

## **Legal, Tolerated, Illegal: IVS Market Value Definition and the “legally Permissible”**

**Sølve BÆRUG, Norway**

**Key words:** Market Value Definition, Legally Permissible, International Valuation Standards, Tolerated Use

### **SUMMARY**

The article argues that we would be better off with a wider interpretation of the requirement of legally permissible use than the wordings in paragraph 32 in the current IVS 2013 standards indicates. That would especially be necessary in informal markets, which typically will be found among low income owners in the developing countries. Especially in informal markets, the situations might be somewhere in the spectrum from clear illegality to some extent of tolerated use or use which seems locally “legally” permissible, but is not considered legal by the government or other authorities. The author point at two reasons for a wider interpretation. The first is that a strict interpretation will render the valuer without comparables in most informal markets and several other markets, including some market segments in developed countries. The second is that a strict interpretation will render the market value definition irrelevant for most purposes and actors in such markets. To demonstrate that these issues are not only relevant in informal markets, some examples are given from formal markets in developed countries.

# **Legal, Tolerated, Illegal: IVS Market Value Definition and the “legally Permissible”**

**Sølve BÆRUG, Norway**

## **1. INTRODUCTION**

This article will argue that we would be better off with a wider interpretation of the requirement of legally permissible use than the wordings in paragraph 32 in the current IVS 2013 standards indicates. Other definitions of market value are somewhat different, but all have some direct or indirect reference as to the use must be “legally permissible” or at least that it must be reasonably probable that the intended use will become permissible.

A strict interpretation of the “legally permissible”- requirement would especially be problematic in informal markets, which typically will be found among low income owners in the developing countries. The prices paid in those markets are often influenced by the fact that the property itself and/or the intended use of the property might be somewhere in the spectrum from clear illegality to some way of tolerated use or use which seems locally “legally” permissible, but is not considered so by the government or other authorities.

A strict adherence to a legally permissible state of property and use will lead to a major challenge in that it will render the valuer without comparables in most informal markets and several other markets, including some market segments in developed countries. Another, and more serious problem, is that a strict interpretation will render the market value definition irrelevant for most purposes and actors in such markets.

The problem with the “legally permissible” requirement is to some extent present in several markets, also in in developed countries. To demonstrate that these issues is not only relevant in informal markets, examples will be given from formal markets in developed countries.

## **2. MARKET VALUE DEFINITION**

There are several separate regional valuation standards defining the exact meaning of “market value”, or explaining the concept. Furthermore, two standards are accepted cross many regions: The International Valuation Standards developed by the The International Valuation Standards Council (IVSC), which are incorporated in several regional standards, and the standards of the Royal Institution of Chartered Surveyors (RICS), which applies to all RICS members worldwide. There are some differences between the standards on to which extent the market value presumes or “reflects” a legally permissible use.

### **2.1 International Valuation Standards 2013**

The current market value definition according to the International Valuation Standards 2013 (“IVS 2013”) is

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Sølve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

“Market value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.” (International Valuation Standards Council, 2013 p 18)

The Exposure draft for the 2017 International Valuation Standards (“IVS 2017 draft”) have the identical wording (International Valuation Standards Council, 2016 p. 20).

The IVS definition is not constrained to real estate (“asset or liability”). Furthermore, it seems broadly in line with common understanding of the market value concept, it is what you would get for the asset or liability if sold in a “normal” market transaction.

The market value definition is detailed in paragraph 30 following the definition, which states

“The definition of market value shall be applied in accordance with the following conceptual framework: [...]”(International Valuation Standards Council, 2013 p 18)

The “following” conceptual framework is given in paragraph 30, letter a to i, elaborating on the different parts of the definition, such as “between a willing buyer”, “after proper marketing” etc. Again, the IVS 2017 draft do not suggest any changes except for minor editorial changes. (International Valuation Standards Council, 2016 p. 20-21).

However, the IVS 2013 furthermore connects the market value to the well-known concept of “highest and best use” (“HBU”), in a separate paragraph (no. 32, p, 20) following the definition and the detailed “conceptual framework” in paragraph 19 and 20. The paragraph 32 states

“The market value of an asset will reflect its highest and best use. The highest and best use is the use of an asset that maximises its potential and that is possible, legally permissible and financially feasible. The highest and best use may be for continuation of an asset’s existing use or for some alternative use. This is determined by the use that a market participant would have in mind for the asset when formulating the price that it would be willing to bid.” (International Valuation Standards Council, 2013 p 20)

The HBU concept is a tool used by valuers, which can be found in textbooks on real estate valuation, see e.g. The Appraisal of Real Estate (Appraisal Institute, 2013). The exact definition has been widely discussed for decades, see e.g. Ibid p 333.

