Valuation under Conditions of Rapidly Changing Price

Oliver A. Morales

President Cuervo Appraisers, Inc.

Philippines

VALUATION UNDER CONDITION OF RAPIDLY CHANGING PRICES

Presentor
OLIVER A. MORALES
President
CUERVO APPRAISERS, INC.
Philippines

Affiliations:

Examiner
Government Licensing Examination for Real Estate Appraiser

Past President
Institute of Philippine Real Estate Appraisers (IPREA)

Past President - Senior Member
American Society of Appraisers (ASA), Philippine Chapter

Past Chairman
Philippine Association of Realtors Board (PAREB)

Past President
Manila Board of Realtors (MBR), Inc.

Director
Assessors & Valuers Association of the Phils. (AVA)

Licensed Real Estate Appraiser

Licensed Real Estate Broker

Valuation Under Condition of Rapidly Changing Prices

Introduction

Change is an inescapable reality. Everything goes through the process we call *change*. It may be a regular and predictable pattern; it may be irregular. Sometimes, things become static but only for a short while.

In real estate, *change* in land values and prices is a major concern. We get an idea of the economic, business, and political activities in a given area based on the degree of change in land values and prices of lands put up for sale.

This paper looks into the causes or reasons for the drastic changes in the prices of real estate properties in selected areas in the Philippines. In particular, focus is made on the two central business districts, namely, Makati and Ortigas. Included in this report are price movements of real estate properties within the 50 kilometer influence limit of the central business district.

Value and Price

Often enough, value and price are used interchangeably. There is a difference between these terms. **Value**, to my mind refers to the perceived benefit that one hopes to realize for owning the thing desired. In addition, that which is desired is limited and/or scarce. Finally, he who desires that thing has the resource to possess it. In other words, purchasing power.

Upon the other hand, **price** refers to the amount of money demanded by the owner of the thing desired for him to transfer ownership.

In the light of the above relationship, the real estate appraiser is called upon to reconcile the differences and renders an opinion on the value of the good presented to him. In his estimate of value, the appraiser defines his opinion of value as ***the highest price estimated in terms of money which a property will bring if exposed for sale in the open market allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used.*** *

The Philippine Experience

At the beginning of the decade of the 80s, the Philippines suffered its worse economic crises. The political situation was beginning to crack, the country's balance of payment was in its ebb and the country defaulted on its loan service obligations with the international banking community. The prime interest rates exceeded 30% per annum. Inflation was at its highest ever.

The real estate industry, consequently felt the economic crunch. The occupancy rates of office buildings in the Makati Central Business District fell to as low as 50%.

---

* *American Institute of Real Estate Appraisers*

Construction of on-going projects were suspended. With the resulting economic uncertainties, prices of lots in the Makati and Ortigas business districts stood still.

The change in government in 1986, popularly known as the *people power revolution* brought hope for a better economic climate. Foreign investors started looking into the prospects of the Philippines.

The Philippine Economy in the 90s

In 1994, Philippine economic conditions significantly improved over the previous year's performance. Foreign investments poured in, public finance improved and the business community here and abroad showed confidence in the government.

Economic observers noted the downward trend of inflation, stability in price indicators and lowering of short-term interest rates. These events were reflected in the increased Gross Domestic Product (GDP) by 4.3% and the Gross National Product (GNP) by 5.1%.

The Philippine economy, however was off to a bad start in 1995 amidst uncertainties in the international financial markets. The beginning of 1995 saw most Asia Pacific currencies and financial markets assailed by the combined effects of the Mexican crisis and the Barings collapse. However, the Philippines came out relatively unscathed, prompting three reputable international credit rating agencies to upgrade the country's rating.

On separate occasions in May 1995, three international credit rating agencies, namely: Moody's, Standard & Poor's (S & P), and Duff and Phelps, upgraded the country's sovereign rating. This development is significant in terms of sending a signal to international investors that the Philippines' recent positive economic performance combined with its achievement of implementing basic financial and structural economic reforms will improve the country's chances of sustaining economic growth in the longer term.

