
Preface

It has been over a century since Alfred Marshal and others created the basis for standard real estate valuation theory, by successfully merging the supply-side approaches of the classical scholars on value with the demand-side theories of the Austrian or marginal utility school. Neoclassical economic theory, which was the product of this synthesis, has been the dominant paradigm in economics for much of the past century and, continues to be so up to the present. Standard real estate valuation theory (and practice) thus largely reflects its roots in neoclassical (i.e. mainstream) economics.

A critical assessment of the present state of real estate valuation theory and practice should come to the conclusion that it is in crisis in the Kuhnian sense. This state of affairs is, in turn, reflective of the deep malaise that mainstream economic theory finds itself in, a malaise that has been sharply accentuated by the 2008 global financial crisis. The unexpected and unforeseen collapse of real estate values in the USA which presaged that crisis provided a compelling indictment of the parlous state of mainstream economic theory generally, and real estate valuation theory more particularly. With regard to the latter, other, less dramatic, markers of crisis include declining academic research interest in the subject and failure to agree on fundamental terms and concepts (such as the real meaning of the concept of market value itself). In the area of professional practice, numerous experiments around the world have repeatedly demonstrated that valuers are unable to estimate 'market value', as conventionally defined, with reasonable precision. The hegemonic position of neoclassical economic theory in economic thought for its part has, in the last few decades, come under serious threat from a variety of contenders, collectively described as heterodox theories. The implications of these alternative theoretical frameworks for real estate valuation theory are yet to be worked out and have not appeared in the extant literature.

This book critically reviews and updates real estate valuation theory in light of developments in heterodox economic theory. Heterodox economic theory, principally institutional economics and critical realism, is used as critical lens through which problems in standard valuation theory and practice are expatiated. The book provides for a radical departure from the standard treatment of the subject matter, thereby providing the basis for an alternative and competing paradigm. The 2008 global financial crisis, caused in part by problems in the pricing of residential real estate in the USA, underscores the importance of appropriate valuation practice for

the proper functioning of the economic system, which in turn rests upon the foundational assumptions of the underlying theory.

The book is arranged in eight chapters. Chapter 1 discusses philosophical, conceptual and definitional aspects of the standard theory. Also highlighted is the role of theory in the advancement of knowledge. The intention is to provide an overview of the key issues, as well as to highlight contemporary problems, controversies and lacunae in theory. The chapter makes the case for an alternative theory of real estate market value, by highlighting key theoretical and practical problems in contemporary practice that the standard theory is unable to illuminate.

Chapter 2 places the neoclassical basis of standard value theory in a historical context. The theory of value and its variant in market or 'exchange' value has exercised the minds of philosophers and economists for centuries, resulting in a very rich provenance. This chapter traces the evolution of (market) value thought, from ancient Greece up to the neoclassical synthesis of the nineteenth century. The intention is to summarise the contribution of each era, but also to demonstrate how value theory has always been a product of its time, sometimes changing dramatically over the centuries. The chapter therefore puts the hegemonic position of neoclassical economics in market value theory into a proper context.

Chapter 3 is a critical appraisal of the five 'traditional' methods used for the valuation of real estate, namely the sales comparison, investment, cost, residual and accounts methods. While the methods' basic principles and applications are discussed, the focus of the chapter is to surface the (mostly hidden) neoclassical theoretical assumptions underlying each valuation method and, secondly, to highlight the practical problems encountered in application. This chapter therefore clarifies the links between the traditional valuation methods and the fundamental assumptions of neoclassical economics.

Automated Valuation Methods (AVMs) represent the most advanced application of the fundamental assumptions of neoclassical theory to the valuation of real estate. Their use has been on the ascendancy around the world, especially in the period leading up to the 2008 financial crisis. By increasingly taking a larger share of the market from traditional manual valuations, AVMs have come to be viewed by some as a threat to the long-term survival of the profession. Chapter 4 explains how the theoretical and methodological assumptions of neoclassical economic theory come together, or are applied, in AVMs.