If the HBU concept was intended to be a formal part of the IVS 2013-definition of the market value, the concept should have been incorporated in the definition itself or in the conceptual framework in paragraph 30 letters a-i. The HBU concept is not mentioned in that section.

However, while the HBU concept is not a formal part of the IVS 2013 definition, it is not quite clear how the valuer should understand the “will reflect” remark. Is this intended to be only a reminder for the valuer that a HBU-analysis might be useful in the valuation process, or is it a more

substantial meaning, specifically that the market value should be constrained to the value according to the HBU concept?

The IVS 2013, including Guidance Notes, are as of 2016 in their entirety incorporated in Australia & New Zealand Valuation and Property Standards (ANZVPS) (Australian Property Institute, 2016). Furthermore, the European Valuation Standards of 2016 (“EVS 2016”) and the standards of the Royal Institution of Chartered Surveyors (“Red book 2014”) is compliant with the IVS 2013 Standards, albeit they are not fully incorporated. However, as we soon will shortly discuss, there are important differences between the IVS 2013 and the current standards in the USA and in Canada, one main difference being that those standards do not have one specific definition of “market value”.

## **2.2 European Valuation Standards 2016**

The European Standards (EVS) provides the minimum standards that The European Group of Valuers' Associations (TEGoVA) Member Associations “...must adopt in their own standards, supplementing such additional requirements as are deemed necessary by legislation, regulation or generally accepted practice within a specific state.” (The European Group of Valuers' Association, 2012 p 9) The current standard is effective from 1 June 2016.

The definition of the market value is:

“The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion.”(The European Group of Valuers' Association, 2016 p 17)

The definition, which is identical to the definition in Regulation 575/2013/EU (the Capital Requirements Regulation) uses the word “property” where IVS uses the more general “asset or liability”. Otherwise, it is identical with the IVS definition except for some minor differences in phrasing.

However, the EVS 2016 do not refer to the concept of HBU in the same way (“will reflect”) as in the IVS 2013 paragraph no. 32 p. 20. The EVS standard discusses the HBU concept in paragraphs 5.3.7-5.3.12 on pages 24-26. The 2016-edition added the following comment to paragraph 5.3.7 “[The HBU] approach is thus Market Value limited by an assumption and not a simple Market Value or an element within Market Value.” (Ibid, p 24) It is followed up in paragraph 5.3.12, remarking

“As each point of the definition of highest and best use (except the requirement for evidence) places some constraint on the definition of Market Value, the highest and best use assumption will not necessarily be the same as Market Value, ...” (Ibid p 26)

The EVS especially mentions potential permissions or other future opportunities as an example where an HBU approach will place constraint on the market value definition, both in paragraph

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

5.3.12 (Ibid p. 26) and in paragraph 6.3.2 (Ibid p. 89) and paragraph 6.6.2 (Ibid p 92), the latter focusing on a similar challenge with the “legally permissible”-requirement as we are in this article:

“While the definition of Market Value in EVS 1 allows such [future change in the legally permissible] to be taken into account, in the absence of planning permission or suitable zoning, the potential future use may not pass the “legally permissible” test inherent in IFRS 13’s definition of highest and best use. In that case the Fair Value would be lower than the Market Value.” (Ibid, p 92)

The EVS do not focus on the “legally permissible”- aspect in terms of use that is not and will not be legally permissible, but which the potential buyers factors into their willingness to pay for the property.

### **2.3 RICS standards 2014**

The global standards of the Royal Institution of Chartered Surveyors (RICS) effective from January 2014 is stated in the “Red book” as identical to the IVS 2013 definition (The Royal Institution of Chartered Surveyors, 2013 p 9, 53).

The Red book 2014 lays at least the same emphasis on the HBU concept, including “legally permissible” than what the IVS does (if not more), mentioning the concept in the paragraph immediately following the market value definition (1.2.2 vs. 1.2.1 in VPS 4 Basis of value, assumptions and special assumptions (Ibid p 53)).