Moody's upgraded the country's foreign currency debt rating from Ba3 to Ba2 in May 11, 1995. According to Moody's, "the upgrade on the country's credit rating was based on improved economic and political fundamentals since the rating agency's initial ratings assignment in July 1993." Last May 9, 1995, Duff and Phelps assigned an initial rating of BB to the country's foreign currency obligations. In late May, S & P also upgraded its sovereign credit ratings from BB- to BB. Notably, the previous credit ratings of BB- assigned by S & P to the Philippines was considered as a speculative grade (or non-investment grade) and one of the lowest among 13 developing countries, especially in the Asian region.

The improvement of the country's sovereign credit rating is a good attraction for more foreign investments in the country, both in the form of portfolio capital flows and direct foreign investments. Moreover, this will augur well for Philippine-based blue-chip companies (like PLDT, San Miguel Corporation, Petron Corporation, etc.) who are tapping the international capital markets as a source of long-term capital for expansion and modernization.

The source of growth for the economy can be attributed to two underlying economic factors: on the demand side, investment growth and export expansion, and on the supply side, higher agriculture production, robust manufacturing output and services growth.

According to the Board of Investments (BOI), equity investments, both foreign and local, registered with the BOI grew by almost 40% in 1994, and by 164% in the first quarter of 1995. This strong investment figures point to investors' growing confidence in the future prospects of the Philippine economy.

Personal consumption expenditures (which accounts for 75% of total expenditures) grew in real terms by about 4.3% in 1995 compared with the 3.0% of 1994 primarily on account of the increase in household incomes and election-related spending.

In addition, the robust growth of agricultural output in late 1994 and the continued strong influx of overseas contract worker (OCW) remittances also contributed to greater consumption spending by beefing up the incomes of rural households. Also, more people in the labor force were absorbed by the economy occasioned by the rise in investment expenditures both by the government and the private sector. This higher employment translated to higher household incomes. This is verified by the downward movement of the unemployment rate in 1994. As of January 1995, the unemployment rate has fallen to 8.8% slightly better than the previous year's average unemployment rate of 9.5%. This marked improvement in the unemployment rate is indicative of the growing strength of the domestic economy and its ability to create more stable jobs.

Industrial output particularly of manufacturing continued to be the backbone of production as it recovered lost ground from 1993's production debacle. Industrial output grew by 7.2% in the first quarter of 1995 compared to the 7% growth in output of the year before. With the improvement in power, manufacturing grew by 6.6% in the first quarter. The power crisis two years ago has been practically solved, and the government is encouraging private sector participation in providing more reliable supply. The power outlook in the short term improved significantly. The rehabilitation of old power plants and the astounding success of fast-track power projects practically eliminated power outages of prior years.

The success of the build-operate-transfer (BOT) scheme in providing private-sector-led infrastructure investments, particularly in power-related projects gave the government some breathing space in infrastructure spending. These BOT power projects provided 1,444 megawatts (MW) in additional power generating capacity sufficient to supply the power requirements within the short-term.

Public Finance

For the first time in over twenty years, the government posted budget surplus of about P18.1 billion brought in by the proceeds from privatization of government owned corporations such as the National Steel Corporation, and the sale of Fort Bonifacio.

The tax laws implemented in 1994 also helped in raising revenue for the government. These tax laws, apart from being fiscal revenue measures, are also meant as structural reforms in the fiscal sector. There are more tax reform measures being contemplated by the government such as the 10% minimum corporate income tax, modified gross income tax for big corporations, simple gross income tax for small corporations and the Php24,000 flat rate for individual income taxpayers.

In the next five years, the national government is expected to realize an average budgetary surplus of around Php15 Billion per annum on the strength of sustained lower interest rates in the medium term and higher tax revenue flows from personal and corporate incomes as a result of the fiscal reforms that will be implemented in 1996.

Growth Prospects

With the present favorable environment of declining short-term interest rates and a relatively stable foreign exchange rate, investment spending and export production is expected to continue their steady climb in the next five years.

The decline in short-term interest rates will encourage companies to firm up and hasten their capital expansion. Moreover, firms in consumer industries, consumer durables and real estate will benefit the most in the next five years with the improvement of household and corporate incomes.

The improvement in the Philippine economy may be gleaned from the rate of growth in the real estate developments shown in the following tables.

