA” could be Rs.16000/ sq.mt.

Value of plot “A”: 1600 SM @ Rs 16000/Smt
 $= 2,56,00,000$

This land will be subject to liability of recurring expenses of Rs.2000/ month or Rs.40,000/year till perpetuity. This liability has to be deducted from land value. Capitalising annual lease rental of Rs. 4,00,000/Year at 8%, we get:

Lease rent liability value

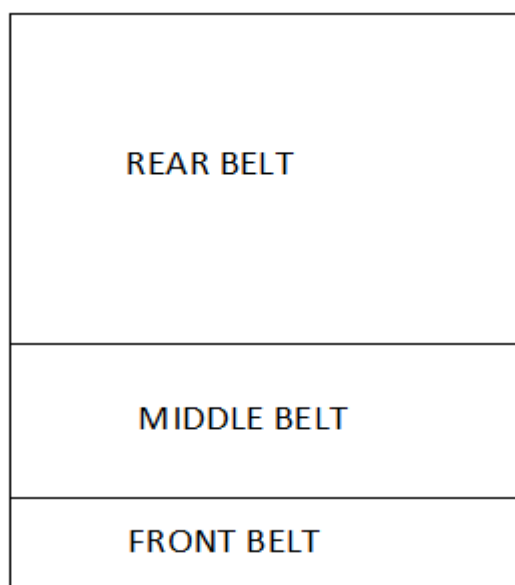
$= 4,00,000 \times 100/8$

= Rs.50,00,000/- ... (b)

Net value of plot = Rs.2,56,00,000— Rs.50,00,000= Rs.2,06,00,000/- (c)

► Belting Theory

- Useful in valuing large size, large area lands.
- Sales of similar comparable large size lands are not available.
- Courts have observed that these methods should be adopted as ‘last resort’.



► Case of mathura prasad, supreme court held – “where a large area of land in an urban locality is sought to be acquired in determining the market value, the method of belting is appropriate.

► Front Belt: This belt is assumed to be of 25 to 30 meters depth. It is advisable if the depth is same as depth of the

comparable sale instance plot.

- ▶ Middle Belt: This belt is 1.5 times the depth of front belt. i.e.38 Mt to 45Mts.
- ▶ Rear Belt : The depth of this belt is the remaining balance depth of plot.

Example

A large size plot having 100 meters road frontage and 500 meters depth is required to be valued for purchase. Work out the value of plot by Belting Theory, if nearby small size plots are available at the rate of Rs.6000/sq.mt.

Solution:

Depths of 1, 2 and 3rd belts are adopted at 30 m., 45 m. and 425 m. respectively. Rates of these belts are adopted at Rs.6000/sq.mt., Rs.4000/sq.mt. & Rs. 3000/sq.mt. respectively.

Value of 1 st belt

$$= 100 \times 30 \times 6000 \text{ Rs. } 1,80,00,000$$

Value of 2nd belt

$$= 100 \times 45 \times 4000 = \text{Rs. } 1,80,00,000$$

Value of 3rd belt

$$= 100 \times 425 \times 3000 = \text{Rs. } 12,75,00,000$$

Total value

$$= \text{Rs. } 16,35,00,000$$

- ▶ Case of fabric pvt. Ltd.9, gujrat high court held “the method of valuation by belts is arbitrary and artificial”.
- ▶ Case of collector of jabalpur10,m.P.High court held “where large area of land is acquired, for being laid out in the smaller plots as house sites, allowance will have to be made for the space which will be taken up for roads and also for costs of laying roads and for providing other amenities”.
- ▶ Shersingh11, supreme court has held “we can not reject belting theory on the grounds that belting theory is not normally adopted”.
- ▶ Calcutta metropolitan development authority12, supreme court held “adoption of belting theory method by high court was not proper”.

▶ Hypothetical Plotting Scheme

- ▶ If sales of large size plots in the locality are not available then and then only this scheme can be applied.
- ▶ Plot should be in developing area of town where demand for housing site exists.
- ▶ The plot should be of sufficiently large size area so that it could be divided into several small size plots.
- ▶ Depth of the original plot should be considerably more as compared to road frontage (width).
- ▶ Value as agricultural land rather than potential N.A. Use.
- ▶ Sp. Land acq. Officer elura13, supreme court held – “value fetched by sale of small extent land can not be adopted for large extent land. Loss of land for road and park, expenses for development should be deducted”.

Example

An buyer desires to purchase a plot admeasuring 100m x 250m. size in out-skirts area of a town. Prevalent rate of small size plots (400 S.M. to 600 S.M. plot area), in the locality, abutting main road, is Rs. 20000/S.M. Garden area required to be provided is 10% of total plot area. Adopt road width at 12 meter and 9 meters. Sale of all plots is likely to take 2 years. Adopt road cost at Rs.4000/SM, cost of laying services at Rs.400/SM. Architects fees at 6% of cost of amenities. Assume Developer's profit at 12% and expected rate of return 9%. Ignore legal and stamp charges and adopt brokerage an advertisement charges at 2% of sale price. Advice on fair purchase price of the plot by adopting plotting scheme method of valuation . Also work out value of the plot by Belting theory.

Solution

A hypothetical layout is first prepared for the plot . From the fig on the next page, relevant details works out as under.

TOTAL AREA OF PLOT 100m X 250m = 25000 SQ.MT.

10% GARDEN AREA = 25000 x 10% = 2500 SQ.MT.

* INTERNAL ROAD AREA =(AS PER Fig)= 6200SQ.MT.

GROUP 'A' PLOTS: PLOT NOS. (1) TO (8) = (8 NOS.)

* GROUP 'B' PLOTS PLOT NOS. (9) TO (26) = (18NOS.)

GROUP 'C' PLOTS: PLOT NOS. (27) TO (42) =(16 NOS.)

In the above layout, Central garden of 100 m. x 40 m. with 4000 SM. area is proposed. 12 meters and 9 meters wide internal layout roads are also proposed.

Total 42 plots are proposed which could be divided into 3 groups for value purpose.

Group 'A' Plots : Along main road.

8 Nos. Plots each with size of 20mx35m=5,600 Sq.Mts.

Group 'B' Plots: (Overlooking Garden):

12 Nos. x 20m. x 35m = 8400 Sq.Mts..

4 Nos. X 20 m X 40 m. = 3200 Sq.Mts.

2 Nos. x 20 m. x 38 m. = 1520 Sq.Mts.

= 13,120 Sq.Mts.

Group 'C' Plots

Last zone 6 Nos. x 20 m. x 35 m. = 4200 Sq.Mts.

2 Nos. x 25m.x35m. = 1750 Sq.Yds.

4 plots x 600 sq.mts. = 2400 Sq.Yds.

4 plots x 650 sq.mts = 2600 Sq.Mts.

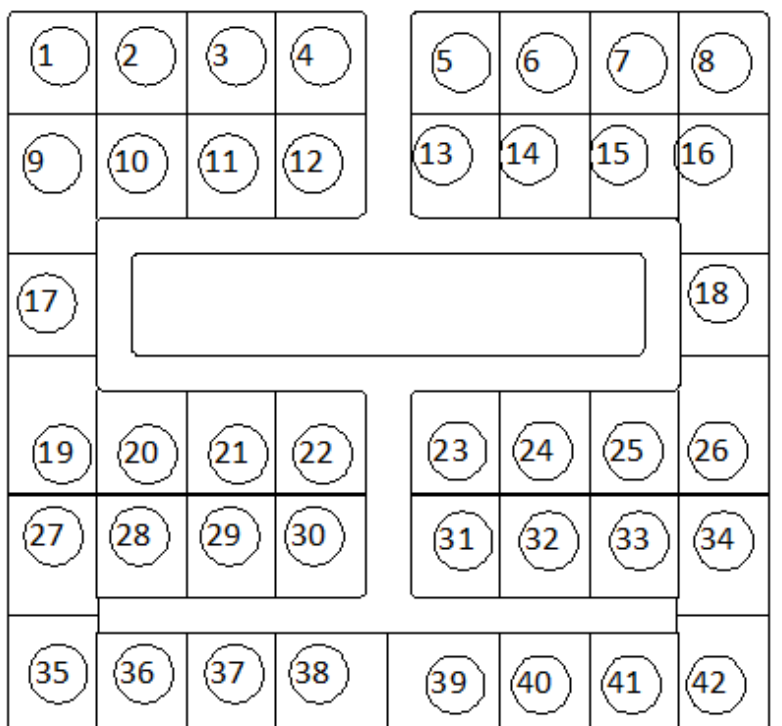
= 10,950 Sq.Mts

Total area of all 42 plots internal roads. = 29,670 Sq.Mts.

Total road area worked out from figure is

= 6200 Sq.Mts

As plots with main road frontage have value of Rs. 20000/sq.mt., rate for 'A' group plots is estimated at Rs. 20000/sq.mt. Rate of 'B' group plots is estimated at Rs.18000/sq.mt. and rate of 'C' group plots is estimated at Rs.16000/sq.mt. This discount of 10% and 20% is not a fixed percentage and it could vary depending upon town, locality, demand and market trend, evidenced by instances of sale of similar comparable plots.



Value of plots

"A" Group = 7000 sq.mts. @ Rs. 20000/ sq.mt.
= Rs. 11,20,00,000

"B" Group = 13,120 sq.mts @ Rs 18000/sq.mt.
=Rs. 23,61,60,000

"C" Group = 10950 sq.mts @ Rs 16000/sq.mt.
=Rs. 17,52,00,000

Total Realisation Rs. 53,33,60,000/-

As sale of all plots will take 2 years period value is deferred for 1 year at 9 % yeild Present value (deferred value) of land :

$53,33,60,000 \times 0.917 = 0.917 = \text{Rs. } 48,01,46,790/-$

Say Rs. 48,01,46,790/-

From this receivable value following expenses are deducted.

Cost of road construction 6200 sm @ Rs 4000/ sm
= Rs. 2,48,00,000

Cost of amenity water and light 25,000sm @ Rs400 per sm
=Rs.1,00,00,000

Cost of Garden Development 3500 sm @ Rs. 200 /sm
=Rs 70,00,000

Total cost = Rs. 4,18,00,000

Cost of Architects fees 6% of developer's cost :
Rs 25,08,000/-

Developer's profit @ 12 % of Rs.48,01,46,790 land value
=Rs. 5,76,17,620/-

Cost of advertisement & brokerage 2% land value
=Rs. 96,02,940/-

Total

= Rs. 10,90,20,560/-

Netrealisable value =Rs. 50,55,97,120/- -Rs.12,14,98,400/-
= Rs. 37,11,26,230/-

The investor/ developer can also be advised to offer a sum of Rs. 37.11 cr for the plot.

▶ **Reason in value difference in between belting theory and hypothetical plotting model**

i. No value of garden land and road land are adopted in plotting scheme but in belting theory value of these portions of land is considered. In market no developer pays any value for road and garden area as its F.S.I. is not available for construction on the remaining land.

ii. Cost of infrastructure in plot is wholly ignored in belting theory.

iii. Developer cum investor's profit is not considered in belting theory.

iv. Middle belt and rear belt plots are discounted at 33% and 50% under the belting theory but in actual market, discount may not be so high and it could range between 10% to 30% only.

▶ **Front foot value concept**

- ▶ Many a times state govt. Undertakes developments of large areas of certain region or town portions .
- ▶ To provide housing sites for LIG/MIG persons in the society.
- ▶ Laying out of plots, infrastructure facilities are provided and then plots are sold to the public .
- ▶ value plots based on road frontage of plot interlinked with depth of such plots.

4.9. Net Present Value

- ▶ “Depreciated Cost”
- ▶ Net Present Value = Current Replacement Cost – Depreciation for age.
- ▶ i. It is assumed that prospective buyer, a man of ordinary prudence, would first consider what would be the cost to him, if he acquires similar brand new asset from the market. (Reproduction Cost new).
- ▶ ii. Second assumption is that such a buyer would also consider “How much less he should pay” for the old asset (Depreciation) which he is actually getting instead of brand new asset.

4.10. Types of Estimating Cost of Construction

- ▶ Book Value Method.
- ▶ Flat Rate Method.
- ▶ Cost Index Method.
- ▶ Detailed Quantity Method.
- ▶ Reinstatement Method.
- ▶ **Book value Method**
 - ▶ Book value method is simplest.
 - ▶ Have correct and reliable historic cost of the building.

Example

A jet water loom machine was purchased in year 2000 at the cost of Rs.2,40,000/-. Cost Index factor for year 2000 was 100 with base year 1960 as 1.00. Calculate replacement cost of machine in year 2015 if Cost Index Factor for year 2015 is 150.50 with same base year.

Solution:

Replacement cost = Book Value x Cost Index Factor
= 2,40,000 x 150.50/100 = Rs.3,61,200/-

It should be noted that this method of cost estimation as if new, should be adopted only if price of similar new machine is not readily available from the

market. Some times when particular model of machine is no more manufactured or imported machine is not available in the market, this method is very much useful.

This method of finding out Replacement Cost is also sometimes useful to cross check reasonableness of the quotation for a new machine.

▶ **Flat Rate Method**

- ▶ On the basis of unit rate of building area
- ▶ Carpet area basis or total built-up floor area basis.

▶ **Cost Index Method**

- ▶ Determined by C.P.W.D. At present, C.P.W.D. Has adopted 1-10-2007 as base year with building cost index at 100 for city of Delhi.
- ▶ Cost index of any place in India can be worked out for any year by comparing cost of building materials and labour in subject town with rates of building materials .

▶ **Detailed Quantity Method**

- ▶ In this method, detailed quantities of all civil work items, carried out in the completed building , are worked out.
- ▶ Then prevalent rates of such civil works items, as quoted in market in year of valuation ,are adopted. These details will give correct cost estimate of the building.

▶ **Reinstatement Method**

- ▶ Cost is similar to detailed quantity method of cost estimating, with a difference that depreciation is not deducted from reproduction cost.

4.11. Types of depreciations .

- i. Physical depreciation.
- ii. Depreciation due to economic obsolescence.
- iii. Depreciation due to functional obsolescence.
- iv. Depreciation due to technological obsolescence.

▶ **Physical depreciation**

- ▶ Manner of usage
- ▶ Environmental aspect
- ▶ Natural Force Aspects
- ▶ Accidental Aspects

▶ **Economic obsolescence**

- ▶ Optimum economical use
- ▶ Highest and best use of land
- ▶ Higher depreciation in such case will not be unreasonable.
- ▶ Not to permit removal of unauthorized hutments in the plot without providing free alternate accommodation to dwellers is yet another example of economic obsolescence.

▶ **Functional obsolescence**

- ▶ Out dated and their planning and designing are of types which are contrary to the present day requirements of its users.
- ▶ Old chawl buildings with common toilet blocks .
- ▶ A brand new machine or a computer may suffer from functional obsolescence .

▶ **Technological Obsolescence**

- ▶ Old load bearing structures with thick walls .
- ▶ To stay in high rise R.C.C. Framed structures having thin partition and external walls.
- ▶ Now replaced by R.C.C. Framed or steel framed constructions.

► **Methods of depreciations**

1. Direct Appraisal Method (Lump sum depreciation).
2. Written down Value Method, (Accountant's Method).
3. Straight Line Method. (More preferred for machineries)
4. Constant Percentage Method .(This linear method is preferred by P.W.D. Engineers).
5. Sinking Fund Method (This interest based method is used for buildings).
6. Sum of the digit method.
7. Declining Balance Method. (Accounts method).
8. Statutory Depreciation Method. (Taxation purpose)
9. Other modern methods of depreciation.

► **Direct Appraisal Method: (Lump sum method)**

- An adhoc % of depreciation based on valuers own experience.
- May be useful in case of machines and for small structures like compound wall, wells, roads where wear and tear are unpredictable and even repairs and restoration costs are beyond calculations

Example

If replacement cost of a factory is Rs. 50,20,000/- and it is built 30 years ago, find out net present value by adopting observed depreciation.

Solution:

50% depreciation is adopted by visual inspection.

Net present value = Rs.50,20,000 — 0.50 x 50,20,000 = Rs.25,10,000/-

Example

If replacement cost of 7 years old machine is Rs.5,00,000/-, find out its net present value (Depreciated value) by observed depreciation.

Solution:

Lump sum depreciation of Rs. 2,00,000/- is considered by visual inspection.

$$\begin{aligned}\text{Net present value} &= \text{Rs.5,00,000} - \text{Rs.2,00,000} \\ &= \text{Rs.3,00,000/-}.\end{aligned}$$

▶ Written down Value Method

- ▶ By chartered accountants for preparation of balance sheet of a company or firms for use of the company or for taxation purposes or for use of financial institutions.
- ▶ Written down value (V_n) is denoted by formula:
- ▶ $V_n = C(1 - P)^n$
- ▶ V_n = value in the year.
- ▶ C = original capital cost (historical cost).
- ▶ P = % of rate of depreciation.
- ▶ N = number of year in which value is required.

Example

Find out W.D. Value of a machine purchased at the cost of Rs.1,30,000/- after 5 years of service life at 5% rate of depreciation.

Solution:

$$\begin{aligned}V_n &= 1,30,000(1 - 0.05)^5 \\ &= 1,30,000 \times 0.7737 \\ &= \text{Rs.1,00,591/-}.\end{aligned}$$

This working can also be done in 5 stages by calculating individual for each year.