### **2.4 USPAP 2016-2017**

The standards of the The Appraisal Foundation, effective January 1, 2016 through December 31, 2017, do not state any definition of the market value, only an explanation (The Appraisal Foundation, 2015 p 3-4) However, the standards highlights the following with bold font following the explanation:

“Appraisers are cautioned to identify the exact definition of market value, and its authority, applicable in each appraisal completed for the purpose of market value.”

The USPAP requires the appraiser to develop an opinion of the highest and best use of the real estate when necessary for credible assignment results in developing a market value opinion (Standards Rule 1-3 (b) (Ibid p 19-20)), and further elaborating on the concept throughout the standards, especially on pages 92-96 and 291-92, thus indicating the importance of such analysis in the jurisdictions where USPAP is relevant.

### **2.5 CUSPAP 2016**

The Canadian standards of the Appraisal Institute of Canada, effective May 1, 2016, states three different “Acceptable definitions of “Market Value”” (Appraisal Institute of Canada, 2016 p 100-

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

101) in paragraph 16.14.3.i, 16.14.3.ii and 16.14.3.v. The latter one is identical to the IVS definition.

The CUSPAP requires in paragraph 6.2.13 that the Member in the report must «define, analyze and resolve the highest and best use» (Ibid, p 30).

In conjunction with the EVS 2016 comments on highest and best use, it is noteworthy that the CUSPAP explicitly do not exclude a HBU based on another context than the one occurring on the valuation date:

“In the context of properties where the highest and best use is for land use change (e.g. rezoning or redevelopment), the Member must reasonably support the imminence or probability of the land use change.” (Ibid, p 37)

### **3. CATEGORIES OF NOT “LEGALLY PERMISSIBLE”**

As observed by among others EVS and CUSPAP, a use, which is not permissible at the valuation date, may become permissible in the future. Such future permissible use may or may not be included in a strict highest and best use definition. Such issues is briefly discussed by Johnson, Atwood & Walther (2010) and by Johnson & Walther (2010) regarding the application of “legally permissible” part of HBU in Generally Accepted Accounting Principles (GAAP).

Use that may become legal is not the case which we are looking into in this article. Our concern is when the property itself, the use and/or the transaction is not and will not be totally “legally permissible”.

Legality of a property itself, legality of the use of the property and/or the legality of a certain transaction of property may be enforced by the government or other public entities or by other private owners of rights for which the state of the property, use or transaction represents a breach of their rights. From here on will the article refer to both of these as “government or owners”.

#### **3.1 Gray zones**

As far as the state of the property, use and transactions concerns, there often is no clear dichotomy between what is legally permissible and what is not. There might be states of the property, uses and/or transactions that might be described as semi-legal, quasi-legal, “grey” or similar wordings. For instance, Payne and Durand-Lasserve (2012) notes

“Insecure tenure covers a wide range of local situations, from total illegality to various forms of tolerated occupation, or occupation legitimized by customary practices but not considered as legal by government or local authorities.” (Payne & Durand-Lasserve, 2012 p 2)

Further they observe

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

“It has been common for many years to discuss land tenure and property rights in terms of some form of duality. However, in practice, many tenure categories may be partly legal (e.g., officially recognized subdivisions), creating gradations of legality.” (Ibid, p 3)

Most experienced professionals in real estate knows that the exact delimitation of legality is in fact quite often blurred. It is often not possible, given the time and effort the relevant stakeholders are willing to assign to the task to establish the (il)legality, either because the exact fact or activity is not known or cannot be sufficiently proven, and/or because the legal rules are unclear or contradictory.

### **3.2 Tolerated use**

Some property, activity and/or transactions are probably illegal, but one way or another tolerated by the government or owners. The degree of “tolerating” may vary in a broad continuum. Examples might be, in the most obvious way of tolerating, an activity is nominally illegal, but openly tolerated by the government or owners. Example of this might be “sleeping” regulations or regulations that nominally is requirements, but is enforced only as intentions, not requirements, or not enforced at all. An example between private owners is trespass to land that is tolerated by the owner of the trespassed property.

Another degree of “tolerating” is when a property, activity and/or transaction is nominally illegal, but silently tolerated by the government or owners that might otherwise have to act on the illegality if it “must”. Typically, such “illegality” will not meet enforcement because the government or owners give little or no priority to detect any of such “illegality”. An example is that several western countries seldom or never performs internally control of existing dwellings to check if the dwelling still is according to the relevant building permits, requirement of the electrical installations and so on, so illegal internal re improvements may in some respect be seen as de facto (silently) tolerated.