Table 1
Development Permits and Licenses to Sell
(In Units)

Development Permits	1992	1993	1994
PD 957	95,777	37,890	16,921
BP 220	93,175	56,103	40,414
Condominium	15,034	5,423	11,126
Simple Subdivision	38,958	13,871	3,605
RA 7279		129	379
Farmlot	16,248		
Memorial Park		63,026	
Industrial Subdivision	278	106	1,638
License to Sell			
PD 957	43,747	56,355	58,303
BP 220	44,125	56,457	73,795
Condominium	2,652	2,126	8,601
Simple Subdivision	6,769	8,828	4,056
RA 7279	1,838	10,849	
Farmlot	464	27	
Memorial Park	77,798		
Industrial Subdivision	203	242	

Source: Housing and Land Use Regulatory Board (HLURB)

Table 2

	Total Area (In Hectares)	Developed	Occupied 1995
Anabu I & II Ind'l Center	1,403.0	-	
Canlubang Ind' l Estate	170.0	170.0	90.0
Carmelray Ind'l Estate	225.0	200.0	110.0
Cavite Export Proc. Zone	275.9	227.0	48.9
Dasmariñas Ind'l Estate	13.1	13.1	5.9
First Cavite Ind'l Estate	118.1	51.0	38.0
Gateway Business Park	161.0	102.2	18.2
GMA Ind'l Estate	11.7	11.7	11.1
Laguna Int. Ind'l Estate	102.0	85.0	62.0
Laguna Technopark	168.6	158.8	87.4
Science Park	158.0	116.0	75.0

Source: Cuervo Far East, Inc.

Infrastructure Development Program

From 1995 up to the year 2000, the Department of Public Works and Highways (DPWH) is set to build a total of more than 1,500 kilometers of new and improved roads and expressways in Metro Manila, and extension of the North and South Luzon Expressways.

The government embarked on mass transport project and water supply for Metro Manila, liberilized the telecommunications and power industries to support the requirements of industries.

Liberalization

The administration of President Ramos adapted a privatization and liberalization programs immediately upon assumption of office. The government-owned Philippine National Bank, Philippine Airlines, and Petron, an oil refining company was sold to the public. The Banko Sentral Ng Pilipinas (Central Bank) approved the application of ten foreign banks to operate in the Philippines. Industries previously limited to Filipinos were opened to allow as much as 100% foreign-ownership.

The Capital Market

At the start of the 90s leading property developers offered their shares to the public. Filinvest Land, Inc. a major player in residential housing development housing, went into initial public offering (IPO). Other real estate developers followed and their respective offerings were an outstanding success.

Inflation

By the third quarter of 1996, the inflation rate was about 8.0% and expected to settle at about 7.0% by year-end 1996. The purchasing power also improved tremendously.

Commercial Sites

The demand for lands in strategic locations pushed the prices of commercial lots to unprecedented levels. The average historical prices of commercial lots in selected locations are shown below.

Table 3
Average Prices of Prime Commercial Lots By Location
Pesos Per Sq. Meter

	1993	1994	1995
Manila, Roxas Blvd.	40,000	50,000	65,000
Quezon City, Aurora Blvd.	20,000	25,000	30,000
San Juan, Ortigas Ave.	30,000	45,000	60,000
Makati, Salcedo Village	200,000	250,000	280,000
Mandaluyong, EDSA	35,000	50,000	60,000
Parañaque, A. Santos Ave.	15,000	20,000	25,000
Muntinglupa, Madrigal Bus. Park	30,000	50,000	60,000
Pasig, Ortigas Complex	120,000	150,000	180,000

Source: Cuervo Appraisers, Inc.

MAKATI CENTRAL BUSINESS DISTRICT

The Makati CBD has a total land area of about 200 hectares. Four hundred of the top 1,000 corporations have their headquarters here. Most prime office developments in Makati are located along Ayala Avenue, Makati Avenue, and Paseo de Roxas. Large foreign corporations such as IBM, Hongkong Bank, Citibank, Procter and Gamble and Caltex Philippines are located along these thoroughfares. Salcedo and Legaspi Villages, which lie to the north and south of Ayala avenue, also account for a sizable amount of office floor space as does Sen. Gil Puyat Avenue.