► Straight Line Method

- Equal % of depreciation is allowed on its original capital cost for each year of life. This is more common for assets like plants and machineries.

The formula is $D = \frac{C-F}{N}$

D = Annual depreciation.

C = Original capital cost.

F = Final value or salvage value at the end of the life.

N = Total number of year of asset i.e. total life.

Example.

Value a machine purchased 2 years before at cost of Rs.1,40,00,000/-. Total life of machine is 20 years. Work out depreciated present value after 2 years age if salvage value of machine is 10% of original cost.

Solution:

Depreciation amount/year = $(1,40,00,000 - 1,40,000) / 20 = \text{Rs.}5,14,800/\text{year}$

Net present value after 2 years = $\text{Rs.}1,40,00,000 - 2 \times 5,14,800 =$

$\text{Rs.}1,29,70,400/-$

You will find that under this method, full original capital cost of machine is recouped back in 20 years period.

► Constant Percentage Method

- rate of depreciation is first assumed and instead of working out depreciation separately,

$$D = \frac{P(100 - Rd)^N}{100}$$

D = Depreciated value (Net present value).

P = Present day Replacement Cost.

Rd= Rate of depreciation.=100/total age

N= Number of years since construction (Age)

Example

What shall be the Net Present Value of a building by use of constant percentage method of depreciation, if Replacement Cost of the building is Rs.70,00,000/-, total life of building is 75 years and age of the building is 20 years as on today.

Solution:

Rd= 100/75 = 1.33%, n =20 years, p= 70,00,000

$$D = p \times \left(\frac{100 - Rd}{100} \right)^n / 100$$

$$= (70,00,000 \times (.9867)^{20})$$

$$= 53,55,507/-$$

► Sinking Fund Method

- Widely used for estimating N.P.V. of the buildings.
 - Lower depreciation per year in initial years of life span of the asset and higher depreciation per year in later period of life of the asset or building.
- (1) To first work out Annual Sinking Fund by formula:

$$S = \frac{R}{(1+R)^n - 1}$$

R = Rate of interest

n = Total life span in number of years

(ii) Next step is to find out accrued sum 'A' for Re. 1/- in number of years age by use of formula:

$$A = \frac{(1+R)^m - 1}{R}$$

m = Age of building

R = Rate of interest

(iii) Then total depreciation is found out by formula:

$$\% \text{ Depreciation} = 100 \times S \times A$$

(iv) Finally N.P.V. is found out by the use of formula:

Net Present Value = Replacement Cost - % Depreciation for age

Example

Work out N.P.V. of building if total life of building is 60 years. Replacement Cost is Rs.50,00,000/-, Age is 10 years and rate of interest is 4-1/2%.

Solution:

$$S = \frac{0.045}{(1+0.045)^{60}-1} = 0.0034$$

R = Rate of interest

n = Total life span in number of years

(ii) Next step is to find out accrued sum 'A' for Re. 1/- in number of years age by use of formula:

$$A = \frac{(1+0.045)^{10}-1}{0.045} = 12.288$$

m = Age of building

R = Rate of interest

(iii) Then total depreciation is found out by formula:

% Depreciation = $100 \times S \times A = 100 \times 0.0034 \times 12.288 = 4.178 \%$

Total depreciation = $4.178 \times 50,00,000/100 = \text{Rs. } 2,08,900/-$

So, NPV = $\text{Rs. } 50,00,000 - \text{Rs. } 2,08,900 = \text{Rs. } 47,91,100/-$

► Sum of the Digit Method

► "Digit" derived by summation of years of total life span of the asset.

Digit of asset is found by formula

$$D = \left(\frac{1+L}{2} \right) L$$

Where L = Total life span in years

Σ = Sigma (summation)

If total life of building is 60 years Digit

$$= \left(\frac{1+L}{2} \right) \times L = \left(\frac{1+60}{2} \right) \times 60 = 1830$$

$$\Sigma 5 = 1/1830 + 2/1830 + 3/1830 + 4/1830 + 5/1830$$

$$=0.00054+0.0011+0.0016+0.0022+0.0027$$

$$=0.00814 \%$$

$$=0.0082 \%$$

▶ Declining Balance Method

- ▶ W.D.V. (written down value)method used by accountants

$$D = 1 - \left(\frac{VS}{B}\right)^{\frac{1}{n}}$$

Formula for rate of annual depreciation

D = Rate of Depreciation/year

VS =Salvage Value

B =Original Cost of asset

n =Total life span of asset

Example

If the original cost of machine is Rs. 3,00,000/- and salvage value is 20%, total life of machine is 8 years. Work out present value after 2 years by Declining Balance Method.

$$D = 1 - \left(\frac{VS}{B}\right)^{\frac{1}{n}}$$

$$D = 1 - \left(\frac{60,000}{3,00,000}\right)^{\frac{1}{8}} = 0.1822 /year$$

N.P.V. after 1t year = 3,00,000 - 3,00,000 x 18.22/100

= 3,00,000 - 54,060

= Rs.2,45,340/-

N.P.V. after 2nd year = 2,45,340- 2,45,340x 18.22/100

= 44700/-

= 2,44,980-44929/-

=2,00,040/-

▶ Statutory Depreciation Method

- ▶ Depreciation is adopted as prescribed in income tax act.
- ▶ Residential building 5 % per year.
- ▶ Non residential building 10 % per year.
- ▶ Hotel building 20 % per year.
- ▶ Temporary erections 100 % per year.

- ▶ Motor car 20 % per year
- ▶ Plant and machineries 15 % per year.
- ▶ Computer 60 % per year.
- ▶ Furniture 10 % per year.

▶ **Obsolescence are of two types.**

- ▶ (i) Curable obsolescence.
- ▶ (ii) Incurable obsolescence.
- ▶ In case of curable obsolescence the valuer must try to find out “Cost to Cure”.

Example

Find out net present value of the building by Sinking Fund Method and also by Straight Line Method if replacement cost of the building is 20,00,000/-. Age is 55 years and total life of building is 65 years. Adopt 4-1/2% rate of interest.

Solution:

(A) By Sinking Fund method.

$$\text{Depreciation} = 0.9 \times 20,00,000 \times .0027 \times 227.918 = \text{Rs.}11,07,680/-$$

$$\text{N.P.V. Rs.}20,00,000 - \text{Rs.}11,07,680 = \text{Rs.}8,92,320/- \text{ (A)}$$

(B) By Straight Line Method.

$$\text{Depreciation} = C-F / N = (2000000-200000)/65 =$$

$$= \text{Rs.}27692.2/\text{year.}$$

Total depreciation for 55 years

$$= 27692.2 \times 55$$

$$= \text{Rs.}76,153/-$$

Say Rs.15,23,071/-

$$\text{N.P.V. Rs.}20,00,000 - \text{Rs.}15,23,071$$

$$= \text{Rs.} 4,76,929/- . \text{ (B)}$$

It will be seen that straight-line method gives higher depreciation. For a structure with only 10 years future life, higher depreciation is more appropriate.

The value of structure at scrap at 10% of Replacement Cost ,i.e. $10 \times 20,00,000/100 = \text{Rs.} 2,00,000/-$ could also be considered fair for such an old

building. However actual physical condition of the building will be deciding factor.

4.12. Different types of Life

- ▶ Economic Life.
- ▶ Physical Life.
- ▶ Life due to obsolescence.
- ▶ Life due to legal constrains.

- ▶ **Economic Life**
 - ▶ Actual service life of the building or a machine.
 - ▶ Bad or neglected maintenance and excessive wear and tear reduces economic life of the asset.

- ▶ **Physical Life**
 - ▶ It is the actual survival life of the building before collapse.

- ▶ **Life due to Obsolescence**
 - ▶ Building becomes obsolete due to changes in life style in the society.

- ▶ **Life due to Legal Constrains**
 - ▶ Erected on leasehold land which has only 30 years lease period.
 - ▶ Good workmanship enhances life of the structure.
 - ▶ Proper maintenance and good upkeep of the building and timely structural repairs
 - ▶ Excessive usage of building increases wear and tear.
 - ▶ Design and foundation criteria of building also would increase or decrease life

Example

A factory building having 2000 sq.mts. builtup floor area is constructed in year 1990. Total area of plot is 4000 sq.mts. Replacement cost of building in March 2015 is Rs.7500/sq.mt. Land rate for industrial user is Rs. 20000/sq.mt.in 2015. Value the property today for Bank loan purpose.

Solution:

Land value = 4000 Sq.Mts @ Rs. 20,000/sq.mt. =Rs.8,00,00,000

Building Replacement Cost 2000 Sq.Mts. @ Rs.7500/- Per Sq.Mt.

= Rs.1,50,00,000

Less : Depreciation for 25 years.

= .9 x 1,50,00,000 x 25/60

= Rs.56,25,000

Net Present Value = Rs.1,50,00,000 - Rs.56,25,000

= Rs.93,75,000 ... (b)

Total value of factory = Rs.8,00,00,000 + Rs.93,75,000

= Rs.8,93,75,000/- (C)

5. Market approach

5.1. Syllabus

Market Approach to Value

- Types of Market, Demand and Supply Curve, Bell Curve for Overall Sales Performance (Probability Distribution),
- Market Survey & Data Collection, Sources of Sale Transactions,
- Comparison of Sale Instances – Factors of comparison and weightages for adjustment in value,
- Hedonic Model and Adjustment Grid Model under Sales comparison Method.
- Land characteristics and its effect on Land Values
- Hypothetical Plotting Scheme for value of large size land
- Residue Technique and other development methods
- Valuation for Joint Venture Development of property
- 6 marks
- 3 Hours

5.2. Introduction

- ▶ Most important and widely used approach to value any type of asset.
- ▶ Consumer goods, shares and stocks, plant and machinery or Real Estate viz. open land or land with building.
- ▶ May be market for consumer goods.
- ▶ Principle operating in market of consumer good are also effective in Real Estate Market.
- ▶ “Market is Supreme”

5.3. Various Methods Under Market Approach

- ▶ Sale Comparision Method
- ▶ Development Method or Residual Method.

5.3.1. Sales Comparision Method : (Direct Market Comparision Method)

- Adhoc Comparision Technique.
- Adjustment Grid Model.
- Price Quality Regression Technique.
- Weightage Score System.

5.3.2. Development Method: (Residual Method/ Indirect Comparision)

- Actual Sales Basis (Owner occupied).
- Actual Sales Basis (Tenants occupied).
- Hypothetical Building Scheme (Ownership concept).
- Hypothetical Building (Income concept).
- Based on principle of comparison and substitution.

5.4. Types of market

- Buyers Market.
- Sellers Market.
- Stable Market.

▶ **Buyers Market**

- Supply to the purchasers are far in excess of demand, it is Buyers Market.

▶ **Sellers Market**

- Less than demand for such units in the market , prices tend to go up due to competition amongst buyers to purchase these units even at higher price.

▶ **Stable Market**

- Demand exists, supply also exists but due to various reasons, purchasers stop purchasing or defer the purchase of premises.

5.5. Types of property

- ▶ Marketable properties like flats, shops, offices, factories etc.
- ▶ Non marketable properties like Schools, Temples, Museum, Public or Government buildings, Municipal Public utility buildings like Fire station, Hospitals, Monumental building.

5.6. Four Group of Factors Affecting Value of the Property

5.6.1. Economic Factors

- Demand and supply of properties.
- State and Central Govt. Policies for land development.
- Economic and Taxation policies of Government.
- Income and wage level of residents, trends for saving and paying capacities of people in the locality.
- Money market situation.

- Cyclical boom and recession periods in real estate market.
- Expected rental yields and returns on investment in real estate.
- Inflation or deflation in nations economy.
- Availability of money on credit from Banks and other institutions and rate offered for such advances.
- Burden of property tax and other maintenance outgoings.
- Better alternative use against current inferior use.
- Employment opportunities and development potential in area.
- Availability of alternative or substitute asset in the market.
- Local population, per capita income of residents

5.6.2. Physical (Technical) Factors

- Land characteristics : Size, shape, plot area, vista, frontage, orientation, soil type, topography etc.
- Infrastructure facility : Good network of roads, water supply, drainage system, power supply and telecommunication links.
- Prominence and placement : Main road, by-lane, remote area location.
- Building characteristics
 - R.C.C. framed or load bearing structure.
 - Expected future life and age of structure.
 - Deterioration and present condition.
 - Specification of building, (Civil, electrification and plumbing items).
 - Aesthetics and workmanship quality.
 - Obsolescence due to change in technology or change in life style.
 - Maintenance and repair liability.
- Functional aspect : Optimum use of space, good planning and design with no wastage, high utility value, modern habitation style.
- Amenities : Swimming pool, garden, lift, security system, car parking facility, Health club, Children's play area.
- Environmental aspect : Noise and smoke pollution level, sea or lake frontage, nuisance due to railway track, industries or airport, climatic condition.
- Natural calamity : Earthquake prone areas, flooding and cyclone hazards, Tsunami prone areas.

5.6.3. Social Factors

- Locality: Poor class, middle class, posh areas (Life style and living standards of residents of the locality).
- Neighbourhood: Well developed, less developed, slum like, cremation ground, dumping ground, nuisance due to community hall, cinema, school on adjoining plot.
- Civic amenities: Proximity of shops, Mall, market, school, cinema, community hall, hospital, railway station, bus stand, garden.
- Population: Density in area and population growth, congestion.
- Means of communication: Railway, road way or water ways.
- Prestige aspect: Prestigious building, prominent location, renowned personality like film star or industrialist or politician or a celebrity as next door neighbour.
- Political factor: Linguistic or Religious communal unrest.
- Racial habitation: Parsi colony, Mohmedan locality, Hindu colony, Catholic colony. Brahmanwada and Maharwada.
- Religious factor: Proximity of Temple, Church, Mosque, Place of worship.
- Personal factors: Sentimental considerations, beliefs in 'Vastu' principles or Feng Sui norms, Liking for specific neighbourhood, Speculative intent.
- Stigma aspects: Haunted house, Dislike for Vyagramukhi or Tee junction plots, fear due to past history of cyclone, Tsunami ,flood or earthquake, case history of murder or suicide on property, previous use of land as Kabrastan or Cremation ground.

5.6.4. Legal Factors

- Social legislation like The Rent Control Act 1948.
- Land Reform Legislation like : The Urban Land Ceiling Act 1976.
- Ecological Restriction Like : Coastal Regulations.
- Transfer of Property Act with lease provisions.

- Covenants under lease or conveyance deed.
- Land Acquisition Act.
- Laws Governing Building Construction like Development Control Rules/ Building Bylaws/ Town planning and Zoning Regulations.
- Laws Governing Land : Town Planning Act/Municipal Corporation Act/ U.L.C. Act/Rent Act.
- Wealth Tax Act/Income Tax Act.
- Law on earthquake resistant building.
- Reservations under different Acts.

5.7. Adhoc Comparision Technique

$P = f(\text{STLA})$

P = Price of the property in the market.

F = Stands for function of

S = Size or covered area of the premises.

T = Time factor at which asset is traded in the market.

L = Location of the property.

A = Age or physical conditions of the property.

Example

An building, 700 sq.mts. area, on ground floor of building was recently sold at Rs.4,40,000/Sq.Mt. Find out fair value for 120 sq.mts. Gala which is on 1st floor of same building.

Solution:

Consider location and size factor. For industrial units upper floor is a disadvantage and hence fetch lower rate. Smaller size may or may not be so much important for the industrial unit as compared to upper floor situation aspect. Rate of Rs.3,80,000/SM. For subject gala is estimated. Market value of subject gala = 120 SM. @ Rs.3,80,000/SM.= Rs.45,60,00,000/-

Example

A residential flat, 80 sq.mts. Area in 15 years old building is sold at Rs. 40,000/Sq.Mt. in May 2010. Building is on main road and it has garden and parking facilities in the plot. Advice of fair purchase price in April 2011 for 60 sq.mts. Flat, in nearby by-lane, in building which is 30 years old and having inferior specification than sale instance flat.

Solution:

Consider age, location and time factor of sale instance flat as against these aspects of subject flat. Equated rate of sale instance flat for April 2010 could be 3% for 1 year difference i.e. Time factor.

4% for 15 years age and specification difference.

3% for main road location.

10% (Overall % decrease)

Equated rate of sale instance flat $= (0.90 \times 40,000) = \text{Rs.}36,000/\text{Sq.Mt.}$ Same rate is estimated for the subject flat.

Fair value of subject flat $= 60 \text{ SM @ Rs.}36,000/\text{Sm}$

Rs.21,60,000/-

Example

Advice on fair purchase price for the plot having an area of 90 sq.mts. On main road of town, for year June 2015. Civic amenities are closeby but plot is 2 M. Lower than the road level. Following 3 sales are available in locality.

Sale 'A' : 1100 SM. Corner plot abutting on the road running parallel to the main road , sold in Dec.2013 for Rs.90,00,000/-

Sale 'B' : 650 SM. Plot in by-lane sold in September 2014 for Rs.48,60,000/-.

Sale 'C' : 450 SM. Plot at 1 KM. Distance in poor class locality sold in May 2014 for Rs.26,20,000/-. Adopt 12%/year price rise in real estate market rates.

Adopt Cost of earth filling at Rs.150/CM.

Solution:

Consider location and time factor for all 3 sales.

Sale 'AA': Rate $= 90,00,000/1100 = \text{Rs.}8180/\text{Sq. Mt.}$

- 15% for corner plot.