### **3.3 Not tolerated, but unenforceable rules**

A property, activity and/or transaction can be illegal, and not tolerated by the government or owners, but sometimes they have little or no effective power to stop the activity. Reasons for this might be difficulty of documenting the activity in a way that is sufficient in a court trial, a lack of legal instruments to stop or hinder the activity, a lack of necessary political support, a lack of resources, corruption, threat of violence etc.

### **3.4 Benefit higher than the cost for the owner**

Some activities is clearly illegal and will be reacted upon if discovered, but the probability and severity of the reaction is not enough to outweigh the profits or other gains of the illegality. In combination with the above mentioned categories, some owners makes a rather amoral calculation of the cost and benefit of illegal property, use or transactions: If the expected benefit outweighs the expected cost, then these owners will be inclined to proceed with the illegal property, use or transaction.

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

A typical example out of the real property realm which some might find relevant, is driving faster than the speed limit. It is illegal, but the gains is far higher than the cost (probability of being caught and the speeding ticket the driver gets) in many jurisdictions. In such instances the market players takes the possibility of illegal use into their consideration of the possible use of the asset (the car). A potential buyer of a sports car would probably be contemplating both legal (driving below the speed limit) and illegal (speeding) use of that car as long as the possibility of being caught speeding is not too high and the consequence not too severe.

## **4. STATE, USE AND TRANSACTON OF PROPERTY**

### **4.1 Illegal, but tolerated or relevant state of the property**

Some properties has been improved in illegal ways. Owners build or rearranges structures without the required allowances from the authorities or necessary agreements from other property owners. They install or improves electricity, plumbing and so on without the required allowances, and/or without the required authorization of the electrician, plumber and so on.

Furthermore, some properties has improvements that was legal at one time, they are not anymore in the way that is required by later governmental or other regulations. This would render the property in a state that in some ways area illegal.

Some properties has been improved in ways that interfere with other owners property rights. This is common in squatter settlements in several developing areas.

In several instances, the relevant government or owners more or less tolerates such illegalities according to one of the abovementioned categories. In the most developed part of the world, the effect of such illegalities on the market prices might be relatively insignificant in most markets. However, the proportion of the effect of such illegality is more common in some market segments, especially in the lower priced part of the markets.

In the developing part of the world, there might be hundreds of millions of structures in squatter areas, which to at least a considerable degree is “illegal”, but more or less tolerated, both by the governments, and owners of other property rights that are affected. The cost of correcting every illegality in such markets may be high compared to the prices paid for those properties.

What is relevant for the definition of market value, is that at least some potential buyers factor in that there is little need to correct such illegal, but tolerated state of the property. What is more: The proportion of the potential buyers that makes such amoral judgements do not need to be high to have an effect on the observed market prices. Those (possibly few) who ignores the illegalities have a tendency to have the highest willingness to pay for the property, and therefore have a higher probability to end up as the buyer. Lastly, the more “illegality” the property has, the higher probability that the buyer will be one that disregards the need to correct such illegality, and so have a higher willingness to pay for the property than a buyer that will correct the illegal parts of the property.

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality  
Helsinki, Finland, May 29–June 2, 2017

## **4.2 Illegal, but tolerated or relevant use of the property**

Properties are – like cars – not always used in a totally legal way.

Some properties are not used according to the relevant zoning. Some are not inhabited in the correct way according to regulations (e.g. inhabited even when inhabitation is not allowed. Some are inhabited by foreigners when a only a national resident is permitted to inhabit the property). Some are used for activities that is not according to relevant private agreements, negative servitudes, and so on.

Another example of what might be coined as illegal use, is when there is a price regulation on rented properties, and the property is let for a higher price than the regulation allows.

Most professionals can presumably imagine several similar examples of illegal use which in fact exists in their market areas. It is not uncommon that such nominally illegal use will be more or less tolerated by the relevant bodies.

Again, it is probable that a property where an illegal use is the most beneficial for a potential owner will be sold to a buyer who will have a higher willingness to pay because of such illegal use. For instance, permanent dwelling is not allowed in second homes in several jurisdictions. However, several of the second homes are (illegally) used as permanent dwellings, especially those close to larger urban areas, an illegality which some governments seems not too eager to pursue and correct, see e.g. Damsgaard, (2007). When such second homes are sold, some of these market prices are obviously influenced by the potential possibility of (illegal) permanent habitation by the prospective buyers.

