

VALUATION PROTOCOL – VALUATION APPROACHES AND METHODS

Reference: Valuation Protocol – Valuation Approaches and Methods

Effective Date: 1 January 2025, earlier adoption permitted and encouraged

Owner: Manager Professional Standards

Valuation Protocol –Valuation Approaches and Methods

Introduction

This Valuation Protocol, and its purpose, is to provide guidance to Valuers when considering the relevant and appropriate application of valuation approaches and methods (methodologies or techniques). Members are reminded to ensure that *valuation reports*¹ contain terminology that is consistent with International Valuation Standards (IVS) and API standards documents and guidelines.

The API advises that the terms “approach(s)” and “method(s)” *must*² be used as outlined in this Valuation Protocol and are not interchangeable.

This Valuation Protocol contains references to the 2025 edition of the IVS.

Whilst this Valuation Protocol discusses general valuation principles and concepts that may be applicable to the valuation of any asset type, it primarily deals with and relates to the valuation of real property interests (or the bundle of rights that make up the legal interest that is the subject of the valuation).

Approaches versus Methods

It is important for Valuers to understand the differences between valuation approaches and the methods or analysis techniques that may be applicable under those approaches.

The IVS describes and defines three (3) principle approaches utilised in valuation. They are based on the economic principles of price equilibrium, anticipation of benefits or substitution.

The three valuation approaches in the IVS are:

- (1) market approach,
- (2) income approach, and
- (3) cost approach.

Valuers should ensure that the use of the term “approaches” is reserved for describing any of the three (3) valuation approaches described and defined in the IVS.

The term “method” should be used to describe the methodology, technique or analysis that the Valuer applies when undertaking valuations.

There are numerous methods that may be applicable under the three valuation approaches.

¹ **‘valuation report’** means a report that has been prepared by a Valuer following the valuation process.

² **‘must’** means an unconditional responsibility to follow/comply with all that is prescribed or required in this Valuation Protocol.

For valuations of real property the 'market approach' is most commonly used however, the 'income approach' and 'cost approach' are also regularly used. In some scenarios the *valuation process*³ may necessitate analysis techniques and/or a valuation calculation that involves a combination of multiple approaches or methods.

Valuation Approaches

As noted previously, the IVS describes and defines three (3) valuation approaches.

It is the role of the Valuer to identify the most appropriate valuation approach used by market participants having regard to the basis and premise of value and to identify what the key market drivers (value determinants) are for the subject asset class.

Valuers *should*⁴ consider the detail and verify the accuracy of data and information to ensure that the approach selected is supported by the analysis of relevant inputs.

The selection of the valuation approach by the Valuer *should* maximise the use of relevant observable inputs.

Valuers *must* consider whether more than one valuation approach (or multiple methods within a single approach) is appropriate.

Where different approaches, or different methods within the same approach, result in different amounts, the Valuer *should* undertake procedures to understand why the amounts differ. It is not appropriate to simply average two or more amounts to estimate value. The process of analysing and reconciliation of any differing amounts into a single value, without averaging, *should* be explained by the Valuer in the valuation report. Valuers *should* apply *professional judgment*⁵ when reconciling differing amounts into their opinion of value.

Market Approach

The market approach provides an estimate of value by comparing the subject asset with identical or comparable (similar) assets for which price information is available.

The market approach requires the comparison of analysed metrics from observable inputs which are compared and adjusted with the same metrics for the subject asset.

The assessment of *market value*⁶ and *market rent*⁷ using the market approach *must* be based on inputs, derived through the analysis of market transactions.

³ **'valuation process'** means all the necessary enquiries, investigations, procedures and processes, including the physical inspection of the tangible asset by the Primary Valuer, which is a pre-requisite for a valuation, required to fully inform the Valuer's reasoning and analysis in accordance with the practice accepted as proper by the API. (API Rules of Professional Conduct)

⁴ **'should'** indicates responsibilities and requirements in this Valuation Protocol that are presumptively mandatory to be followed/complied with unless the Valuer is able to demonstrate, in the report, opinion or other advice, that alternatives were sufficient to achieve the same objective.

⁵ **'professional judgement'** means "the use of accumulated knowledge and experience, as well as critical reasoning, to make an informed decision." (IVS)

⁶ **'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 property marketing and where the parties had each acted knowledgeably, prudently and without compulsion." (IVS)

⁷ **'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 transactions, after proper marketing and where the parties had acted knowledgeably, prudently and without compulsion." (IVS)

Income Approach

The income approach provides an estimate of value by converting future cash flow to a current value. Under the income approach, the value is assessed by reference to the value of income and/or cash flow generated by the asset.