+ 18% for time period difference (18 months)

+ 3% (overall % increase)

Rs. 8180 + Rs. 245 Rs.8425/- per sq.mt is the adjusted rate.

Sale 'BB' : Rate = $48,60,000/650 = \text{Rs.}7470/\text{Sq.Mt.}$
+ 10% for by-lane location.
+ 9 % for time period difference (9 months)
+ 19% (Overall % increase)
Rs.7470 + Rs, 1420 : Rs.8890/- per sq.mt is the adjusted rate.

Sale 'C': Rate = $26,20,000/450 = \text{Rs.}5820/\text{Sq.Mt.}$
+ 40% location aspect.
+ 11% Time period of 11 months.
+ 51% (overall % increase)
Rs 5820 + Rs. 2960 : Rs.8780/- per sq.mt is the adjusted rate.

Estimated base rate of Rs. 8500/SM for the subject property. The plot is 2 M. Below road level involving 1 SM x 2 M filling. i.e. 2 C.M. Earth filling in the plot/sq.mt. of plot. Cost of earth filling : 2 C.M. at Rs. 150/CM : Rs,300/Sq1Mt. Net rate of plot : Rs.8500 - Rs.300 = Rs.8200/. per Sq.Mt. in June 2015. Fair purchase price of plot : 850 SM. @ Rs. 8,500/SM.= Rs.72,25,000/-

5.8. Data Collection Sources

- Sales recorded at the Registrar's office of the concerned district.
- Information from local brokers/residents (Local Enquiry).
- Advertisements in Newspapers.
- Land Acquisition cases data.
- Auction sale information of different authorities
- Valuers own Data Bank.
 - Area of the plot shown in Government Records called 7/12 Utara or area shown in Extract from the Property Register Card.
 - Area stated in conveyance deed.(Title deed).
 - Area shown in sanctioned plan. (If building is erected on plot).
 - Area as per actual survey carried out on site by the valuer.

5.9. Plot areas

- Area shown in purchase document.
- Area shown in society's record/condominium record.

- Area shown in sanctioned plan of the building.
- Area as per actual survey on site by valuer.

5.10. Analysis of Data

- Sales having very low rate and suspected or manipulated price to save stamp duty.
- Sales which may be special value sales or hijacked price in sale to claim higher loan
- Sales of too large size plots,
- Sales which are at too far away distance from location of subject property
- Sales of land with tenanted buildings .
- Sale properties which have too many attributes contrary to attributes of subject property
- Sales which are not at arms length such as sale between relatives
- Sales taken place for earlier

5.10.1. Weightages for Land Comparison

Subject Property Attribute	Sale instance property Attribute	Weightage To be applied to sale inst.rate
Double frontage	Single frontage	15% to +20%
Large size plot	Small size plot	- 15%to-40%
Time Factor (current year)	12 months before	+ 5% to + 15% Per year
Main Road	By-lane	+15%to+30%
Plot without access road (i.e. Landlocked land.)	Plot abutting road	-75% to - 80%
Joint ownership	Single ownership	- 5% to -15%
Low lying land	Level ground	Deduct for cost of earth filling
Sea front plot	Away from sea	- 20% to +30%
Pending litigation Stay of Court against sale)	No litigation	- 30°0 or more
Forced Sale by Authority	Normal Market Sale	- 15% to -30%

5.10.2. Weightages for ownership flats

- Specification
 - Ordinary
 - Standard
 - Delux
 - Super Delux
- Interior planning
- Proximity of Civic Amenity
- Floor levels
- Orientation
- Age of Building
- Size of flats
- Amenities
- Neighbourhood
- Prestige Aspect
- Condition of Flat
- Maintenance charges
- Litigation

5.10.3. Weightages for ownership shops

- Pedestrian Traffic
- Counter space and Display width
- Placement in building
- Storage facility
- Car parking facility
- Amenities
- Eating House facility

5.10.4. Weightages for Industrial Galas

- Floor level
- Power/Water/Labour
- Amenities
- Highway
- Parking

5.11. Adjustment Grid Model

Location Factor

- Rank (5) if civic amenities are closeby.
- Rank (3) if amenities are at moderate distance.
- Rank (1) if amenities are far off say at 1 KM distance.

Size Factor:

- Rank (5) if flat area is 75 sq.mts. or less.
- Rank (3) if flat area is 75 sq.mts. to 150 sq.mts.
- Rank (1) if flat area is 150 sq. mts. or more.

Age Factor

- Rank (5) Building less than 10 years age.
- Rank (3) Building having age 10 -30 years period.
- Rank (1) Building having age 30 years or more.

Specification Factor

- Rank (5) Delux specification.
- Rank (3) Standard specification.
- Rank (1) Poor specification.

Example

A residential property (subject property) is in 4 years old building. The building is in middle class locality on road parallel to main road. Building is 4 years old with good specification and good aesthetics. Area of flat is 90 sq.mts. Marble flooring is provided. Value the flat as on 31-3-2018 based on following 3 sale instances which are readily available for comparison.

Sale 'A': 125 sq.mts. flat sold on 31-8-2017 at Rs.160000/Sq.Mt rate. Building is 22 years old and abuts on main road. Good specification and marble floor are provided. Building is with garden and swimming pool.

Sale 'B': 85 sq.mts. flat sold on 31-1-2018 at Rs.112000/Sq.Mt rate. It is in by lane but it is closer to market and school as compared to subject flat. Building is 18 years old and specification is average with mosaic tiles flooring.

Sale 'C': 50 sq.mts. flat sold on 30-10-2017 at Rs.80000/Sq.Mt rate. It is at 1 kilometer distance from the market and station. It is in poor class locality. Building is 30 years old with poor specification.

Solution:

Grid Table given below is as per Adjustment Grid Model.
(It is a Balance Sheet of weighted values).

Grid table

Sr no	Details of factors	Subject flat 85 Sq.mt.	Sale "A" 125 SM	Sale "B" 85 SM	Sale "C" 50 SM	Remarks
1	Sale price	To find	160000	112000	80000	Rs/sm
2	Time factor	March 2010	-5 months	+2 months	+5 Months	
3	Adjustment for time		-5% -8000	+2% +22400	+5% +8000	Weightage 1% per month
4	Adjusted Rate		152000/-	89600/-	72000/-	Rs./SM
5	Location Factor Rank 3		5 -15%	3 -5%	1 25%	
6	Size Factor Rank 3		1 +5%	3 Nil	1 +5%	
7	Age factor Rank 5		1 +9%	3 +7%	1 13%	22-4=18 18-4=14 30-4=26
8	Specification factor Rank 3		5 -10%	3 +15%	1 +25%	
9	Overall wightage		-11% -Rs 16720	+17% Rs. 19420	+58% Rs. 48720	
10	Adjusted Rate	6700	135280	109020	120720	

Rate estimated for subject flat = Rs.110000/- Per Sq.Mt.

Value of subject flat on 3 1-3-2018

85 SM. @ Rs.110000/SM. = Rs.93,50,000/-

5.12. Price Quality Regression Technique

$$Y = a + b x$$

Y = Estimated sale price of property

a = Market price factor or time factor.

b = Quality factor or regression coefficient.

X = Ranking factor.

5.13. Weightage Score System

- ▶ In this method, 50 to 60 factors are identified and they are grouped in seven categories viz. Land, Building (Engineering and Architectural aspects), Location, Locality Services, Economic legal and social factors.
- ▶ Identifying relevant factors of comparison and their levels.
- ▶ Assigning appropriate weightages to relevant factors of comparison and their levels.
- ▶ Preparing weightage Criteria Table.
- ▶ Working out total weightage score for each of the properties rented/let out and/or sold, and that of the property to be valued.
- ▶ Comparing the properties on the basis of total weightage score, areas and the dates of transaction and estimating fair market value.

5.14. Development Method

- ▶ An indirect manner of deriving land rate from sale transaction.

$$R = \frac{C-S}{A}$$

R = Rate of land/Unit area.

C = Sale consideration amount.

S = Scrap value or depreciated cost of building.

A = Total area of plot.

- ▶ Sale of land could be with vacant house in corner of the plot.
- ▶ Sale of land could be with owner occupied house centrally placed in the small plot.
- ▶ Sale may be of ownership flat/shop/office with vacant or owners possession.
- ▶ Land value can be derived in each of these situations by residual technique.
- ▶ Following examples will explain its working.

Example

A 160 sq.mts. land is sold on May 2018, with 125 sq.mts. bungalow built in corner of the plot. Sale consideration is Rs.1,00,00,000/-. Bungalow is 20 years old and replacement cost is Rs.85000/SM. Calculate land rate in 2018 by Residual Technique.

Solution

In this case bungalow is not very old. Again its placement is in corner of the plot. Hence development is possible by retaining it.

Present value of bungalow	= R.C. - Depreciation.
Replacement Cost	= 125 SM. @ Rs.85000/SM.
	= Rs.1,06,25,000/-
Depreciation	= $0.9 \times 1,06,25,000 \times 20/60$

	= Rs.31,87,500/-
Net Present Value (S)	=10625000- 3187500
	= Rs.7437500/-
C= 1,00,00,000/-, A= 160	
Land Rate : R =(C—S)/A	=(1,00,00,000-7437500)/160
	= Rs.16,015/- Per Sq.Mt

Example

A property with 1500 sq.mts. plot area and with three storeyed rented building in corner of the plot is sold in Feb. 2018 for Rs.9,00,00,000/-. Builtup area of rented building is 225 SM/floor. F.S.I. of zone is 1.00. Net total rent from 12 tenants of building is Rs.80000/- per month. Calculate derived rate of land from this sale by Residual Technique.

Solution

Value of tenanted building by rental method.

$$\text{Rs.80000} \times 12 \times 100/8 = \text{Rs.1,20,00,000}$$

$$\text{Total Sale price} = \text{Rs.9,00,00,000}$$

$$\text{Less: Bldg. Value} = \text{Rs. 1,20,00,000}$$

$$\text{Net Sale value} = \text{Rs.7,80,00,000}$$

Unutilised balance F.S.I. available in the plot

$$= 1500 - 3 \times 225$$

$$= 825 \text{ Sq.Mts.}$$

$$\text{Rate of land} = 7,80,00,000/825 = \text{Rs.94545/- Per Sq.Mt.}$$

Example

A developer is offered a property having 1500 sq.mts. plot with 400 sq.mts. tenanted structure. F.S.I. is 1.00. Rehousing cost for tenants are Rs 320000/SM. Settlement period with tenants is 1 year. Legal cost Rs.10,00,000/-. Interest on borrowed capital is 12%. Developers profit is 15%. Scrap value Rs.8000/SM. Rate of open plot of land in locality is Rs.160000/SM. Advice on fair purchase price of property that could be offered to plot owner if developer intends to sale the property after removal of tenants encumbrance and before constructing new building on the plot.

Solution: Sale value of plot as if open.

= 1500 Sq.Mts. @ Rs.160000/- Per Sq.Mts.	= Rs.24,00,00,000
Add: Scrap value of shed : 400 SM @ 8000/SM.	= Rs. 32,00,000
Total receivable sale income	= Rs.24,32,00,000
Expenses prior to development.	
(1) Cost of rehousing tenants elsewhere	
400 SM at Rs.3,20,000/S.M	= Rs.12,80,00,000
(2) Legal expenses.	= Rs. 15,00,000
(4) Developers profit @ 15% Sale price 12.95cr	= Rs. 1,94,25,000
(5) Interest on borrowed capital @ 12% for 1st year on rehousing cost of tenants i.e. 12.950 cr	= Rs 1,55,40,000
Total expenses	= Rs 16,44,65,000
Say	= Rs 16,44,65,000 (b)
Total receivable income	=Rs.24,32,00,000
Less Expenses	= Rs 16,44,65,000
Net residue value for land	= Rs 7,87,35,000
This is realisable after 1 years. Hence Deferring value at 12% for 1 years,we get	
Net Present Value	= 7,87,35,000 x0.892
	=Rs.7,02,31,620 (c)
Rate of land =Rs.7,02,31,620 /1500	= Rs.46821/- Per Sq.Mt.

It will be seen that though prevalent rate of land in the locality is Rs160000/SM., due to tenants encumbrance, land rate has fallen down to Rs.46821/Sq.Mts.

5.15. Hypothetical Building Scheme (Income Concept)

Example

An entrepreneur wants to buy a property by undertaking building project for regular rental income. Relevant details of the property are as under. Area of office = 3000 sq.mts. Permissible F.S.I. = 1.00. Zoning of plot is commercial. Prevalent rental value for builtup area of offices in the locality is Rs.300/SM/month. Property taxes are Rs.70/SM/month. Building construction

cost is Rs.9000/SM. Expected rate of return on investment is 12%. Adopt Insurance at 0.5% of rent, collection and repair and maintenance expenses at 5% of Rent. Calculate land price that could be offered to the land owner by residue method.

Solution:

Total builtup area of offices = 3000 sq.mts.
 Total Annual Receivable Income = 3000 x 300 x 12
 =Rs.1,08,00,000/Year

Less: Probable outgoings.

Property taxes: 3000 x 70 x 12	= Rs. 25,20,000
Repairs 5% of G.R.	= Rs. 5,40,000
Insurance 1/2% of G.R.	=Rs.54,000
Collection & Management 3% of G.R.	=Rs. 3,24,000
TOTAL	= Rs 34,38,000
Net Receivable Income	= Rs.73,62,000/year

Investor desires 12% yield on his investment. Capitalising net income at 12% in perpetuity, we get capital value of land and building (Total sale price):

$$= 73,62,000 \times 100/12$$

$$= Rs 6,13,50,000/-$$

Full rental income is not likely to start atleast for 2 years period. About one year will be required for construction and one year to find all tenants for premises available in building. The value is therefore deferred at 12% for 1 year (1/2 period of commencement of full income).

Net present value :-Rs. 6,13,50,000x 0.892
 =Rs.5,47,24,200/-

Expenses for completing project:

i) Building cost : 3000 SM @ Rs.9000/SM.	= Rs.2,70,00,000
ii) Architects & Consultants fees 3% of cost	= Rs. 8,10,000
iii) Advertisement and brokerage 1% of probable annual rental.	= Rs.2,70,000
iv) Legal and administrative cost 2% of building value.	= Rs. 5,40,000
y) Total expenses	= Rs.2,86,10,000
Net Present Value today	= Rs.5,47,24,200/
Less : Expenses	Rs. 2,61,14,200
Land price that could be offered	= Rs 2,61,14,200/-
The Investor could offer towards land price a sum not exceeding	= Rs 2,61,14,000/-

It should be noted that interest on borrowed capital is not considered in the working. The investor proposes to invest his own funds in the project for monetary gain. Hence question of borrowing outside funds and pay interest on same does not arise. However if investor borrows fund from market, interest should be allowed and corresponding price to be offered will reduce.

However there are certain other aspects which should also be considered in this working.

i) There is a risk of rental yield falling at future date depending upon demand and supply condition in the locality, money market situation and financial or economic policies of the country.

ii) There may be vacancies in offices which may result in fall of forecasted rental yield. Appropriate weightages should be considered for these aspects.

5.16. Limitations of Market Approach

- ✓ Compare well but differ. Valuer has to make adjustments for this difference and this task is very difficult.
- ✓ Lack of scientific and correct market data
- ✓ Rate difference is noticed in same locality during same year.

6. Professional Ethics and Standards

Syllabus

- Model Code of Conduct as notified by MCA under the Companies (Registered valuers and valuation) Rules 2017

- Other Engagement Considerations

4 marks

1 hour



6.1. Meaning of Business Ethics

- Deals with morality in the business.
- An art or science of maintaining harmonious relationship with society.

6.2. Need of Professional Ethics

- To increase the confidence of end users of information by reducing their level of risk
- To trust the professional who is providing the assurance
- Order to be trusted the auditor needs to be independent of their clients and be sufficiently competent
- Diligency to complete their assignments satisfactorily.
- To improve the image of the profession and to restore trust between users of accountancy services.
- Accountants operate (and are perceived to operate) according to an accepted code of ethics.
- The spirit of the code to every day practice the framework and principles.

6.3. Valuation Standards

As per Chapter IV of Registered Valuers and Valuation) Rules, 2017, Valuation Standards may be stated as:

(1) A registered valuer shall make valuations as per the Valuation Standards notified from time to time by the Central Government.

(2) Until such time as the Valuation Standards are notified by the Central Government, a valuer shall make valuations as per -

- a) an internationally accepted valuation methodology;
- b) valuation standards adopted by any valuation professional organisation; or
- c) valuation standards specified by Reserve Bank of India, Securities and Exchange Board of India or any other statutory regulatory body.

6.4. Integrity and Fairness

As per rule 12(e) of the companies (registered valuers and valuation) rules, 2017, integrity and fairness includes:

Follow high standards of integrity and fairness in all his/its dealings with his/its clients and other valuers.

Shall maintain integrity by being honest, straightforward, and forthright in all professional relationships.

To ensure that he/it provides true and adequate information and shall not misrepresent any facts or situations.

Shall refrain from being involved in any action that would bring disrepute to the profession.

Shall keep public interest foremost while delivering his services professional competence and due care

Shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.

Shall carry out professional services in accordance with the relevant technical and professional standards that may be specified from time to time. A valuer shall continuously maintain professional knowledge and skill to provide competent professional service based on up-to-date developments in practice, prevailing regulations/guidelines and techniques.