## **4.3 Illegal, but tolerated sales price**

In some jurisdictions, prices of certain types of properties are regulated. This tends to lead to a grey or outright black market on the relevant properties. The gray or black market prices might be illegal, but in several markets the governing bodies seems not to wish to interfere even with well-known “black market” property prices. A well-known example is the openly tolerance of black market transactions of tenancy of rent regulated flats in several western countries see e.g. Eriksson and Lind (2005).

Prices above the regulated maximum prices may in some markets be legal as far as the private agreement concerns, but the illegality occurs if the buyer do not disclose the actual price to the relevant authorities. The price regulated rural land market in Norway works in this fashion (OECD, 2008): If the buyer discloses an actual sales price which is too high according to the governmental regulations, the buyer must resell the property to an acceptable (and lower) price, but the “too high” transaction price itself is not illegal.

## **4.4 Illegal, but tolerated transaction**

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

There are properties or property rights that cannot legally be sold in the way they actually are sold. One example is certain types of tribal land. Another example is property rights which according to the jurisdiction or by private agreements is not possible to transfer, for instance because it is not legal to subdivide the property in the way that the sale in fact does, but which is sold anyway. Again, these transactions might be tolerated to a certain degree by the government or owners.

## 5. COMPARABLE SALES VS. LEGALLY PERMISSIBLE

The amount for which a property is exchanged is a result of the opinion of value among the market players. The seller will not accept a price lower than what the property is worth for the seller, the buyers will not pay a higher price than what the property is worth for the buyer.

There are abundant indications that the typical market player do not strictly adhere to what is legally permissible in the nominal sense. People drive their cars above the speed limits, and contemplate that possibility of such illegal use when they buy cars. If there were (or when there are) cars that could not be driven above the speed limit because of some technical installment in the vehicle, there might be possible to see market prices of cars that are – in that respect – truly based on a legally permissible use. However, until then, there is no feasible way of knowing if the amount of what a car is exchanged for is solely based on “legally permissible” use.

There are market segments where it seems that every legal transaction is motivated by illegal use. For instance can Radar detectors be legally bought and owned in several jurisdictions, but not legally used in a moving vehicle (Wikipedia, 2016). However, one will be hard pressed to establish any legal use for such instruments that explains the observable prices of such instruments.

In the property market, there are, as indicated, several submarkets where similar situations arises: Many buyers of the second homes close to urban areas, or a dwelling in a squatter area do not fully intend to use the property in a legally permissible way, and the prices will reflect their true intentions. That leaves the valuer with a methodological challenge: How can the comparison method be used if it is a requirement that the market value should be based upon a use that “reflects” the legally permissible use, when many or all the comparables are sales that are substantially influenced by potential buyers also contemplating illegal use?

There are not many instances where the valuer can interview or in other ways reveal whether the buyers of comparables are going to correct any state of the property that is not “legally permissible”, whether they are only going to use the property in a “legally permissible” way, whether they only are going to sell the property in a legally permissible way and so on. That would leave the valuer with a major challenge when valuing properties where buyers potentially factoring in some illegal use effect the market prices. How could a valuer possibly know whether the market players involved in a comparable sale in fact based their judgement of value solely on “legally permissible” use? Therefore, a strict adherence to the “legally permissible”-rules seems to exclude the comparable sales method in submarkets where illegal property, use or transactions is common. This could for instance easily be the case in several important markets of unregistered land and properties in developing areas.

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

The problem of legally permissible also arises in some real estate markets in developed countries, because the market prices are influenced by use that is not fully “legally permissible”. Second homes in markets where they often are illegally used for permanent living is already mentioned.

One further example from developed countries is that “gray” letting markets exists in many urban areas with high pressure on the renting flats. The owners sometimes let out property which not fully comply to regulations on lettable properties, the agreements between the property owner and the tenant are not always fully in accordance with the legal requirements or the property owner do not pay taxes quite according to the applicable tax regulations in the jurisdiction. This “grey” market possibility influences the markets for properties suitable for hire in those areas. A strict adherence to the “legally permissible”-requirement of the comparables would leave the valuer with a major challenge of using the comparison method in these markets.

Another example in developed countries are rural markets where the land prices may be affected by widespread tax evasion by the farmers (a proverb in some potato production areas states they grow two types of potatoes: Kerr’s Pink and “Cash Noire”).

Yet another example in developed countries area rehabilitation projects that are bought by persons or small companies which do not in detail follow the regulations and rules when rehabilitating those properties, uses some illegal workers etc.

