

The interests of stakeholders in the real estate sector when valuating commercial property

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1. Introduction

- Problem statement & examples
- Research questions

2. State of the field

- Asymmetric information, moral hazard, principal-agent problem
- Behavioral real estate
- Real estate organizations

3. Purpose of the Dissertation

- Process
- Expected outcome

INTRODUCTION

- Problem statement & examples
- Research questions

„State-of-the-art“ real estate valuation (analysis) of the 1970s:

„Such analysis (...) is too often characterized by questionable **assumptions**, incorrect data, conceptually illegitimate models, dubious **motives**, perverse **ethics**, and fraudulent representations.“

(Hayes/Harlan, „Caveat Emptor in Real Estate Equities“,
Harvard Business Review, 1972, P. 92)

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□ **Valuation / transaction process**

- National (AT: ÖNORM, LBG) & international norms, practices (e.g. DCF)
- Real estate broker/advisor ↔ valuator ↔ (institutional) investor

□ **Examples**

Interests

- Real estate broker: fee (% or fixed amount)
- Investor: book value

Information

- Real estate broker: more (?)
- Investor: less (?) (= > value/price estimation might be influenced)

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□ Research questions

- How can we illustrate and explain the stakeholders' interests / behavior?
- Does asymmetric information exist between them?
- Moral hazard in commercial property appraisal?

Narrowed down to:

- Stakeholders / market players: real estate brokers & (institutional) investors
- Commercial real estate (retail, office, logistics, hotels)
- Transaction purpose
- Austria & CEE (RO, HU, CZ, SK, SI)

STATE OF THE FIELD

- Behavioral Real Estate
- Asymmetric information, moral hazard, principal-agent problem
- Real estate organizations

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□ Behavioral Real Estate

Evolutionary economics

- term introduced by Thorstein Veblen (1857-1929)
- economic organization is a dynamic process involving permanent transformation
- anthropology, sociology, psychology, and Darwinian principles
- progress in relation to evolution & how human behavior extends to economics

Behavioral economics

- applies psychological insights into human behavior
- explains economic decision-making
- identifies and models deviations from classical approaches (Ricardo, Mill)
- establishes empirically their importance in the economic decisions

□ Behavioral Real Estate

Scientific literature

- Diaz / Graaskamp: "Highest and Best Use"
- Diaz (1990): „selection of comparable transactions"
- Gallimore/Wolverton (1997): the appraiser is influenced when he knows the selling price of the asset he values
- Gallimore (1994, 1996): „availability heuristics", „confirmation heuristics"
- Diaz/Wolverton (1998): „appraisal smoothing"
- Diaz/Hansz (1997): valuers rely on the judgement of previous valuers if they are not familiar with the specific market
- Kinnard et al. (1997): „client's pressure"
- Wolverton/Gallimore (1999): „client's feedback"
- Levy/Schuck (1999): the influence of the more experienced clients on the valuator
- Scott (1988): „shopping the appraisal"

□ Behavioral Real Estate

Scientific literature: James A. Graaskamp

- urban land economics, behavioralism, decision-making, social responsibility, risk-management, institutional investment, appraisal, feasibility, development
- an appraisal is a systematic application of behavioral research in which the appraiser strives to fit the attributes of the property into a market context driven by decisions of market participants
- „researchers should turn to behavioral research to try to understand the driving forces of the decision makers, the models they use, and the decision-making context“ (DeLisle & Worzala 2004 on Graaskamp)
- subjective valuations: prices are set through negotiation => first define the most probable buyer => „the most probable selling price“

□ Theory of the firm

Principal-agent theory

- Jensen/Meckling (1976)
- *agent* enjoys a degree of decisional freedom and the ability to conduct business for the *principal*

Asymmetric information

- Laffont/Martimort (2002):

„By the mere fact of delegation, the principal often loses any ability to control those actions that are no longer observable (...). Those actions cannot be contracted upon because no one can verify their value.“

- Forms:
 - Hidden characteristics (adverse selection)
 - Hidden intentions (ex-ante: hidden characteristics; ex-post: hold-up)
 - Hidden information
 - Hidden action
- } **moral hazard**

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Asymmetric information	Problems	Causes	Solutions and instruments
Hidden characteristics	Adverse selection	The agent is not transparent	Guarantees, reputation
Hidden intentions	Adverse selection Hold-up	The Principal depends on the Agent	Replacement clauses, handover guarantees, set-off clauses
Hidden action	Shirking Consumption on the job	Supervision costs and possibilities, limited resources	Profit sharing, penalty clauses, monitoring, reporting
Hidden information	Fringe benefits	Agent's own interests	Signaling, screening, self-selection through certificates, monitoring, reporting

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□ Real Estate Organizations

International:

- International Ethics Standards Coalition (2014)
- TEGoVA (2009)
- Appraisal Institute (1991)
- Counsellors of Real Estate (1953)
- FIABCI (1949)
- Urban Land Institute (1936)
- RICS (1868)

Austria:

- BVFI; ÖVI; ÖGNI; ARE; IMMQU; Appraisal unions; CARI; ImmoABS

□ Real Estate Organizations

Ethical foundations and principles related to real estate business practice:

- Confidentiality and non-disclosure information to third parties
- Sharing all relevant information between contractual parties
- Integrity, transparency, respect
- Respecting the national laws and norms
- Responsibility towards business partners
- Expertise and adequate business knowledge
- Continuous professional development

PURPOSE OF THE DISSERTATION

- Process
- Expected outcome

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HOW?

Qualitative research: NVIVO

Quantitative research: brokers' fee in Austria and CEE

WHO?

Real estate brokers (20-30)

Investors (10-20 / asset class)

WHEN?

Interviews (including test phase): Oct. 2017 – Jul. 2018

Analysis and interpretation: Aug. – Oct. 2018

WHAT?

Face-to-face interviews which will be afterwards anonymized

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Expected outcome

Literature

- Behavioral real estate
- Principal-agent problem
- Moral hazard

Governance

- Corporate governance
- Code of ethics
- Socio-economic and real estate related development – regulations and incentives

Practice

- Transparency
- Ethical sensitivity
- Awareness

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Thank you!

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