The valuer shall not disclaim liability for his/its expertise or deny his/its duty of care, except to the extent that the assumptions are based.

A valuer shall not carry out any instruction of the client insofar as they are incompatible with the requirements of integrity, objectivity and independence.

A valuer shall clearly state to his client the services that he would be competent to provide and The services for which he would be relying on.

6.5. Independence and Disclosure of Interest

As per Rule 12(e) of the Companies (Registered Valuers and Valuation) Rules, 2017, Independence and Disclosure of Interest includes:

A valuer shall act with objectivity in his professional dealings by ensuring that his/its decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party.

A valuer shall not take up an assignment if he/it or any of his/its relatives or associates is not independent in terms of association to the company.

A valuer shall maintain complete independence in his/its professional relationships .

A valuer shall wherever necessary disclose to the clients, possible sources of conflicts of duties and interests.

A valuer shall not deal in securities of any subject company after any time when he/it first becomes aware of the possibility of his/its association with the valuation.

A valuer shall not indulge in “mandate snatching” or offering “convenience valuations” in order to cater to a company or client’s needs. The valuer shall not charge success fee.

6.6. Confidentiality

As per Rule 12(e) of the Companies (Registered Valuers and Valuation) Rules, 2017, Confidentiality includes:

A valuer shall not use or divulge to other clients or any other party any confidential information about the subject company.

6.7. Information Management

A valuer shall ensure that he/ it maintains written contemporaneous records for any decision taken, the reasons for taking the decision, and the information and evidence in support of such decision. This shall be maintained so as to sufficiently enable a reasonable person to take a view on the appropriateness of his/its decisions and actions.

A valuer shall appear, co-operate and be available for inspections and investigations carried out by the authority, any person authorised by the authority, the registered valuers organisation with which he/it is registered or any other statutory regulatory body.

A valuer shall provide all information and records as may be required by the authority, the Tribunal, Appellate Tribunal, the registered valuers organisation with which he/it is registered, or any other statutory regulatory body.

A valuer while respecting the confidentiality of information acquired during the course of performing professional services, shall maintain proper

working papers for a period of three years or such longer period as required in its contract for a specific valuation, for production before a regulatory authority or for a peer review. In the event of a pending case before the Tribunal or Appellate Tribunal, the record shall be maintained till the disposal of the case.

6.8. Gifts and Hospitality

As per Rule 12(e) of the Companies (Registered Valuers and Valuation) Rules, 2017, Gifts and hospitality includes:

A valuer or his/its relative shall not accept gifts or hospitality which undermines or affects his independence as a valuer. Explanation.— For the purposes of this code the term ‘relative’ shall have the same meaning as defined in clause (77) of Section 2 of the Companies Act, 2013 (18 of 2013).

A valuer shall not offer gifts or hospitality or a financial or any other advantage to a public servant or any other person with a view to obtain or retain work for himself/ itself, or to obtain or retain an advantage in the conduct of profession for himself/ itself.

6.9. Remuneration and Costs

As per Rule 12(e) of the Companies (Registered Valuers and Valuation) Rules, 2017, Remuneration and Costs includes:

A valuer shall provide services for remuneration which is charged in a transparent manner, is a reasonable reflection of the work necessarily and properly undertaken, and is not inconsistent with the applicable rules. A valuer shall not accept any fees or charges other than those which are disclosed in a written contract with the person to whom he would be rendering service.

6.10. Occupation, Employability and Restrictions

As per Rule 12(e) of the Companies (Registered Valuers and Valuation) Rules, 2017, Occupation, employability and restrictions includes:

A valuer shall refrain from accepting too many assignments, if he/it is unlikely to be able to devote adequate time to each of his/ its assignments.

A valuer shall not conduct business which in the opinion of the authority or the registered valuer organisation discredits the profession.

7. Report writing

- Reports-Quality, Structure, Style.
- Report writing for various purposes of valuation-Sale, Purchase, Purchase, Mortgage, Taxation, Insurance, Liquidation
- Contents of the report: Instruction of Clients, Valuation Date, Site Inspection, Location, Ownership History, Data Collection and Analysis, Type of Construction, Valuation Method, Value Estimation, Conclusion

2 marks

1 hour



7.1. Report writing

- ▶ It is a communication – narration of incident.
- ▶ Forms of report
 - Oral & written reports
 - Technical & non technical reports
 - - Non technical – Novel, Journal, magazine, press, media
 - -Technical - audit report, medical report, estate management, financial
 - - Management reports, structural survey report, town planning report, valuation report

7.2. Process

- Mandate
 - -Clarity
 - Acceptance
 - Contract
Legal binding
 - Identification of task & objective
 - Define the scope , limitation and adopting methodology
 - Collection of data & information
 - Analysis of information & data
 - Conclusion & opinion

7.3. Attitude & skill

- Report should be a marketing tool for you: it will reflect your hard work
- Relation with the client.

7.4. Professional integrity

- Unbiased & balanced report
- Detach from property/client - don't do valuation for own/relative properties

7.5. Accountability

- Signed by valuer

- Do not use words like “ it is learnt”, “some body informs me”
- Disclose what has been done(scope), what has not been done,(limitation)
- Don’t hide any information.

7.6. Inquisitive & analytical mind

- Scrutinize his own work, cross examining himself
- Out word looking analytical mind, with logical manner, open mind.

7.7. Perseverance & Hard work

- How to overcome the slackness after completing the field work
- By preparing annexure like photos, map, etc

7.8. Technical skill

- Acquiring qualification, experience, training, maintaining technical competence are essential
- Update economic trend, logical thinking of price, cost, interest to be valued, benefit, security.

7.9. Communication skill

- Maximum meaning in minimum words
- Good communication skill with poor technical knowledge - misleading report
- Sound technical knowledge with poor communication skill - no practical use

7.10. Client requires

- Structural condition,
- Feasibility addition, alteration, & its cost
- Management of estate
- Valuation of properties for various purpose

7.11. Contract - offer & acceptance

Disclose the interest if any with the property/company
Client – job provider, end user, pay master.

7.12. I hereby declare that:

I. The information provided is true and correct to the best of my knowledge and belief.

ii. The analysis and conclusions are limited by the reported assumptions and conditions.

I have read the Handbook on Policy, Standard and Procedures for Real Estate Valuation by Banks and hfis in India, 2011, issued by IBA and NHB, fully understood the provisions of the same and followed the provisions of the same to the best of my ability and this report is in conformity to the Standards of Reporting enshrined in the above Handbook.

I have no direct or indirect interest in the above property valued.

I/ my authorized representative by the name of Who is also a 'valuer', has inspected the subject property on..... Vi. I am a registered Valuer under Section 34AB of Wealth Tax Act, 1957, Category..... for valuing property up to

I am/am not an approved Valuer under SARFAESI ACT-2002 and am approved by the Bank.

I have not been depanelled or removed from any Bank/Financial Institution/Government Organization at any point of time in the past.

7.13. Introduction

- Mandate
 - -Skill – Technical, Communication
- Report must give
 - Information about valuation
 - Data
 - Analysis of data
 - Reasoning
 - Specific conclusion with opinion
 - Your advice
 - Straightforward, meaningful
 - Report is a marketing tool.

- Format – Merits & demerits
- Type of Report
 - Written report, oral report
- Technical report, Non Technical report

7.14. Process of report

- Identifying the task & Objective
- Scope & Limitation and methodology
- Data collection
- Data analysis
- Conclusion and opinion

7.15. Essential attitude & Skill for Report writing

- Direct contact with clients
- Accountability
- Technical knowledge
- Unbiased balanced report

7.16. General structure & process of writing a report

1. Title of the report
2. Introduction/Identification of property
3. Description of the property
4. Title & Ownership
5. Location & Situation
6. Procedure adopted
7. Presentation of data
8. Analysis of data
9. Conclusion
10. Supporting materials

7.17. Purpose of valuation

1. Purchase for occupation/investment
2. Sale
3. Lease
4. Mortgage
5. Income tax, wealth tax, capital gain
6. Compulsory acquisition including injurious affection
7. Estate management
8. Matter related to planning laws

7.18. Forwarding letter

7.19. Title of report

7.20. Collection of information and data

- Identification of the property
- Interest to be valued
- Purpose of valuation
- Date of valuation
- Suggested scope & limitations
- Sale / rental instances

7.21. Approaches

- Cost approach
- Income approach
- Market approach

7.22. Evidencies

- Sources of Information & Data
- 1.Public Records
 - - Tahsildar office/City survey office
 - - SRO
 - - PWD
 - - Municipal records
 - - Development authority
- Publications & Economic Journals
 - Census book
 - Economic journals & Publications
- Site Inspection
 - Access
 - Proximity to amenities & Utilities
 - Surrounding developments
 - Land- size, shape, level, boundaries, dimensions,
 - Buildings – engineering, architecture features
 - Open space
 - Occupation
 - Gross annual rent, outgoings,

- Encumbrances, Easement rights, unauthorized constructions,
 - Encroachments
 - Instances of rentals
 - Verifications of instances of sale, instances of rentals
- Certain specific inquiries on site
 - Leased Properties
 - Instances Of Sale
 - Latent Defects
 - Relative Importance

7.23. Analysis of information & data

- Land value & Market rent
- Rate of interest for capitalization
- Discussion of instances of Rentals & Sales
- Conclusion, opinion & Advice

7.24. Supporting materials

- DCR rules
- Legal provisions
- Maps
- Plan
- Photography
- Charts
- Schedule table – building value repair cost, rents, rental & sales
- Statement
- GLV
- Documents, lease deeds, rental agreements,
- Property tax, EB card,
- Definition of FMV, FSV, RV, IV, Methodology of valuation
- Sale instance, Rental instance table

8. Case Studies

2 marks

2 hours training

Source (sabapathy)

- **1. *K.P. Varghese vs ITO (1981) 131 ITR 597 (SC)***

In the case of K. P. Varghese¹, Supreme Court held, “It is well known fact borne out by practical experience that the determination of fair market value of a capital asset is generally a matter of estimate based to some extent on guess work and despite the utmost bona fides, the estimate of the fair market value is bound to vary from individual to individual. The postulate underlying Sub sec. (2) is that the difference between one honest valuation and another may range up to 15 % and that constitutes the class of margin cases which are taken out of the preview of sub-sec (2) in order to avoid hardship to the assessee.” Here, the court considered 15 % variation between two estimates as normal.

- **2. *Gold Coast Trust Ltd. vs Humphray (1949) 17 ITR 19***

In case of Gold Coast Selection Trust Ltd.¹, justice Viscount Simon stated, “If the asset is difficult to value but none the less of a money value, the best valuation possible must be made. Valuation is not an exact science. Mathematical certainty is not demanded, nor indeed is it possible. It is for Commissioners to express in terms of the money value, attributed by them to the asset their estimate, and this is a conclusion of fact to be drawn from the evidence before them”.

- **3. *Rustam C Cooper vs Union of India AIR 1970 SC 564***

- In Bank Nationalisation Case 2, the Supreme Court has explained the word property as, “In its normal connotation ‘property’ means the “highest right a man can have to anything, being that right which one has to lands or tenements, goods or chattels which does not depend on another’s courtesy: it includes ownership, estates and interests in corporeal things, and also rights such as trademarks, copyrights, patents and even rights in personam capable of transfer or transmission, such as debts, and signifies a beneficial right to or a thing considered as having a money ‘ value, especially with

reference to transfer or succession, and to their capacity of being injured’
Thus the court has included all types of property viz. tangible.

- **4. *Hays Will Trust vs Hays and Others (1971) 1 WLR 758***

- In case of *Hays Will Trusts*⁴, Ungood-Thomas J. of Chancery Division held :
- “They are directed to the sale being in such manner as would obtain the best possible price in the market. It does not mean that the price to be fixed by valuation is the highest possible price that might be obtained. It has been established time and again in these courts, as it was in our case, that there is a range of price, in some circumstances wide, which competent valuers would recognise as the price which ‘property would fetch if sold in the open market. “The most likely price, in the absence of consultation between the valuers representing conflicting interests, would presumably be the mean price.”

- **5. *V.C. Ramchandran vs CWT (1979) 126 ITR 157 Karnataka HC***

- In case of *V. C. Ramchandran*⁵¹, the Karnataka High Court stated, “In our opinion the principle applicable for the interpretation of taxing statutes cannot be imported and applied to the valuation of property in a given case, which constitutes a question of fact. If there are more than one valuation of the same property, the one which is reasonable and nearer to the correct market value, having due regard to all the relevant facts and circumstances of the case alone should be accepted. Therefore, in such a case if the higher valuation between several valuations appears to be a reasonable one, the same has got to be accepted. We are unable to accede to the submission that in cases where value of the property is ascertained under more than one method, the lowest should be accepted.”

- **6. *Subh Karan Choudhury vs IAC (1979) 118 ITR 111 Kolkatta HC (Special Value / FMV)***

- In the case of *Subhkarana Chowdhury*⁶, Calcutta the High Court held, “Valuation of fully tenanted property should be made on the basis of capitalisation of rental method.”

- **7. *Wenger & Co. vs DVO (1978) 115 ITR 648 Delhi HC (Combination of Methods)***

- In the case of *Wenger & Co.*, Delhi the High Court, held, “District Valuation officer adopted two methods to value the property. For owner occupied portion he calculated the value on the basis of what were the rates prevalent for sale of commercial flats in Connaught Place extension area. For the tenanted portion he capitalised the rental value. It is well-known fact that giving possession of buildings, though previously rented out, fetches better market price. It cannot be assumed that the hypothetical purchaser would let out the self-occupied portions which he buys from the hypothetical seller or would let out such portions in the condition in which he buys them. The method adopted by District V. O. and his approach is not only acceptable but also in accordance with the principles of evaluation. “

- **8. *Sorab Talati vs Josheph Michem Appeal 101 of 1949 - Vol.- 2 of SOC - page 162 (Bombay) (Invest Theory of Rent)***

- In 1949, Small Causes Court of Bombay, for the first time, laid down principles of Rent Fixation (Standard Rent) in the case of *Sorab Talati*¹. In this case, the Court approved of Investment Theory in preference to Comparable Rent Theory to fix Standard Rent of the rent controlled premises. In this case, the court considered return or yield from Gilt Edged Security as the basis for determining fair return to the landlord on his investments in land and buildings. Considering and comparing alternative forms of sound investments viz. Govt. Security and immovable property, the Court upheld following returns as fair returns to the landlord on his capital investment in land and buildings. 1.50% return i.e. more than the average yield on long term government security was approved as fair return on land investment and 2.50 % return more than the average yield on long term government security was approved as fair return on investment in buildings. For leasehold properties, 1% extra yield on both types of investment was considered fair, to account for extra risk of investing capital, in leasehold properties. Obviously, these norms and principles continued to be followed for several years for all types of rented properties and even for other purposes.

- **9. CWT vs P.N. Sikand (1977) 107 ITR 922 SC**
- In case of P. N. Sikand³², the Supreme Court held, “It is clear on the application of this test that in present case, 50% of the unearned increase in the value of the land would be diverted to the lessor before it reaches the hands of the assessee as part of the price. The assessee holds the leasehold interest on condition that if he assigns it, 50 % of the unearned increase in the value of the land will be payable to the lessor.” Court further stated, “it must be held that in determining the value of the leasehold interest of the assessee in the land for the purpose of assessment to wealth tax, the price which the leasehold interest would fetch in the open market were it not encumbered or affected by the burden or restriction contained in clause (13) of the lease deed, would have to be reduced by 50%. of the unearned increase in the value of the land on the basis of the hypothetical sale on the valuation date.”
- **10. SLAO (Eluru) vs Jasti Rohini (1995) 1 SCC 717 SC**
- In case of Sp.Land Acq. Officer Elura¹³, the Supreme Court held, “Value fetched by sale of small extent land cannot be adopted for large extent land. Loss of land for road and park, expenses for development should be deducted”.
- **11. Shubh Ram and Others vs State of Haryana (2010) 1 SCC 444**
- In the case of Subhram¹⁵, the Supreme Court discussed this entire process in following words. “The value of one Sq.Yds. of undeveloped land is not the same as one Sq.Yd. of developed residential plot. If there is large tract of agricultural or undeveloped land, obviously the entire extent cannot be sold as residential plots. If such land has to be sold as residential plots, it is first necessary to make a layout of plots in such land. This would mean that a provision will have to be made for roads to provide access to each plot in the layout. In hypothetical layout method of determination of market value, as a first step, the areas that will be used for roads, drains, parks/playgrounds and community areas, will have to be excluded from the total extent of the acquired land. But merely deducting the areas required for roads, drains, parks will not convert a large tract of undeveloped land into developed ‘residential layout. For that, considerable financial outlay has to be made.