The rise in land prices and relaxation of building restrictions led to a construction boom that saw Makati's population surge to unplanned proportions.

The shrinking number of available office spaces in Makati has put pressures on lease rates, now averaging Php400 per square meter per month, up by 45% from 1994 figure. Selling prices likewise are hitting new highs as may be seen in the following table.

Table 4
1996 Selling Price of Selected Makati Office Space

Building	Price (Pesos/Sqm)
Citibank Tower	P75,000
Antel Office Tower	70,000
Multinational Bancorp. Ctr	77,000
Petron Megaplaza	70,000
Equitable Tower	75,000
Corinthian Plaza	70,000
World Center	75,000

Source: Cuervo Far East

ORTIGAS CBD

With the current shortage of office space in Makati, the 95 hectare Ortigas Commercial Center has become a more attractive option. The Ortigas CBD is located in Pasig City between the cities of Makati and Quezon, directly off EDSA Avenue or Circumferential Road 4 (C-4). Office development in Ortigas started during the 70s with the construction of the Meralco, Ortigas, Philcomcen and Padilla buildings.

The 90s saw Ortigas grow to almost equal that of the Makati CBD. The giant corporations located in Ortigas such as San Miguel Corporation, Asian Development Bank, SM Megamall, Robinson's Galleria and the Shangri-La Plaza have lured other companies into Ortigas Complex. In addition, the relocation of the Philippine Stock Exchange to Ortigas drew other finance companies and banks into the Center.

Prices

Current lease rates averaging about Php400.00 to Php500.00 per square meter per month are classified Grade A office buildings. The price per square meter of land now runs to as high as Php210,000 per square meter. Around three years ago, the same property can be had for as low as Php100,000 per square meter.

THE CALABARZON

The provinces of Cavite, Laguna, Batangas, Rizal and Quezon (CALABARZON) was identified as growth areas outside Metro Manila. Large tracks of land formerly devoted to agriculture were developed into industrial estates, residential subdivisions, and golf courses. The divestment by the Philippine government of such prime lands as Fort Bonifacio military reservation and the Alabang Stock Farm led to developments of other areas in the periphery of Metro Manila. The effect of these developments may be seen in the rapid increases in the price of land by leaps and bounds.

Other Forces Affecting Prices of Properties

The supply of dwelling units in the Philippines lags behind demand by more than 500,000 units and grows by about 200,000 a year for Metro Manila and the CALABARZON alone.

The shortage of vacant lands in Metro Manila for development into homesites led developers to the outlying municipalities of Metro Manila where lands are still available at a much lower cost. However, the opening of new residential subdivisions and relocation of factories closer to the source of labor supply, pushed land values to record highs. The migration of rural population to the newly-opened industrial centers brought more pressures to the already tight supply of dwelling units. Consequently, rent went up inspite of the rent control law.

The boom in construction activities in Metro Manila and other urban centers of the Philippines created job openings not only in the construction industry. The cement plants expanded their production capacities and absorbed more workers. Likewise, allied industries such as steel, paints, aggregates, etc. enjoyed brisk business. All these activities increased employment levels and purchasing power.

Responding to the increased demands for more funds, the banking community and the government lending agencies reduced interest rates to more affordable levels. This move encouraged developers to acquire more lands and beefed up their inventories.

The local government units (LGU) realized the upward trend and cashed in on the opportunity to generate more revenues. They reviewed their realty tax structures and in many cases, particularly, Metro Manila, the realty taxes were adjusted upwards by as much as one thousand five hundred per cent. In addition, the LGUs saw it fit to rationalize their existing zoning ordinances and introduced zonal valuation.

Land reform has always been a major political issue in the Philippines. The land for the landless program and the urban land reform program have always been an effective election platform. This program gathered momentum in 1986 and influenced to a significant degree the value of land which in the process created controversies between the landowner and the government agencies tasked with implementing the land reform program.

THE ROLE OF REAL ESTATE APPRAISERS

The events obtaining in the Philippines as narrated above suggest the very significant role of the real estate appraiser in resolving issues on land valuation. The traditional approaches to value demand considerable reflection from the appraiser. The changes in the economic, social, and political arena make the job of the appraiser more complicated and demands of him to be more pragmatic in order to develop methodologies that will reflect a fair and reasonable value prevailing in the marketplace.