Chapter 5 is a critique of the neoclassical economics basis of standard real estate valuation theory. The critique presented is from the vantage point provided by two interrelated theoretical frameworks, namely critical realism and new institutional economics (NIE). The chapter has two principal objectives. Firstly, it is to explain why conventional theory is inadequate, or inappropriate, for the analysis of actual real estate markets. The second objective is to prepare the ground for an alternative theoretical framework, one that provides a more competent explanation for the identified theoretical and practical problems in contemporary valuation practice.

The alternative theory is developed in two parts, namely ontological foundations and the substantive theory. The first part, in Chap. 6, puts together the meta-

theoretic foundations of the alternative theory, while the substantive theory is developed in the seventh. Using insights from critical realism and new institutional economic theory, these two chapters construct a new paradigm for the conceptualisation of the market value of real estate, in the original sense of the term.

For an alternative theory to claim superiority over an extant theory, it should satisfy at least two conditions. First, the alternative should be able to explain all, or most, of what its rival does, so that a switch does not result in a loss or diminished explanatory power. Secondly, the alternative should be able to explain (some or most) of what the rival can't. The aim of the final chapter is to demonstrate that the alternative theory meets both conditions. With that aim in mind, the chapter has two interrelated objectives. The first is to provide an explanation why the standard theory is inadequate, or inappropriate, to deal with the highlighted theoretical and practical problems in contemporary valuation practice. The second is to demonstrate the superior explanatory powers of this alternative theory to these same problems. The alternative theoretical framework is, in particular, employed to explain practical problems, such as price bubbles in real estate markets, valuation accuracy, anchoring and client influence, among others.

This book is primarily targeted at an academic audience. It is pitched at a postgraduate (and higher) level, though elements in it may be of interest to some undergraduate programmes. It will be of interest primarily to economists and those in the property/real estate discipline. The book, however, deals with themes of great interest in philosophy and sociology. It could be used in courses such as advanced real estate valuation, urban land economics, value theory, heterodox economic theory, methodology in economics, history of economic thought and moral philosophy. Further, to the extent that it aims to provide theoretical explanations for some of the practical problems in real estate valuation practice, the book will, in that sense, be of interest to professional real estate valuers/appraisers, investment analysts and related practitioners in the real estate industry.

This is not yet another book on real estate valuation. It is unique in at least three major respects. Firstly, it, as indicated above, develops an alternative paradigm, in the true and original meaning of the concept, to standard market value theory. Given that the majority, if not all, of the books on this topic subscribe to mainstream (i.e. neoclassical) value theory, the field for competition is considerably narrowed. Secondly, with regard to competition for content, this book is different from many others because of its central focus on value *theory*, as opposed to practical or vocational aspects of real estate valuation. This is an area that is hardly covered in the literature. This quote (Canonne and Macdonald 2003, p. 113) is instructive:

a detailed scrutiny of over one hundred major North American real estate handbooks and real estate appraisal manuals, treatises and anthologies, starting with Hurd (1903) and covering one hundred years, reveals that the theory of value—from Xenophon to Ricardo, Marx and Hobson—is systematically neglected. The literature reviewed here deals insignificantly with the concepts of value, and barely half deal with both economic law and principles of value. Two-thirds do not cover the history of value theory, and others do not touch on any stage of the development of value thought. A parallel survey of academic thesis and dissertations, dictionaries and lexicons revealed a similar neglect.

It is the case that North American books tend to emphasise the *financial* aspects of real estate, being targeted as they are at business schools. The situation is not any better with valuation literature in the British Commonwealth where traditionally, due to the ‘surveying’ origins of the profession, there has been an emphasis on valuation *methods*. Further, the disconnection of the surveying profession from the economics discipline (where market value theory has its disciplinary home) has meant that significant developments in economic theory have not easily filtered through to influence valuation theory and practice.

Finally, the book is unusual in its comprehensive treatment of the subject matter. The book covers not only the theory but also the history, methods and problems of real estate valuation.

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