- The land will have to be converted from agricultural to non agricultural residential use by paying necessary fees to the revenue authorities. Then the roads will have to be asphalted or concreted. Drains will have to be dug and lined with R.C.C. or stone, for drainage of rain water. Electricity, water and sewage lines will have to be laid. Deposits will have to be made to the authorities dealing with electricity, water and sewage removal.
- The development will also involve the service of surveyors, engineers and developers. All these involve considerable expenditure. Further, as there will be time gap between the expenditure for development and the actual sale of plots, the cost of development will also have an element of interest on investment. The developer who undertakes the development and invests monies for development would also expect a reasonable profit when the plots are sold. All these expenditure and factors are standardised into 33% 'deduction towards expenses of development.'
- **12. *Jawaji Nagnathan vs REV. DIV. Officer (1994) SCC - 4 Page 595 SC***
- In case of Jawajee Nagnatham, the Court held, "It is therefore, clear that the Basic Valuation Register prepared and maintained for the purpose of collecting stamp duty has no statutory base or force. It cannot form a foundation to determine the market value mentioned there under in instrument brought for registration. Evidence of bona fide sales between willing prudent vendor and prudent vendee of the land acquired or situated near about that land possessing same or similar advantageous features would furnish basis to determine market value."
- **13. *Chimanlal Hargovinddas vs SLAO - Pune, AIR 1988 SC 165***
- The following factors must be etched on the mental screen:
- A reference under section 18 of the Land Acquisition Act is not an appeal against the award and the Court cannot take into account the material relied upon by the Land Acquisition officer in his Award unless the same material is produced and proved before the Court.

(2) So also the Award of the Land Acquisition officer is not to be treated as a judgment of the trial Court open or exposed to challenge before the Court hearing the Reference. It is merely an offer made by the Land Acquisition

officer and the material utilised by him for making his valuation cannot be utilised by the Court unless produced and proved before it. It is not the function of the Court to suit in appeal against the Award, approve or disapprove its reasoning, or correct its error or affirm, modify or reverse the conclusion reached by the Land Acquisition officer, as if it were an appellate court.

(3) The Court has to treat the reference as an original proceeding before it and

determine the market value afresh on the basis of the material produced before it.

(4) The claimant is in the position of a plaintiff who has to show that the price offered for his land in the award is inadequate on the basis of the materials produced in the Court. Of course the materials placed and proved by the other side can also be taken into account for this purpose. (5) The market value of land under acquisition has to be determined as on the crucial date of publication of the notification under sec. 4 of the Land Acquisition Act

(dates of Notifications under secs. 6 and 9 are irrelevant).

(6) The determination has to be made standing on the date line of valuation (date of publication of notification under sec. 4) as if the valuer is a hypothetical purchaser willing to purchase land from the open market and is prepared to pay a reasonable price as on that day. It has also to be assumed that the vendor is willing to sell the land at a reasonable price.

(7) In doing so by the instances method, the Court has to correlate the market value reflected in the most comparable instance which provides the index of market value.

(8) only genuine instances have to be taken into account. (Some times instances are rigged up in anticipation of Acquisition of land).

(9) Even post notification instances can be taken into account (1) if they are very proximate, (2) genuine and (3) the acquisition itself has not motivated the purchaser to pay a higher price on account of the resultant improvement in development prospects.

(10) The most comparable instances out of the genuine instances have to be identified on the following considerations:

(i) proximity from time angle,

(ii) proximity from situation angle.

(11) Having identified the instances which provide the index of market value the price reflected therein may be taken as the norm and the market value of the land under acquisition may be deduced by making suitable adjustments for the plus and minus factors vis-a-vis land under acquisition by placing the two in juxtaposition.

(12) A balance-sheet of plus and minus factors may be drawn for this purpose and the relevant factors may be evaluated in terms of price variation as a prudent purchaser would do.

(13) The market value of the land under acquisition has there after to be deduced

by loading the price reflected in the instance taken as norm for plus factors and unloading it for minus factors (14) The exercise indicated in clauses

(11) to (13) has to be undertaken in a common sense manner as a prudent man of the world of business would do.

(14) The evaluation of these factors of course depends on the facts of each case. There cannot be any hard and fast or rigid rule. Common sense is the best and most reliable guide. For instance, take the factor regarding the size. A building plot of land say 500 to 1000 sq. yds cannot be compared with a large tract or block of land of say 1000 sq. yds or more. Firstly while a smaller plot is within the reach of many, a large block of land will have to be developed by preparing a lay out, carving out roads, leaving open space, plotting out smaller plots, waiting for purchasers (meanwhile the invested money will be blocked up) and the hazards of an entrepreneur. The factor can be discounted by making a deduction by way of an allowance at an appropriate rate ranging approx. between 20% to 50% to account for land required to be set apart for carving out lands and plotting out small plots.

The discounting will to some extent also depend on whether it is a rural area or urban area, whether building activity is picking up, and whether waiting period during which the capital of the entrepreneur would be looked up, will be longer or shorter and the attendant hazards.

(15) Every case must be dealt with on its own facts pattern bearing in mind all these factors as a prudent purchaser of land in which position the Judge must place himself.

(16) These are general guidelines to be applied with understanding informed with common sense.

Key to remember

1. Verghese

15 % variation in two valuers opinion

2. Gold Crust trust

Valuation is not a Science

3. Rustom

Scope of property to value

4. Will

Price varies with circumstances

5. Ramchandra

Lowest value should be accepted

6. Subhakaran

Rental property should be capitalised

7. Wenger

Rental Capitalisation can be replaced by market approach.

8. Sorab Talati

Rate of return (1.5% on long term government security and 2.5% more on average yeild)

9. SIKAND

For lease hold property (50% unearned increase of land has to go to lessor)

10. Jasti

Small extent land can not be adopted for large extent

11. Shubh Ram

Same as 10(Hypothetical development model-33% deduction)

12.Jawaji

Stamp duty is not evidence for market value

13.Hargovinddas

How to value land under acquisition



9. International valuation standard

9.1. Why IVS?

The objective of the IVS is to increase the confidence and trust of users of valuation services by establishing transparent and consistent valuation practices.

Why IVS in India?

Is it mandatory?

Valuation for non-fiscal purposes banking/finance, land acquisition, insurance, rent fixation,

Valuation for fiscal purposes

A standard will do one or more of the following:

Identify or develop globally accepted principles and definitions
Identify and promulgate considerations for the undertaking of valuation assignments and the reporting of valuations
Identify specific matters that require consideration and methods commonly used for valuing different types of *assets* or liabilities

9.2. STRUCTURE OF IVS 2017

The IVS Framework

IVS General Standards

IVS Asset Standards

▶ The IVS Framework

This serves as a preamble to the IVS the IVS Framework consists of general principles for valuers following the IVS regarding objectivity, judgment, competence and acceptable departures from the IVS

▶ IVS General Standards

These set forth requirements for the conduct of all valuation assignments including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting. They are designed to be applicable to valuations of all types of *assets* and for any *valuation purpose*

▶ IVS Asset Standards

The Asset Standards include requirements related to specific types of *assets* .

These requirements must be followed in conjunction with the General Standards when performing a valuation of a specific *asset* type. The Asset Standards include certain background information on the characteristics of each *asset* type that influence value and additional *asset*-specific requirements on common valuation approaches and methods used .

9.3. Contents of IVS Framework

- Compliance with Standards
- Assets and Liabilities
- Valuer
- Objectivity
- Competence
- Departures
- Salient feature

▶ Objectivity

The process of valuation requires the *valuer* to make impartial judgments as to the reliability of inputs and assumptions.

For a valuation to be credible, it is important that those judgments are made in a way that promotes transparency and minimises the influence of any subjective factors on the process.

Judgment used in a valuation must be applied objectively to avoid biased analyses, opinions and conclusions.

Objective valuation is the heart of valuation practice

9.4. General Standards

- IVS 101 Scope of Work
- IVS 102 Investigations and Compliance
- IVS 103 Reporting
- IVS 104 Bases of Value
- IVS 105 Valuation Approaches and Methods

9.4.1.IVS 101 SCOPE OF WORK

- a) Identity of the *valuer*
- b) Identity of the *client(s) (if any)*
- c) Identity of other intended users (if any)
- d) *Asset(s) being valued*
- e) The valuation currency
- f) *Purpose of the valuation*
- g) Basis/bases of value used
- h) Valuation date

- (i) The nature and extent of the valuer's work and any limitations thereon:

Any limitations or restrictions on the inspection, enquiry and/or analysis in the valuation assignment *must be identified (see IVS Framework, paras 60.1-60.4)* If relevant information is not available because the conditions of the assignment restrict the investigation, these restrictions and any necessary assumptions or special assumptions (see IVS 104 Bases of Value, paras 200.1-200.5) made as a result of the restriction *must be identified*

- (j) The nature and sources of information upon which the valuer relies:

The nature and source of any relevant information that is to be relied upon and the extent of any verification to be undertaken during the valuation process must be identified

- (k) Significant assumptions and/or special assumptions:

All significant assumptions and special assumptions that are to be made in the conduct and reporting of the valuation assignment must be identified.

- (l) The type of report being prepared:

The format of the report, that is, how the valuation will be communicated, *must be described*.

9.4.2. IVS 102 Investigations and Compliance

20.0 Investigations

20.1 Must be appropriate for the purpose of the valuation assignment and the basis(es) of value

20.2. Sufficient evidence must be assembled by means such as inspection, inquiry, computation and analysis

20.3. Limits *may be agreed on the extent of the valuer's investigations. Any such limits must be noted*

20.4. When a valuation assignment involves reliance on information supplied by a party other than the *valuer, consideration should be given as to whether the information is credible or that the information may otherwise be relied upon.*

9.4.3. IVS 103 Reporting General Requirements

20.1. The *purpose of the valuation,*

20.2. Compliance with this standard does not require a particular form or format of report; however, the report *must* be sufficient to communicate to the intended users.

20.3. The report *should* also be sufficient for an appropriately experienced valuation professional with no prior involvement with the valuation engagement to review.

30. Valuation Reports

30.1. Where the report is the result of an assignment involving the valuation of an *asset* or *assets*, the report *must* convey the following, at a minimum:

- (a) the scope of the work performed,
- (b) the approach or approaches adopted,
- (c) the method or methods applied,
- (d) the key inputs used,
- (e) the assumptions made,
- (f) the conclusion(s) of value and principal reasons for any conclusions reached, and
- (g) the date of the report (which *may* differ from the valuation date).

30.2. Some of the above requirements *may* be explicitly included in a report or incorporated into a report through reference to other documents (engagement letters, scope of work documents, internal policies and procedures, etc).

40. Valuation Review Reports

40.1. Where the report is the result of a valuation review, the report *must* convey the following, at a minimum:

(a) the scope of the review performed, including the elements noted in para 20.3 of IVS 101 *Scope of Work* to the extent each is applicable to the assignment,

(b) the valuation report being reviewed and the inputs and assumptions -upon which that valuation was based,

(c) the reviewer's conclusions about the work under review, including supporting reasons, and

(d) the date of the report (which *may* differ from the valuation date).

40.2. Some of the above requirements *may* be explicitly included in a report or incorporated into a report through reference to other documents (eg, engagement letters, scope of work documents, internal policies and procedures, etc).

9.4.4. IVS 104 Bases of Value

Introduction

10.1. Bases of value (sometimes called standards of value) describe the fundamental premises on which the reported values will be based. It is critical that the basis (or bases) of value be appropriate to the terms and *purpose of the valuation* assignment, as a basis of value *may* influence or dictate a *valuer's* selection of methods, inputs and assumptions, and the ultimate opinion of value.

10.2. A *valuer may* be required to use bases of value that are defined by statute, regulation, private contract or other document. Such bases have to be interpreted and applied accordingly.

IVS 104 Bases of Value

10.3. While there are many different bases of value used in valuations, most have certain common elements: an assumed transaction, an assumed date of the transaction and the assumed parties to the transaction.

10.4. Depending on the basis of value, the assumed transaction could take a number of forms:

- (a) a hypothetical transaction,
- (b) an actual transaction,
- (c) a purchase (or entry) transaction,
- (d) a sale (or exit) transaction, and/or
- (e) a transaction in a particular or hypothetical market with specified characteristics.

10.5. The assumed date of a transaction will influence what information and data a *valuer* consider in a valuation. Most bases of value prohibit the consideration of information or market sentiment that would not be known or knowable with reasonable due diligence on the measurement/valuation date by *participants*.

10.6. Most bases of value reflect assumptions concerning the parties to a transaction and provide a certain level of description of the parties. In respect to these parties, they could include one or more actual or assumed characteristics, such as:

- (a) hypothetical,
- (b) known or specific parties,
- (c) members of an identified/described group of potential parties,
- (d) whether the parties are subject to particular conditions or motivations at the assumed date (eg, duress), and/or
- (e) an assumed knowledge level.

20. Bases of Value

20.1. In addition to the IVS-defined bases of value listed below, the IVS have also provided a non-exhaustive list of other non-IVS-defined bases of value prescribed by individual *jurisdictional* law or those recognised and adopted by international agreement:

- (a) IVS-defined bases of value:
 1. Market Value (section 30),
 2. Market Rent (section 40),
 3. Equitable Value (section 50),
 4. Investment Value/Worth (section 60),
 5. Synergistic Value (section 70), and
 6. Liquidation Value (section 80).

(b) Other bases of value (non-exhaustive list):

1. Fair Value (International Financial Reporting Standards) (section 90),
2. Fair Market Value (Organisation for Economic Co-operation and Development) (section 100),
3. Fair Market Value (United States Internal Revenue Service)(section 110), and
4. Fair Value (Legal/Statutory) (section 120):
 - a. the Model Business Corporation Act, and
 - b. Canadian case law (Manning v Harris Steel Group Inc).

20.2. *Valuers must* choose the relevant basis (or bases) of value according to the terms and *purpose of the valuation* assignment. The *valuer's* choice of a basis (or bases) of value *should* consider instructions and input received from the *client* and/or its representatives. However, regardless of instructions and input provided to the *valuer*, the *valuer should* not use a basis (or bases) of value that is inappropriate for the intended *purpose of the valuation* (for example, if instructed to use an IVS-defined basis of value for financial reporting *purposes* under IFRS, compliance with IVS *may* require the *valuer* to use a basis of value that is not defined or mentioned in the IVS).

20.3. In accordance with IVS 101 *Scope of Work*, the basis of value *must* be appropriate for the *purpose* and the source of the definition of any basis of value used *must* be cited or the basis explained.

20.4. *Valuers* are responsible for understanding the regulation, case law and other interpretive guidance related to all bases of value used.

20.5. The bases of value illustrated in sections 90-120 of this standard are defined by organisations other than the IVSC and the onus is on the *valuer* to ensure they are using the relevant definition.

30. IVS-Defined Basis of Value – Market Value

30.1. Market Value is the estimated amount for which an *asset* or liability *should* exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

30.2. The definition of Market Value *must* be applied in accordance with the following conceptual framework:

(a) “The estimated amount” refers to a price expressed in terms of money payable for the *asset* in an arm’s length market transaction. *Market Value* is the most probable price reasonably obtainable in the market on the valuation date in keeping with the market value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer. This estimate specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale, or any element of value available only to a specific owner or purchaser.

(b) “An *asset* or liability *should* exchange” refers to the fact that the value of an *asset* or liability is an estimated amount rather than a predetermined amount or actual sale price. It is the price in a transaction that meets all the elements of the Market Value definition at the valuation date.

(c) “On the valuation date” requires that the value is time-specific as of a given date. Because markets and market conditions *may* change, the estimated value *may* be incorrect or inappropriate at another time.

The valuation amount will reflect the market state and circumstances as at the valuation date, not those at any other date.

(d) “Between a willing buyer” refers to one who is motivated, but not compelled to buy. This buyer is neither over eager nor determined to buy at any price. This buyer is also one who purchases in accordance with the realities of the current market and with current market expectations, rather than in relation to an imaginary or hypothetical market that cannot be demonstrated or anticipated to exist. The assumed buyer would not pay a higher price than the market requires.

The present owner is included among those who constitute “the market”.

(e) “And a willing seller” is neither an over eager nor a forced seller prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in the current market. The willing seller is motivated to sell the *asset* at market terms for the best price attainable in the open market after proper marketing, whatever that price *may* be. The factual circumstances of the actual owner are not a part of this consideration because the willing seller is a hypothetical owner.

(f) “In an arm’s length transaction” is one between parties who do not have a particular or special relationship, eg, parent and subsidiary companies or landlord and tenant, that *may* make the price level uncharacteristic of the market or inflated. The Market Value transaction is presumed to be between unrelated parties, each acting independently.

(g) “After proper marketing” means that the *asset* has been exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the Market Value definition. The method of sale is deemed to be that most appropriate to obtain the best price in the market to which the seller has access. The length of exposure time is not a fixed period but will vary according to the type of *asset* and market conditions. The only criterion is that *there must* have been sufficient time to allow the *asset* to be brought to the attention of an adequate number of market *participants*. The exposure period occurs prior to the valuation date.

(h) “Where the parties had each acted knowledgeably, prudently” presumes that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the *asset*, its actual and potential uses, and the state of the market as of the valuation date. Each is further presumed to use that knowledge prudently to seek the price that is most favourable for their respective positions in the transaction.

Prudence is assessed by referring to the state of the market at the valuation date, not with the benefit of hindsight at some later date. For example, it is not necessarily imprudent for a seller to sell *assets* in a market with falling prices at a price that is lower than previous market levels. In such cases, as is true for other exchanges in markets with changing prices, the prudent buyer or seller will act in accordance with the best market information available at the time.

(i) “And without compulsion” establishes that each party is motivated to undertake the transaction, but neither is forced or unduly coerced to complete it.