Traditional/Non-Traditional Valuation

The traditional valuation are the market data, the cost approach, and the income approach. For as long as data are complete and available, the three (3) approaches are utilized, analyzed and reconciled in order to arrive at the final conclusion of value, particularly for highly urbanized commercial sites.

The market data or sales comparison approach is commonly adopted in the appraisal of vacant lots. The cost approach is a measure value for improved properties, including machinery and equipment and other depreciable assets.

Although many private appraisers are admittedly market/cost-oriented, the bigger and multi-resourced appraisal corporations are initiating the move to adopt more modern non-traditional techniques to sustain the complex appraisal requirements of clients as a consequence of rapidly changing prices of real properties. These non-traditional appraisal techniques, already adopted in modern countries, are more in-depth than traditional approaches with regard to procedure and analysis, and the value indication are significant for business decisions by owner-investors and end-users to forecast to their advantage the medium- and long-term prospects of real properties and intangible assets.

Lately, knowledgeable and experienced valuers are getting more involved in complicated assignments like business valuation, financial studies, highest and best use/feasibility study, joint venture study, natural resources valuation, leases and other net present value related appraisals, including macro and micro analysis of the real estate industry and other economic factors and assumptions necessary in the support of the study.

The presentor noted the increasing demands for these non-traditional appraisal requirements and it is expected the demand would persist indefinitely co-extensive with the necessities of the growing economy. *Cuervo Appraisers, Inc.*, in particular, created a special division of researchers and economists primarily tasked to service the growing requirements for business valuation and other special engagements. This progressive growth of appraisal engagements or growth in the appraisal industry, in a way, however require appraisers to persevere and enhance their competence by way of continuous education and analyses of far advanced appraisal science from developed countries in order to adopt the appraisal standards that may be appropriate for local conditions.

On the lighter side, the private and public appraisers conduct continuous dialogue with a view to devise a more appropriate and acceptable appraisal standards for zonal valuation as basis of internal revenue and realty tax, including assisting the Landbank in updating formula for just compensation appraisal of selected agricultural properties covered by agrarian reform. Private appraisers are also getting more involved in the just compensation appraisal of private properties taken for infrastructure and other requirements of the local and national government.

Ecology

The present consciousness on environmental conservation has restricted the extent to which a given property may be developed. The impact on water resource and other community facilities, transportation, pollution and waste disposal must be taken into account.

Market Information

In other countries like the United States, Japan, and countries in Europe, records of real estate transactions can be relied upon generally. The situation is slightly different in the Philippines, where one has to consider and reconcile the recorded sales viz-a-viz the zonal value and, in some cases, the assessor's value.

Similarly, estimate on the income generated by the property is a monumental task. Again, records of transactions are not kept as to allow analysis and evaluation. The appraiser must carefully study and assemble the gross income and other income-expense data foundational to the economic approach.

In the light of the foregoing constraints relative to real estate valuation, it is the common experience of many independent and licensed appraisers that their appraisal findings are challenged. Their competence, fairness and independence are subjected to questions and suspicion.

Many appraisers and appraisal companies stand by their findings even at the cost of losing a valuable client. However, the question is how far can he hold out and stay in business? Without his independence, where can the public go to resolve controversies in values?

CONCLUSION

The appraiser is an arbiter of values. He reconciles the differences between owners and end-users. As such, his independence and competence must take lead. He must be able to stand up against all pressures made to bear on him. In order to attain this so important quality, especially in an environment with continuing expansion of real estate activity, the appraiser must redefine his approaches to value. He must examine the events and its influences on values. He has to broaden his basic knowledge of economics, business, social changes and even common superstition. His technical competence in appraisal work must be backed up by his ability to sift through the maze of information relative to his work.

All told, the appraiser, under conditions of rapid changes must adopt pragmatic attitudes and flexibility in valuation procedures. The former order may no longer be enough to fortify himself against attacks on competence and independence.

Towards this end, appraisal societies and or associations are called upon to formulate appraisal methodologies and ethical standards to serve the interest of the profession and the general public.