Cost Approach

The cost approach provides an estimate of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction taking into consideration elements of time and risk.

The cost approach provides an indication of value by calculating either the current replacement or reproduction cost of an asset and making allowances for depreciation and obsolescence.

The assessment of *market value* using the cost approach is the cost of an asset of equal utility minus adjustments for depreciation factors such as physical, functional and economic obsolescence. Any adjustments should be based on reference and analysis of market-based costs and any applicable market-derived depreciation factors.

Selecting Valuation Approaches and Methods

When selecting the most appropriate valuation approach or method, Valuers are reminded of IVS 103 *Valuation Approaches*, para 10.12 (IVS 2025 edition) which states;

“No one approach or method is applicable in all circumstances with price information from an active market generally considered to be the strongest evidence of *value*.

... Price information from an inactive market may still be good evidence of *value*, but subjective adjustments *may* be needed”.

The selection and application of valuation approaches and methods for real property interests *should* involve the verification and analysis of observable market transactions to inform the inputs to the *valuation process*. A *valuation process* based on observable inputs *should* be afforded greater weight than a process or conclusion based on non-observable inputs.

Valuation Methods

IVS 2025 edition states at IVS 103 *Valuation Approaches*, para 10.03 that;

“Each of these valuation approaches includes different, detailed methods of application.”

It is the Valuer’s responsibility to select and apply the appropriate valuation method or combination of methods when undertaking a *valuation*.⁸

Valuers should seek to maximise the use of relevant observable market evidence and information.

Regardless of the source of the inputs and assumptions used in the *valuation process*, Valuer’s must undertake appropriate analysis to verify and evaluate those inputs and assumptions and their appropriateness for the *valuation*.

⁸ **‘valuation’** means an established evidence based valuation process for assessing the value, including but not limited to market value and market rent, of a tangible asset as a specified date following a physical inspection of the asset by the Primary Valuer. (API Rules of Professional Conduct)

Prices from an active market are generally considered to provide the best evidence of value. Prices and information from an inactive or imperfect market may still provide evidence of value, and in all cases *professional judgement* by the Valuer is required.

The IVS notes at IVS 103 *Valuation Approaches Appendix*, para 10.07 (g) that actual transactions provide better evidence than intended transactions.

Valuers are not required to use more than one valuation method for the *valuation* of an asset. This is particularly the case when the Valuer has a high degree of confidence in the accuracy and reliability of a single valuation method, based on the evidence available.

Where the use of more than one valuation method results in different amounts, the Valuer *should* undertake procedures to understand why the amounts differ. It is not appropriate to simply average two or more amounts to estimate value. The process of analysing and reconciliation of any differing amounts into a single value, without averaging, *should* be explained by the Valuer in the valuation report.

Valuers *should* apply *professional judgement* when reconciling different amounts to form their opinion of value.

The IVS uses the term “comparable transactions method” to describe situations where the Valuer utilises information from market transactions of assets that are similar (or the same) as the subject asset to estimate a value.

The API considers that where the Valuer uses verified observable inputs derived from the analysis of market transactions this falls within the term “comparable transactions method” and is synonymous with market approach methods.

Market transactions (sales or rentals) can be analysed and used under any approach to provide observable inputs for the *valuation process*. Varying degrees of adjustment may be required for comparison purposes between the market evidence and the subject property.

For a valuation of real property interests, valuation methods or techniques of analysis may include, but are not limited to, the following;

- market approach methods involving the analysis of market transactions (sales and rentals) to derive units of comparison that are considered appropriate by market participants fall under the collective term “comparable transactions method”;
- income approach methods involving the calculation of actual or potential income that the property does, or could, generate for the owner and the establishment of the return (yield) required by market participants;
- cost approach methods involving the analysis and application of market derived cost estimates and depreciation allowances;
- a calculation that involves combining various components of value is commonly referred to as a summation method or technique;
- hypothetical development methods which involve the use and analysis of a range of inputs from market approach methods, income approach methods and cost approach methods.

The terminology used to describe the method(s) or technique(s) chosen by the Valuer is a decision for the Valuer and should reflect terminology commonly used in the market by market participants. In all cases, it is the responsibility of the Valuer to clearly outline and explain those methods or techniques in the *valuation report*.

The API is committed to the promotion of best practice within the property industry and welcomes feedback to help achieve this goal.

If there are any comments or feedback regarding this Valuation Protocol, please do not hesitate to contact us at standards@api.org.au.