30.3. The concept of Market Value presumes a price negotiated in an open and competitive market where the *participants* are acting freely. The market for an *asset* could be an international market or a local market. The market could consist of numerous buyers and sellers, or could be one characterized by a limited number of market *participants*. The market in which the *asset* is presumed exposed for sale is the one in which the *asset* notionally being exchanged is normally exchanged.

30.4. The Market Value of an *asset* will reflect its highest and best use (see paras 140.1-140.5). The highest and best use is the use of an *asset* that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use *may* be for continuation of an *asset's* existing use or for some alternative use. This is determined by the use that a market *participant* would have in mind for the *asset* when formulating the price that it would be willing to bid.

30.5. The nature and source of the valuation inputs *must* be consistent with the basis of value, which in turn *must* have regard to the *valuation purpose*.

For example, various approaches and methods *may* be used to arrive at an opinion of value providing they use market-derived data. The market approach will, by definition, use market-derived inputs. To indicate Market Value, the income approach *should* be applied, using inputs and assumptions that would be adopted by *participants*. To indicate Market Value using the cost approach, the cost of an *asset* of equal utility and the appropriate depreciation *should* be determined by analysis of market-based costs and depreciation.

30.6. The data available and the circumstances relating to the market for the *asset* being valued *must* determine which valuation method or methods are most relevant and appropriate. If based on appropriately analysed market-derived data, each approach or method used *should* provide an indication of Market Value.

30.7. Market Value does not reflect attributes of an *asset* that are of value to a specific owner or purchaser that are not available to other buyers in the market. Such advantages *may* relate to the physical, geographic, economic or legal characteristics of an *asset*. Market Value requires the disregard of any such element of value because, at any given date, it is only assumed that there is a willing buyer, not a particular willing buyer.

40. IVS-Defined Basis of Value – Market Rent

40.1. Market Rent is the estimated amount for which an interest in real property *should* be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.

40.2. Market Rent *may* be used as a basis of value when valuing a lease or an interest created by a lease. In such cases, it is necessary to consider the contract rent and, where it is different, the market rent.

40.3. The conceptual framework supporting the definition of Market Value shown above can be applied to assist in the interpretation of Market Rent. In

particular, the estimated amount excludes a rent inflated or deflated by special terms, considerations or concessions. The “appropriate lease terms” are terms that would typically be agreed in the market for the type of property on the valuation date between market *participants*. An indication of Market Rent *should* only be provided in conjunction with an indication of the principal lease terms that have been assumed.

40.4. Contract Rent is the rent payable under the terms of an actual lease. It *may* be fixed for the duration of the lease, or variable. The frequency and basis of calculating variations in the rent will be set out in the lease and *must* be identified and understood in order to establish the total benefits accruing to the lessor and the liability of the lessee.

40.5. In some circumstances the Market Rent *may* have to be assessed based on terms of an existing lease (eg, for rental determination *purposes* where the lease terms are existing and therefore not to be assumed as part of a notional lease).

40.6. In calculating Market Rent, the *valuer must* consider the following:

(a) in regard to a Market Rent subject to a lease, the terms and conditions of that lease are the appropriate lease terms unless those terms and conditions are illegal or contrary to overarching legislation, and (b) in regard to a Market Rent that is not subject to a lease, the assumed terms and conditions are the terms of a notional lease that would typically be agreed in a market for the type of property on the valuation date between market *participants*.

50. IVS-Defined Basis of Value – Equitable Value

50.1. Equitable Value is the estimated price for the transfer of an *asset* or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

50.2. Equitable Value requires the assessment of the price that is fair between two specific, identified parties considering the respective advantages or disadvantages that each will gain from the transaction. In contrast, Market Value requires any advantages or disadvantages that would not be available to, or incurred by, market *participants* generally to be disregarded.

e50.3. Equitable Value is a broader concept than Market Value. Although in many cases the price that is fair between two parties will equate to that obtainable in the market, there will be cases where the assessment of Equitable Value will involve taking into account matters that have to be disregarded in the

assessment of Market Value, such as certain elements of Synergistic Value arising because of the combination of the interests.

50.4. Examples of the use of Equitable Value include:

(a) determination of a price that is equitable for a shareholding in a nonquoted business, where the holdings of two specific parties *may* mean that the price that is equitable between them is different from the price that might be obtainable in the market, and

(b) determination of a price that would be equitable between a lessor and a lessee for either the permanent transfer of the leased *asset* or the cancellation of the lease liability.

60. IVS-Defined Basis of Value – Investment Value/Worth

60.1. Investment Value is the value of an *asset* to a particular owner or prospective owner for individual investment or operational objectives.

60.2. Investment Value is an entity-specific basis of value. Although the value of an *asset* to the owner *may* be the same as the amount that could be realised from its sale to another party, this basis of value reflects the benefits received by an entity from holding the *asset* and, therefore, does not involve a presumed exchange. Investment Value reflects the circumstances and financial objectives of the entity for which the valuation is being produced. It is often used for measuring investment performance.

70. IVS-Defined Basis of Value – Synergistic Value

70.1. Synergistic Value is the result of a combination of two or more *assets* or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer then Synergistic Value will differ from Market Value, as the Synergistic Value will reflect particular attributes of an *asset* that are only of value to a specific purchaser. The added value above the aggregate of the respective interests is often referred to as “marriage value.”

80. IVS-Defined Basis of Value – Liquidation Value

80.1. Liquidation Value is the amount that would be realised when an *asset* or group of *assets* are sold on a piecemeal basis. Liquidation Value *should* take into account the costs of getting the *assets* into saleable condition as well as those of the disposal activity. Liquidation Value can be determined under

two different premises of value:

(a) an orderly transaction with a typical marketing period (see section 160),

or

(b) a forced transaction with a shortened marketing period (see section 170).

80.2. A *valuer* must disclose which premise of value is assumed.

90. Other Basis of Value – Fair Value (International Financial Reporting Standards)

90.1. IFRS 13 defines Fair Value as the price that would be received to sell an *asset* or paid to transfer a liability in an orderly transaction between market *participants* at the measurement date.

90.2. For financial reporting *purposes*, over 130 countries require or permit the use of International Accounting Standards published by the International Accounting Standards Board. In addition, the Financial Accounting Standards Board in the United States uses the same definition of Fair Value in Topic 820.

100. Other Basis of Value – Fair Market Value (Organisation for Economic Co-operation and Development (OECD))

100.1. The OECD defines Fair Market Value as the price a willing buyer would pay a willing seller in a transaction on the open market.

100.2. OECD guidance is used in many engagements for international tax *purposes*.

110. Other Basis of Value – Fair Market Value (United States Internal Revenue Service)

110.1. For United States tax *purposes*, Regulation §20.2031-1 states: “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.”

120. Other Basis of Value – Fair Value (Legal/Statutory) in different jurisdictions

120.1. Many national, state and local agencies use Fair Value as a basis of value in a legal context. The definitions can vary *significantly* and *may* be the result of legislative action or those established by courts in prior cases.

120.2. Examples of US and Canadian definitions of Fair Value are as follows:

(a) The Model Business Corporation Act (MBCA) is a model set of law prepared by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association and is followed by 24 States in the United States. The

definition of Fair Value from the MBCA is the value of the corporation's shares determined:

- (1) immediately before the effectuation of the corporate action to which the shareholder objects,
- (2) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal, and
- (3) without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles pursuant to section

(b) In 1986, the Supreme Court of British Columbia in Canada issued a ruling in *Manning v Harris Steel Group Inc.* that stated: "Thus, a 'fair' value is one which is just and equitable. That terminology contains within itself the concept of adequate compensation (indemnity), consistent with the requirements of justice and equity."

130. Premise of Value/Assumed Use

130.1. A Premise of Value or Assumed Use describes the circumstances of how an *asset* or liability is used. Different bases of value *may* require a particular Premise of Value or allow the consideration of multiple Premises of Value. Some common Premises of Value are:

- (a) highest and best use,
- (b) current use/existing use,
- (c) orderly liquidation, and
- (d) forced sale.

140. Premise of Value – Highest and Best Use

140.1. Highest and best use is the use, from a *participant* perspective, that would produce the highest value for an *asset*. Although the concept is most frequently applied to non-financial *assets* as many financial *assets* do not have alternative uses, there *may* be circumstances where the highest and best use of financial *assets* needs to be considered.

140.2. The highest and best use *must* be physically possible (where applicable), financially feasible, legally allowed and result in the highest value. If different from the current use, the costs to convert an *asset* to its highest and best use would impact the value.

140.3. The highest and best use for an *asset may* be its current or existing use when it is being used optimally. However, highest and best use *may* differ from current use or even be an orderly liquidation.

140.4. The highest and best use of an *asset* valued on a stand-alone basis *may* be different from its highest and best use as part of a group of *assets*, when its contribution to the overall value of the group *must* be considered.

140.5. The determination of the highest and best use involves consideration of the following:

(a) To establish whether a use is physically possible, regard will be had to what would be considered reasonable by *participants*.

(b) To reflect the requirement to be legally permissible, any legal restrictions on the use of the *asset*, eg, town planning/zoning designations, need to be taken into account as well as the likelihood that these restrictions will change.

(c) The requirement that the use be financially feasible takes into account whether an alternative use that is physically possible and legally permissible will generate sufficient return to a typical *participant*, after taking into account the costs of conversion to that use, over and above the return on the existing use.

150. Premise of Value – Current Use/Existing Use

150.1. Current use/existing use is the current way an *asset*, liability, or group of *assets* and/or liabilities is used. The current use *may* be, but is not necessarily, also the highest and best use.

160. Premise of Value – Orderly Liquidation

160.1. An orderly liquidation describes the value of a group of *assets* that could be realised in a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis.

160.2. The reasonable period of time to find a purchaser (or purchasers) *may* vary by *asset* type and market conditions.

170. Premise of Value – Forced Sale

170.1. The term “forced sale” is often used in circumstances where a seller is under compulsion to sell and that, as a consequence, a proper marketing period is not possible and buyers *may* not be able to undertake adequate due diligence. The price that could be obtained in these circumstances will depend upon the nature of the pressure on the seller and the reasons why proper marketing

cannot be undertaken. It *may* also reflect the consequences for the seller of failing to sell within the period available.

Unless the nature of, and the reason for, the constraints on the seller are known, the price obtainable in a forced sale cannot be realistically estimated. The price that a seller will accept in a forced sale will reflect its particular circumstances, rather than those of the hypothetical willing seller in the Market Value definition. A “forced sale” is a description of the situation under which the exchange takes place, not a distinct basis of value.

170.2. If an indication of the price obtainable under forced sale circumstances is required, it will be necessary to clearly identify the reasons for the constraint on the seller, including the consequences of failing to sell in the specified period by setting out appropriate assumptions. If these circumstances do not exist at the valuation date, these *must* be clearly identified as special assumptions.

170.3. A forced sale typically reflects the most probable price that a specified property is likely to bring under all of the following conditions:

- (a) consummation of a sale within a short time period,
- (b) the *asset* is subjected to market conditions prevailing as of the date of valuation or assumed timescale within which the transaction is to be completed,
- (c) both the buyer and the seller are acting prudently and knowledgeably,
- (d) the seller is under compulsion to sell,
- (f) both parties are acting in what they consider their best interests,
- (g) a normal marketing effort is not possible due to the brief exposure time, and
- (h) payment will be made in cash.

170.4. Sales in an inactive or falling market are not automatically “forced sales” simply because a seller might hope for a better price if conditions improved. Unless the seller is compelled to sell by a deadline that prevents proper marketing, the seller will be a willing seller within the definition of Market Value (see paras 30.1-30.7).

170.5. While confirmed “forced sale” transactions would generally be excluded from consideration in a valuation where the basis of value is Market Value, it can be difficult to verify that an arm’s length transaction in a market was a forced sale.

180. Entity-Specific Factors

180.1. For most bases of value, the factors that are specific to a particular buyer or seller and not available to *participants* generally are excluded from the inputs used in a market-based valuation. Examples of entity-specific factors that *may* not be available to *participants* include:

- (a) additional value or reduction in value derived from the creation of a portfolio of similar *assets*,
- (b) unique synergies between the *asset* and other *assets* owned by the entity,
- (c) legal rights or restrictions applicable only to the entity,
- (d) tax benefits or tax burdens unique to the entity, and
- (e) an ability to exploit an *asset* that is unique to that entity.

180.2. Whether such factors are specific to the entity, or would be available to others in the market generally, is determined on a case-by-case basis. For example, an *asset may* not normally be transacted as a stand-alone item but as part of a group of *assets*. Any synergies with related *assets* would transfer to *participants* along with the transfer of the group and therefore are not entity specific.

180.3. If the objective of the basis of value used in a valuation is to determine the value to a specific owner (such as Investment Value/Worth discussed in paras 60.1 and 60.2), entity-specific factors are reflected in the valuation of the *asset*. Situations in which the value to a specific owner *may* be required include the following examples:

- (a) supporting investment decisions, and
- (b) reviewing the performance of an *asset*.

190. Synergies

190.1. “Synergies” refer to the benefits associated with combining *assets*.

When synergies are present, the value of a group of *assets* and liabilities is greater than the sum of the values of the individual *assets* and liabilities on a stand-alone basis. Synergies typically relate to a reduction in costs, and/or an increase in revenue, and/or a reduction in risk.

190.2. Whether synergies *should* be considered in a valuation depends on the basis of value. For most bases of value, only those synergies available to other *participants* generally will be considered (see discussion of Entity-Specific Factors in paras 180.1-180.3).

190.3. An assessment of whether synergies are available to other *participants* may be based on the amount of the synergies rather than a specific way to achieve that synergy.

200. Assumptions and Special Assumptions

200.1. In addition to stating the basis of value, it is often necessary to make an assumption or multiple assumptions to clarify either the state of the *asset* in the hypothetical exchange or the circumstances under which the *asset* is assumed to be exchanged. Such assumptions can have a *significant* impact on value.

200.2. These types of assumptions generally fall into one of two categories:

(a) assumed facts that are consistent with, or could be consistent with, those existing at the date of valuation, and

(b) Assumed facts that differ from those existing at the date of valuation.

200.3. Assumptions related to facts that are consistent with, or could be consistent with, those existing at the date of valuation *may* be the result of a limitation on the extent of the investigations or enquiries undertaken by the *valuer*.

Examples of such assumptions include, without limitation:

(a) an assumption that a business is transferred as a complete operational entity,

(b) an assumption that *assets* employed in a business are transferred without the business, either individually or as a group,

(c) an assumption that an individually valued *asset* is transferred together with other complementary *assets*, and

(d) an assumption that a holding of shares is transferred either as a block or individually.

200.4. Where assumed facts differ from those existing at the date of valuation, it is referred to as a “special assumption”. Special assumptions are often used to illustrate the effect of possible changes on the value of an *asset*. They are designated as “special” so as to highlight to a valuation user that the valuation conclusion is contingent upon a change in the current circumstances or that it reflects a view that would not be taken by *participants* generally on the valuation date. Examples of such assumptions include, without limitation:

(a) an assumption that a property is freehold with vacant possession,

(b) an assumption that a proposed building had actually been completed on the valuation date,

(c) an assumption that a specific contract was in existence on the valuation date which had not actually been completed, and

(d) an assumption that a financial instrument is valued using a yield curve that is different from that which would be used by a *participant*.

200.5. All assumptions and special assumptions *must* be reasonable under the circumstances, be supported by evidence, and be relevant having regard to the *purpose* for which the valuation is required.

210. Transaction Costs

210.1. Most bases of value represent the estimated exchange price of an *asset* without regard to the seller's costs of sale or the buyer's costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction.

9.4.5. IVS 105 Valuation Approaches and Methods

- Introduction
- Market Approach
- Market Approach Methods
- Income Approach
- Income Approach Methods
- Cost Approach
- Cost Approach Methods
- Depreciation/Obsolescence

Above are described in previous chapters with its key parameters and so, it is not repeated here again, however, reader can read it in details from IVSC 2017.

