

'margin of Error' in Property Valuations – Is There a Need for Safety Margins in Compulsory Acquisitions?

Juhana Hiironen, Kirsikka Niukkanen, Juha Ohrankämnen and Ari Laitala (Finland)

Key words: Land management; Valuation; margin of error; property valuation; safety margin; compulsory acquisition; compensation

SUMMARY

The ownership of real property is protected by the constitution in most countries. However, in many cases the “public” has reserved a right to limit the constitutional protection of property when it is necessary for the public good. In Finland compulsory acquisitions are allowed for public interest with full compensation. Compensation shall ensure that the affected party’s financial position is not weakened in the process of compulsory purchase. In the FIG recommendations market value is stated to be the basis of value for the assessment of compensation. The applicability of the market value as a basis of value for compensation has been criticized by stating that the use of market value leads systematically to too low values. This seems to justify a use of certain margin of safety which is the question that will be illuminated in this article. The study analyses the variation in property valuations which is estimated by giving the same valuation task to different property valuers. After each valuer has given his/hers opinion about the market value of the property, standard statistical methods are applied to analyze the results. Standard deviation in the market value estimates provided by experienced valuers was 32%. The overall variation was -68% and +113% from the median estimate. 50% of the valuations stayed within -16% and +33% from the median valuation. The results indicate that the valuation estimates don’t follow the normal distribution. It seems that the estimates tend to be more elastic to higher estimates than to lower ones. In this case the valuers were not familiar with the property market that the valuation task concerned. This means that they should have based their valuation judgement more on the input data and less on the “gut feeling”. The results however indicate the opposite. Based on the results it is undeniable that a compensation based on market value is not a guarantee that it will be possible to purchase an equivalent property as replacement for the compulsory acquired one. It is easy to understand why the market value is in many cases too low for a property owner to feel to have been fully compensated, and half are by definition entitled to feel so! On the other hand the level of compensation should result in a fair balance between public and private interests. The question remains, is the market value a fair balance?