

The Residual Method - Opportunities and Risks

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SUMMARY

The residual method - opportunities and risks

The residual method is used to estimate the value of undeveloped land suitable for developing or land with redevelopment potential. It is concepted on the fact that the process of development or redevelopment is a business and based on this it is possible to find the market value of land in its current condition, taking into account the development potential as part of this process.

This method is simple in concept, but requires a great deal of skill and experience in its application, as minor changes in the assumptions used in the valuation can have a large impact on the final result.

The residual method estimates the value of the property in its developed or redeveloped form, either by comparison or based on the income approach.

From this value, the valuer has to deduct all costs incurred to bring the property to the form that will achieve this price. These include the costs or fees of, among other things, demolition of any existing buildings, planning, infrastructure work, construction if applicable, experts, brokers and for financing the development as well as the developer's profit.

The process and its accuracy are illustrated using the example of the development of a residential area on a former military site, where the potential buyer and the owner had very different opinions about the value of a piece of land.

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