9.4.6. Asset Standards

9.4.6.1. IVS 200 Businesses and Business Interests

- Overview
- Introduction
- Bases of Value
- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for Businesses and Business Interests
- Ownership Rights
- Business Information
- Economic and Industry Considerations
- Operating and Non-Operating Assets
- Capital Structure Considerations

9.4.6.2. IVS 210 Intangible Assets

- Overview
- Introduction
- Bases of Value
- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for Intangible Assets
- Discount Rates/Rates of Return for Intangible Assets
- Intangible Asset Economic Lives
- Tax Amortisation Benefit (TAB)

9.4.6.3. IVS 300 Plant and Equipment

- Overview
- Introduction
- Bases of Value

- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for Plant and Equipment
- Financing Arrangements

9.4.6.4. IVS 400 Real Property Interests

- Overview
- Introduction
- Bases of Value
- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for Real Property Interests
- Hierarchy of Interests
- Rent

9.4.6.5. IVS 410 Development Property

- Overview
- Introduction
- Bases of Value
- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for a Development Property
- Residual Method
- Existing Asset
- Special Considerations for Financial Reporting
- Special Considerations for Secured Lending

9.4.6.6. IVS 500 Financial Instruments

- Overview
- Introduction
- Bases of Value
- Valuation Approaches and Methods
- Market Approach
- Income Approach
- Cost Approach
- Special Considerations for Financial Instruments
- Valuation Inputs
- Credit Risk Adjustments
- Liquidity and Market Activity
- Valuation Control and Objectivity



10. The prospects for valuers under IBBI and IBC processes

Areas for Valuation Under Companies Act

- Section 62(1)(c): Valuing Further Issue of Shares: Company proposes to increase share capital by way of Rights Issue, Employee Stock Option or to any person by special resolution for cash or other than consideration in Cash
- Section 192(2): Restrictions on Non Cash Transactions involving directors: Director acquiring Assets for Non Cash Transactions or Company Acquiring Assets other than cash must be approved by General Meeting and Resolution in General Meeting must be supported by Valuer's Certificate
- Section 230(2)(c)(v): Power to Compromise or make arrangements with Creditors and Members: Kind of Restructuring with creditors or as ordered by Tribunal or under IBC an Affidavit to be submitted along with Valuer's Certificate
- Section 230(3): Scheme of Compromise/ Agreement: Similar to earlier section but when meeting is specifically called by Tribunal then Notice should contain Valuer's Report
- Section 232(2)(d): Report of Expert with Regard to Valuation: u/s 230 when order is made by tribunal for merging companies or division of a company then notice should have valuer's report along with scheme proposed etc.
- Section 232(3)(h): Where Transferee Company is Unlisted, Exit opportunity to shareholder of transferor company: Shareholders of transferor company decides to opt out of merger scheme they should be paid with value of share plus other benefits as per pre determined formula or after a valuation is made
- Section 236(2): For valuing equity shares of Minority Shareholders: If a person or group of persons becomes holder of 90% of shares and wants to buy rest of the shares then they should apply to company for buying rest of the shares for price valued by registered valuer

- Section 260(2): Valuation for arriving at reserve price for company administrator: Original Section of Companies Act moved to IBC where IRP needs to have certificate of Registered Valuer for arriving at Reserve Price
- Section 281(1): Valuation of Assets for submission to liquidator: Moved to IBC and similar provisions in IBC
- **Other Possible Areas in Valuation**
- SEBI Takeover Code: Provision for Valuation of Infrequently traded Shares/Frequently Traded Shares
- SEBI Issue of Capital and Disclosure Regulations, 2009 : Regulation 69E (Infrequently Traded Shares), Regulation 72 (Preferential Issue), Regulation 76 (Preferential Issue in case of Infrequently Traded Shares)
- SEBI Takeover Code: Provision for Valuation of Infrequently traded Shares/Frequently Traded Shares: Regulation 8(2)(e)/ 8(4) says since shares are infrequently traded should consider following parameters; Book Value, Comparable Trading Multiples and Other Parameters as are customary: Presently merchant Banker or CA with 10 Yrs Exp.
- SEBI Issue of Capital and Disclosure Regulations, 2009 : Regulation 69E (Infrequently Traded Shares), Regulation 72 (Preferential Issue), Regulation 76 (Preferential Issue in case of Infrequently Traded Shares): Nothing specified but Merchant Banker or CA like earlier preferred.
- SEBI (Alternate Investment Funds), 2012 : Category I and Category II AIF valuation needed every 6 months. Registered Valuer not defined
- SEBI Regulations for Infrastructure Investment Trusts and Real Estate Investment Trusts: Valuer is as defined in Companies Act, 2013
- SEBI (Alternate Investment Funds), 2012 : Category I and Category II AIF valuation needed every 6 months. Registered Valuer not defined: Funds privately promoted and not normal funds like MF, Gratuity Trust etc.
- Cat I: Funds invests in start ups, social ventures etc.
- Cat II: Cat III is for Derivatives and Cat II is other than I or III
- SEBI Regulations for Infrastructure Investment Trusts and Real Estate Investment Trusts: Valuer is as defined in Companies Act, 2013: InvIT which is like MF registered under SEBI with Min Capital of 10 Lakhs. GMR,

Reliance has the InvIT. Valuation to be done every year in 2 months after March

- SEBI (Sweat Equity Regulations) 2002 : Merchant Banker to obtain Certificate from CA that Valuation is according to AS
- SEBI (Delisting of Equity Shares Regulations), 2009: Stock Exchange to appoint Independent Valuer to determine the value of delisted Equity Shares
- SEBI (Sweat Equity Regulations) 2002 : Merchant Banker to obtain Certificate from CA that Valuation is according to AS: Valuation of Intellectual Property is to be done before Issuing of shares. CA and Merchant Bankers are presently considered for Valuation
- SEBI (Delisting of Equity Shares Regulations), 2009: Stock Exchange to appoint Independent Valuer to determine the value of delisted Equity Shares: Regulation 23(1) stipulates the same and Regulation 23(3)(b) allows onl CA
- FEMA: Many Valuations under FEMA
- FDI: Valuations under FDI
- Income Tax Act: Valuations includes Section 56 of IT Act, Rule 11UA of IT Rules etc.
 - Possible Asset Classes (Section 8A of Wealth Tax Act)
 - Immovable Properties
 - Agricultural Land
 - Coffee, Tea, Rubber, Cardamom Plantations
 - Forest
 - Mines and Quarries
 - Shares, Securities Debentures, Share in Partnership Firm Business Assets including Goodwill
 - Plant and Machinery
 - Jewellery, Works of Art, Life Interest, Reversions & Interest in Expectancy

Earlier Insolvency Regimes in India

- ❖ Prior to enactment of the Insolvency and Bankruptcy Code, 2016 (the “**Insolvency Code**”) the existing framework was governed by:-
 - The Companies Act, 1956 and the Companies Act, 2013;
 - The Sick Industrial Companies (Special Provisions) Act, 1985;
 - The Recovery of Debts Due to Banks and Financial Institutions (“**RDDBI**”) Act, 1993;
 - The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (“**SARFAESI**”) Act, 2003;
 - The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920;
 - Regulations, directions, circulars, rules, notifications and guidelines of the Reserve Bank of India (“**RBI**”).

Benefits of this code:

Previously, four different forums—High Courts, Company Law Board (CLB), Board for Industrial and Financial Reconstruction (BIFR) and Debt Recovery Tribunal (DRT)—have overlapping jurisdiction, which gives rise to systemic delays and complexities in the process. The code overcomes these challenges and would reduce the burden on the courts as all litigation will be filed under the code before the National Company Law Tribunal (NCLT) for corporate insolvency and insolvency of LLPs, and before DRT for individual insolvency and insolvency of unlimited partnership firms.

The code could ensure quicker resolution of NPA problems.

Bankruptcy laws accept that business ventures can fail and allow entrepreneurs to make a new start.

Objectives of the Code:

An Act to consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders Including alteration in the order of priority of payment of

Government dues and to establish an Insolvency and Bankruptcy Board of India (IBBI), and for matters connected therewith or incidental thereto.

Application:

The provisions of this code shall apply to:

(a) Any company incorporated under the Companies Act, 2013 or under any previous company law;

(b) Any other company governed by any special Act for the time being in force.

(c) Any Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008;

(d) Such other body incorporated under any law for the time being in force, as the Central Government may, by notification, specify in this behalf; and

(e) Partnership firms and individuals,

- ▶ In relation to their insolvency, liquidation, voluntary liquidation or bankruptcy, as the case may be.

IBC – The complete CODE

Insolvency & Bankruptcy Code 2016 has been divided into five parts:

- Part-I: Preliminary
- Part-II: Insolvency resolution & liquidation for Corporate persons
- Part-III: Insolvency resolution & bankruptcy for Individuals & partnership firms
- Part-IV: Regulations of insolvency professionals, agencies & information utilities
- Part-V: Miscellaneous

PART-II: Insolvency Resolution and Liquidation for Corporate Persons

- ▶ Sec. 4: Application of this part

Apply to matters relating to the insolvency and liquidation of corporate debtors where the minimum amount of the default is one lakh rupees:

- ▶ Definition of 'Corporate Debtors':

Corporate debtors means

A Company, LLP or any person incorporated with limited liability under any law for time being in force but not include financial service provider (Corporate Person)

Who owes a debt to any person (Individual, HUF, Company, Trust, Partnership, LLP, any other entity established under any statute, Person resident outside India)

Sec. 6: Persons who may initiate corporate insolvency resolution process.

Where any corporate debtor commits a default, a financial creditor, an operational creditor or the corporate debtor itself may initiate corporate insolvency resolution process (CIRP) in respect of such corporate debtor.

Definitions:

"financial creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to; (secured)

"operational creditor" means a person to whom an operational debt is owed and includes any person to whom such debt has been legally assigned or transferred; (non secured)

Corporate Insolvency Resolution Process

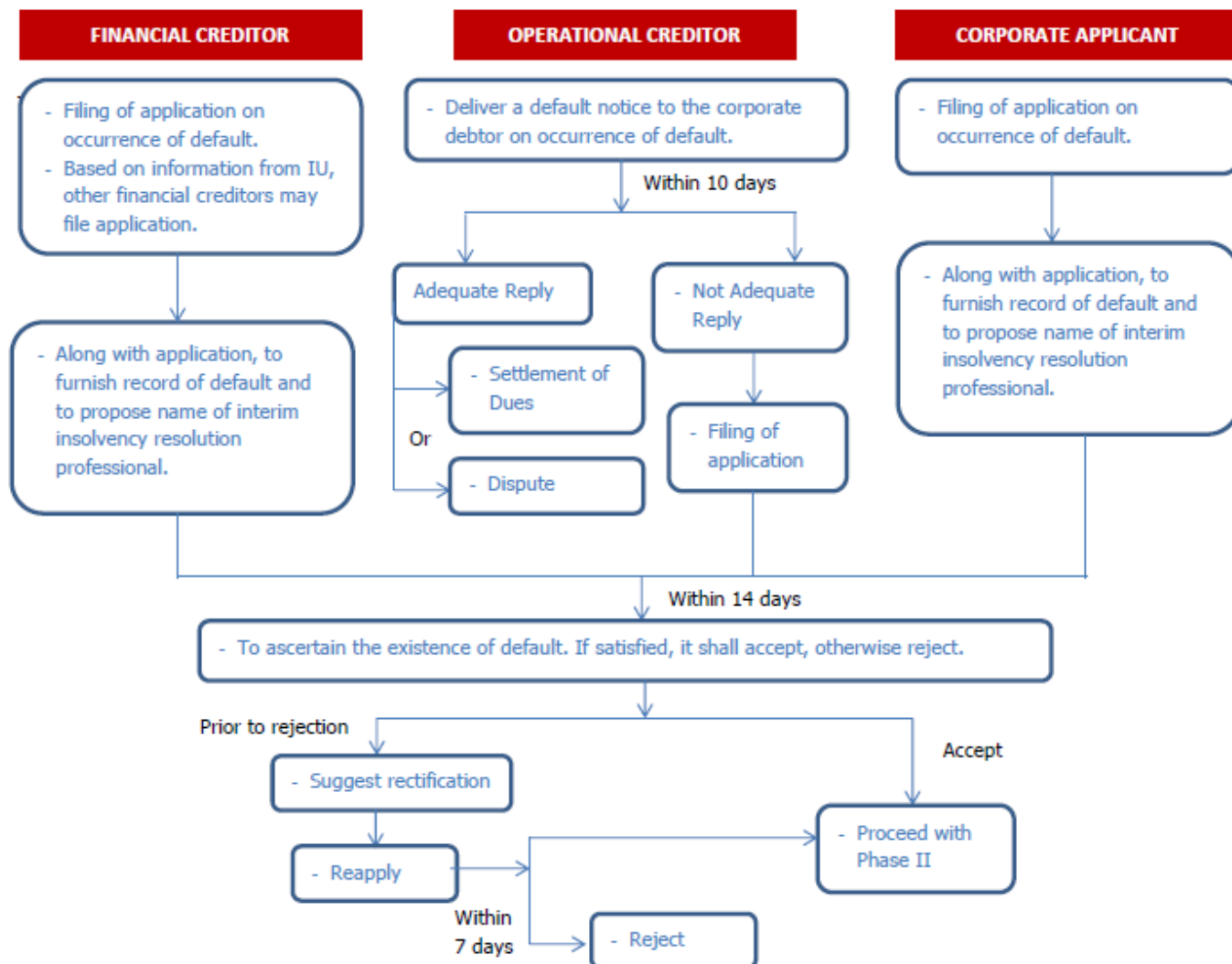
The corporate insolvency resolution process under the Insolvency Code is a time – bound process. The process consists of the following phases:-

- ❖ Initiation of the corporate insolvency resolution process (“**Phase I**”):
Phase I of the corporate insolvency process deals with the following:-

- Filing of the applications with the NCLT;
- Admission or rejection of the application;

➤ In case of rejection, the NCLT may allow the applicant to make

PHASE I



changes and / or revisions to the application and re – apply. On re – application, the NCLT may admit or reject the application.

❖ Phase I for the different types of applicants who can trigger the corporate insolvency process are different. The timelines and the process broadly, for Phase I, relating to the different types of applicants who can trigger the corporate insolvency process are provided below:-

❖ **Sec.7 to 10: Initiation of corporate insolvency resolution process by financial creditor / Operational Creditor/ Corporate Applicant.**

Sec. 11: Persons not entitled to make application

(a) A corporate debtor undergoing a corporate insolvency resolution process; or

- (b) A corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or
- (c) A corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this Chapter; or
- (d) A corporate debtor in respect of whom a liquidation order has been made.

Corporate Insolvency Resolution Process (Sec. 12 to 32): Phase-II

► **Sec. 12: Time limit for completion of CIRP.**

- > Corporate Insolvency Resolution Process shall be completed within 180 days from the date of admission of the application.
- > NCLT may by order extend the duration not exceeding 90 days.
- > Extension shall not be granted more than once.

► **Sec. 13: Declaration of moratorium and public announcement**

- > NCLT, after admission of the application, by an order -
 - a) Declare a moratorium on new and pending suits and enforcement of security interest.
 - b) Cause a public announcement and call for submission of claims.
 - c) Appoint an interim resolution professional.
- > Public announcement shall be made immediately after the appointment of interim resolution professional.

► **Sec. 14: Moratorium**

NCLT shall by order declare moratorium for prohibiting the following –

- a) The institution of suits or continuation of pending suits or proceedings against the corporate debtor
- b) Transferring/ encumbering/ disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein
- c) Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2003
- d) The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor

► **Sec. 15: Public Announcement**

- > Public announcement of the corporate insolvency resolution process shall contain the following information –
 - a) Name & address of the corporate debtor

- b) Name of the authority with which the corporate debtor is registered
- c) Last date for submission of claims
- d) Details of interim resolution professional who shall be vested with the management of the corporate debtor and be responsible for receiving claims
- e) Penalties for false/ misleading claims
- f) Date on which the CIRP shall close

► **Sec.16: Appointment and tenure of interim resolution professional**

> NCLT shall appoint an interim resolution professional within 14 days from the insolvency commencement date.

> Where application for CIRP is made by financial creditor or corporate debtor, resolution professional as proposed that time, shall be appointed as interim resolution professional, if no disciplinary proceedings are pending against him.

> Where application for CIRP is made by operational creditor and no proposal for an interim resolution professional is made, NCLT shall make a reference to the Board for the recommendation of an insolvency professional who may act as an interim resolution professional.

> The Board shall, within ten days of the receipt of a reference from NCLT, recommend the name of an insolvency professional to NCLT against whom no disciplinary proceedings are pending.

> Term of interim resolution professional shall not exceed 30 days from date of his appointment

► **Sec. 17: Management of affairs of corporate debtor by Interim resolution professional (IRP).**

> From the date of appointment of IRP, -

a) The management of the affairs of the corporate debtor shall vest in IRP

b) The powers of the board of directors or the partners of the corporate debtor, as the case may be, shall stand suspended and be exercised by IRP

c) The officers and managers of the corporate debtor shall report to IRP and provide access to documents and records of the corporate debtor

d) The financial institutions maintaining accounts of the corporate debtor shall act on the instructions of IRP in relation to such accounts and furnish all information relating to the corporate debtor.

► **Sec. 18: Duties of IRP**

a) Collect all information relating to the assets, finances and operations of the corporate debtor for determining the financial position of the corporate debtor.

- b) Receive and collate all the claims submitted by creditors.
- c) Constitute a committee of creditors.
- d) Monitor the assets of the corporate debtor and manage its operations until a resolution professional is appointed by the committee of creditors
- e) File information collected with the information utility.
- f) Take control and custody of any asset over which the corporate debtor has ownership rights.

► **Sec. 19: Personnel to extend co-operation to IRP**

> The personnel of the corporate debtor, its promoters or any other person associated with the management of the corporate debtor shall extend all assistance and cooperation to the interim resolution professional as may be required by him in managing the affairs of the corporate debtor.

► **Sec. 20: Management of operations of corporate debtor as going concern**

To preserve the value of the property of the corporate debtor and manage the operations of the corporate debtor as a going concern, IRP shall have the authority to –

- a) Appoint accountants, legal or other professionals
- b) Enter into contracts or to amend / modify the contracts which were entered into before the commencement of corporate insolvency resolution process
- c) Raise interim finance
- d) Issue instructions to personnel of the corporate debtor.

► **Sec. 21: Committee of creditors**

> IRP shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

> The committee of creditors shall comprise all financial creditors of the corporate debtor.

> Related party to whom a corporate debtor owes a financial debt shall not have any right of representation, participation or voting in a meeting of the committee of creditors

> All decisions of the committee of creditors shall be taken by a vote of not less than 75% of voting share of the financial creditors.

► **Sec. 22: Appointment of Resolution Professional (RP)**

> The first meeting of the committee of creditors shall be held within 7 days of the constitution of the committee of creditors.

> The committee of creditors, may, in the first meeting either resolve to appoint IRP as RP or to replace IRP by another RP.

► **Sec. 23: RP to conduct CIRP**

> RP shall conduct the entire CIRP and manage the operations of the corporate debtor.

> RP shall exercise powers and perform duties as are vested or conferred on IRP.

► **Sec. 24: Meeting of committee of creditors**

> The members of the committee of creditors may meet in person or by electronic means.

> All meetings of the committee of creditors shall be conducted by RP.

> The directors, partners and one representative of operational creditors may attend the meetings of committee of creditors, but shall not have any right to vote in such meetings

> Each creditor shall vote in accordance with the voting share assigned to him based on the financial debts owed to such creditor.

► **Sec. 25: Duties of RP**

> To preserve and protect the assets of the corporate debtor, including the continued business operations of the corporate debtor, RP shall undertake following actions -

a) Take immediate custody and control of all the assets

b) Represent and act on behalf of the corporate debtor with third parties, exercise rights for the benefit of the corporate debtor in judicial, quasi-judicial or arbitration proceedings

c) Raise interim finances

d) Appoint accountants, legal or other professionals

e) Maintain an updated list of claims

f) Convene and attend all meetings of the committee of creditors

g) Invite prospective lenders, investors, and any other persons to put forward resolution plans

h) Present all resolution plans at the meetings of the committee of creditors

i) File application for avoidance of transactions

j) Prepare information memorandum

► **Sec. 26: Application for avoidance of transactions not to affect proceedings**

> The filing of an avoidance application by the resolution professional shall not affect the proceedings of the corporate insolvency resolution process.

► **Sec. 27: Replacement of RP by committee of creditors**

> Where, at any time during the CIRP, the committee of creditors is of the opinion that a RP appointed under section 22 is required to be replaced; it may replace him with another RP.

► **Sec. 28: Approval of committee of creditors for certain actions**

RP shall not take any of the following actions without prior approval of committee of creditors:

- a) Raise any interim finance
- b) Create any security interest over the assets of the corporate debtor
- c) Change the capital structure
- d) Record any change in the ownership interest
- e) Give instructions to financial institutions maintaining accounts of the corporate debtor for a debit transaction from any such accounts in excess of the amount earlier decided
- f) Undertake any related party transaction
- g) Amend any constitutional documents
- h) Delegate its authority to any other person
- i) Dispose of or permit the disposal of shares of any shareholder of the corporate debtor or their nominees to third parties
- j) Make any change in the management of the corporate debtor or its subsidiary
- k) Transfer rights or financial debts or operational debts under material contracts otherwise than in the ordinary course of business
- l) Make changes in the appointment or terms of contract of such personnel
- m) Make changes in the appointment or terms of contract of statutory auditors or internal auditors

► **Sec. 29: Preparation of information memorandum**

> The resolution professional shall prepare an information memorandum containing relevant information as may be specified by the Board for formulating a resolution plan.

> The resolution professional shall provide to the resolution applicant access to all relevant information in physical and electronic form.

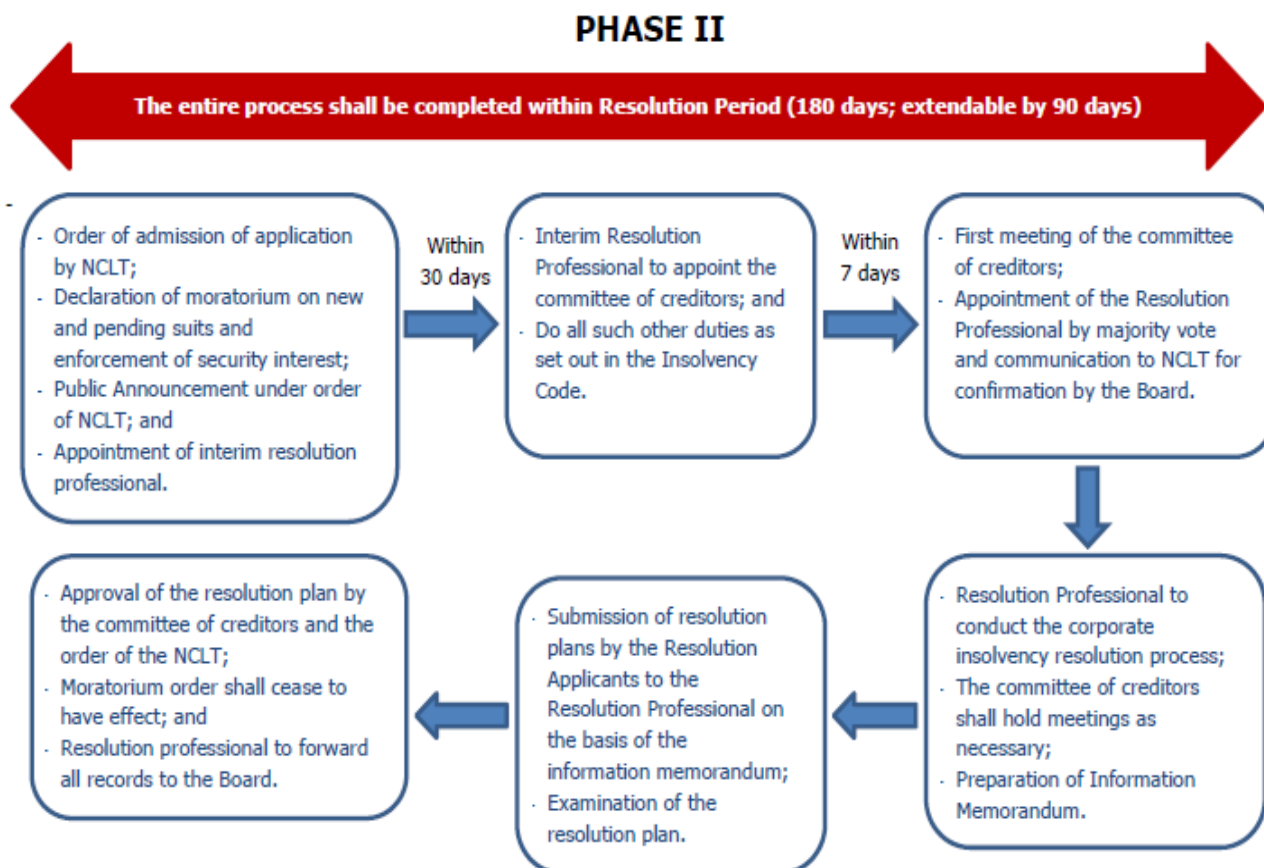
► **Sec. 30: Submission of resolution plan**

> A resolution applicant may submit a resolution plan to the RP prepared on the basis of the information memorandum.

> The RP shall submit the resolution plan as approved by the committee of creditors to NCLT.

► **Sec. 31: Approval of resolution plan**

> If NCLT is satisfied, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.



Corporate Liquidation Process

Corporate Liquidation Process (Sec. 33 to Sec. 54)

- ❖ As per the Insolvency Code, the corporate liquidation process is to be initiated on occurrence of the following:-
 - Expiry of the Resolution Period (180 days; extendable by 90 days) and no resolution plans have been received;
 - NCLT rejects the resolution plan;
 - Prior to approval of the resolution process, by order of NCLT on intimation by the committee of creditors;
 - Application by affected person(s) on the contravention of the approved resolution plan. Vehicle

Position of secured creditor in liquidation:

- ▶ A secured creditor can –
 - a) Relinquish its security interest to the liquidation estate and receive proceeds from sale of assets by liquidator
 - b) Realize its security in the manner as specified in the code.
- ▶ If the secured creditor realizes security interest, he shall inform the liquidator and identify the asset subject to such security interest.
- ▶ Liquidator to verify security interest by record maintained by Information Utility or any other means as may be specified and permit the secured creditor to realize only such security interest as provable.

Secured creditor may enforce, realize, settle, compromise or deal with the secured assets in accordance with the law to recover its dues and in case it faces resistance from Corporate Debtor or any person connected therewith in taking possession or, selling/ disposing of the secured asset it may apply to NCLT to facilitate secured creditor to realize such security interest in accordance with the law for the time being in force and NCLT may pass such order as necessary to permit secured creditor to realize security interest in accordance with the law.

If amount realized by secured creditor is more than its dues, the surplus shall be credited to the account of liquidator.

If amount realized by secured creditor is less than its dues, the remaining debt shall be paid by liquidator as per this Code.

The insolvency costs or liquidation costs shall be realized from the proceeds of such sale of assets by the secured creditor.

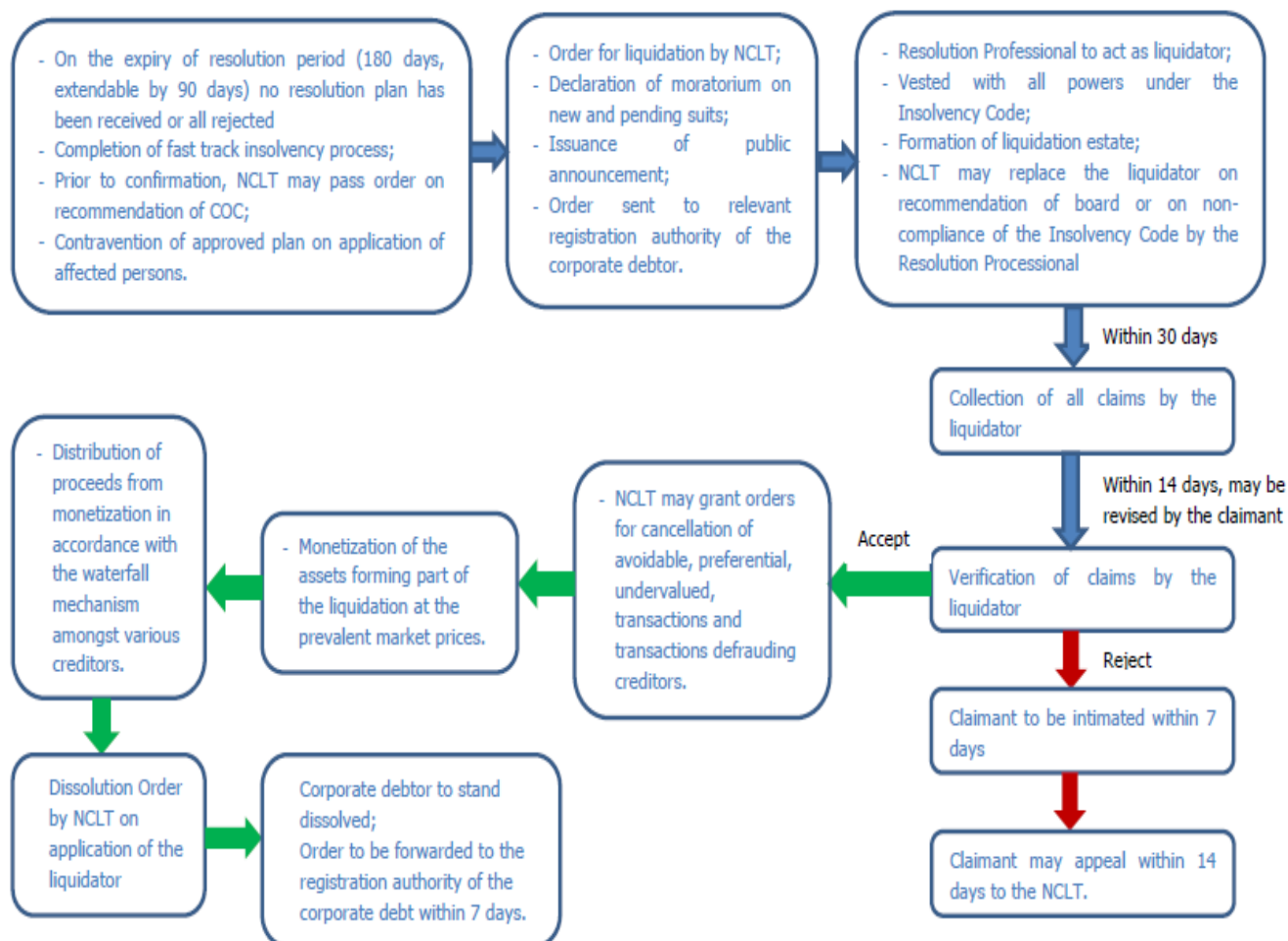
❖ Conduct of Liquidation: The liquidation shall be conducted as follows:-

- Appointment of the liquidator by order of NCLT;
- Declaration of moratorium on initiation of suits by the NCLT;
- Discharge of officers, employees and workmen shall be discharged, except when the business of the corporate debtor is continued;
- Issuance of public announcement;
- Formation of liquidation estate;
- Collection, verification, acceptance and / or rejection of claims;
- Orders by NCLT for cancellation of avoidable transactions etc.;

- Monetization of assets and distribution of proceeds;
- Dissolution of the corporate debtor.

► Liquidation estate shall comprise of –

- a) Any assets over which the corporate debtor has ownership rights
- b) Assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets
- c) Tangible assets, whether movable or immovable
- d) Intangible assets
- e) Assets subject to the determination of ownership by the court
- f) Any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest
- g) All proceeds of liquidation as and when they are realised



❖ Distribution of Assets: The proceeds from the sale of the liquidation estate shall be distributed in accordance with the following waterfall mechanism / order of priority:-

- The insolvency resolution process costs and liquidation costs;

- The following debts which shall rank equally between and among the following:-
 - Workmen's dues for the period of twenty – four months preceding the liquidation commencement date;
 - Debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner as provided under the Insolvency Code;
- Wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding to the liquidation commencement date;
- Financial debts owed to unsecured creditors;
- The following dues rank equally between and among the following:-
 - Any amount due to the State Government and the Central Government in respect of the whole or any part of the period of two years prior to the liquidation commencement date;
 - Debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
- Any remaining dues and debts;
- Preference shareholders, if any; and
- Equity shareholders or partners, as the case may be.

Fast Track Corporate Insolvency Resolution Process(Sec.55 to Sec. 58)

- ❖ The Insolvency Code further prescribes a fast track corporate insolvency process for the entities with less complex structuring or businesses.
- ❖ fast track process shall apply to the following categories of corporate debtors:
 - A small company, as defined under clause (85) of section 2 of the Companies Act, 2013; or
 - A Startup (other than the partnership firm), as defined in the notification dated 23rd May, 2017 of the Ministry of Commerce and Industry; or

- ▶ An unlisted company with total assets, as reported in the financial statement of the immediately preceding financial year, not exceeding Rs.1 crore.
- ❖ The fast track corporate insolvency process will be required to be completed within a period of 90 days with a one – time extension of 45 days.

Voluntary Liquidation of Corporate Persons (Sec. 59)

- ▶ A corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings.
- ▶ Voluntary liquidation proceedings of a corporate person registered as a company shall meet the following conditions, namely:
 - ✓ Declaration from majority of directors, verified by an affidavit stating that –

(i) They have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and

(ii) The company is not being liquidated to defraud any person

Above declaration shall be accompanied with –

- ✓ Audited financial statements and record of business operations of the company for the previous two years
- ✓ A report of the valuation of the assets of the company.

Within 4 weeks of declaration, company have to pass a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator.

If the company owes any debt to any person, creditors representing two-thirds in value of the debt of the company shall approve the resolution passed within seven days of such resolution.

- ▶ Notify the Registrar of Companies and the Board about the resolution to liquidate the company within seven days of such resolution.

- ▶ The provisions of sections 35 to 53 shall apply to voluntary liquidation proceedings for corporate persons with such modifications as may be necessary.
- ▶ Where the affairs of the corporate person have been completely wound up, and its assets completely liquidated, the liquidator shall make an application to the NCLT for the dissolution of such corporate person.
- ▶ NCLT shall pass an order that the corporate debtor shall be dissolved from the date of that order and the corporate debtor shall be dissolved accordingly.
- ▶ A copy of an order, shall within fourteen days from the date of such order, be forwarded to the authority with which the corporate person is registered.

Questions

- **Who can initiate CIRP?**

Ans: Financial creditor, Operational creditor and Corporate debtor itself

- **Can a financial creditor in respect of whom there is no default file an application of resolution?**

Ans: YES, a financial creditor for whom there is no default can still file an application against a corporate debtor provided, the corporate debtor has a default against some other financial creditor. However, in that case, he can only file joint application with the financial creditor for whom there is default.

- **ABC Ltd. has not paid its Bank Loan instalment of last two months, can it go for voluntary liquidation?**

Ans: NO

- **How is the voting share of a creditor in the committee of creditors determined?**

Ans: The voting share is determined based on the value of the debt of the creditor in proportion to the total debt

- **What is the tenure of an interim resolution professional?**

Ans: 30 days from the date of appointment

- **What is the quorum required for convening of the meeting of committee of creditors?**

Ans.: A meeting of committee of creditors shall quorate if members of the committee of creditors representing at least thirty three percent of the voting rights are present either in person or by video/audio means.

- **If there is no financial creditor, how will the committee of creditors be constituted?**

Ans: In such type of scenario, the committee shall be formed comprising of following members –

- a) 18 largest operational creditors by value.
- b) 1 representative elected by all workmen
- c) 1 representative elected by all employees

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