## **6. STRICT “LEGALLY PERMISSIBLE” REQUIREMENT LEADS TO MARKET VALUES OF LESS RELEVANCE**

An interpretation of the market value definition that leads to a state where the valuer have to use other methods than the comparison method is not necessarily a bad interpretation if the market value interpretation otherwise is useful. There is no formal set of criteria to evaluate which alternative market value definition is optimal, and there do not seem to be any clear consensus among professionals on such set of criteria.

There has been some suggestions in academic literature. Lind (1998 p 159) suggests that “the definition should have a clear meaning, the definition should be such that it is possible to know, at least approximately, what the market value is, and finally that the definition should lead to a concept that is relevant for actors on the market”. I will use that structure in the following discussion.

### **6.1 Clear meaning**

There might not be quite clear what a strict interpretation of “legally permissible”-requirement should be. Is e.g. intention of a use based on illegal tax evasion “legally permissible”? However, it seems possible to clarify the requirement to such extent that it would be fair to consider such a requirement to imply a “clear meaning”.

### **6.2 Possible to know what the market value is**

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

A strict interpretation of “legally permissible” will exclude the use of comparable sales in markets where a significant proportion of the potential buyers do not intend to use the property in a totally legally permissible way. Furthermore, in those markets, it will not be possible to evaluate the market value estimates made based upon actual market transactions of the relevant properties. The market value will be purely hypothetical if the valuer imposes the “legally permissible” requirement.

The radar detector-example illustrates this: There are no way of evaluating the “legally permissible”-market value of a radar detector in markets where radar detectors can be sold legally, but is not legal to use. Presumably, few if any buys a radar detector in those markets with the intention of legal use of the equipment. The same goes in property markets where a the proportion of “illegal use” is significant. There is no way of “observe” indications of the “true” market value in such a way as it might be possible if the definition was interpreted without a reference to “legally permissible”, where the actual amounts for which a property is exchanged would be a market value indication.

### **6.3 A concept relevant for actors on the market**

In markets where the properties, use and transactions for the most part is legally permissible, a “legally permissible”-rule is no restriction or clarification of the IVS 2013 market value definition. Such use follows directly from the definition. The test of whether a strict interpretation of the “reflects” comment in IVS 2013 paragraph 32 is preferred when it comes to “legally permissible”, must be based upon a judgement in the markets where the use often is not legally permissible.

In most jurisdictions and market segments, it is legal to sell a property to a buyer that has a willingness to pay influenced by a use that is not legally permissible. (Furthermore, if such transaction is illegal in some markets and jurisdictions, it will probably be quite difficult to enforce such a regulation.) The legal prices paid in the real world markets incorporates to a smaller or greater amount elements of use that is not “legally permissible”. A strict “legally permissible”-interpretation would lead to a market value lower than the probable price in those market. It is not easy to identify situations where such a market value concept would be relevant.

Potential buyers, whether they only contemplate legally permissible use or also might factor in other uses, will face the actual market prices, not prices as if the properties only could be used in a legally permissible ways. For those potential buyers, the hypothetical “legally permissible”- market value would have little or no interest.

Owners will also face the actual market prices if they sell the property. The owners and would use the actual market value, not the “legally permissible use”-market value, when considering selling, judging the value of their estate and so on. The hypothetical “legally permissible”- market value would have no interest for them.

A potential lender would face the actual market value if the property is used as collateral, not the “legally permissible use”-market value. The hypothetical “legally permissible”- market value would have little or no interest for them.

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality

Helsinki, Finland, May 29–June 2, 2017

The government would probably also primarily be interested in the actual market prices for purposes such as policy making, the different types of taxation, monitoring the wealth of the inhabitants and companies regarding financial stability and so on. A purely hypothetical value would be of less use for such purposes.

Finally, for anyone who wants to understand the relevant property market, a hypothetical “legally permissible”-market value would have little or no interest.

However, a concept of market value where the use is restricted to “legally permissible” might be of relevance in some realms, especially in rules of compensation. In several jurisdictions, such rules incorporates some degree of restriction to compensation to legal use of the property. That concept might however not be totally followed in detail in practice, partly because it is common to establish the “fair” compensation on the ordinary market prices, at least as a starting point, even if illegal use significantly influences those prices. A rationale for this practice might be that it usually is legal to sell the property at market prices that are influenced by illegal use.

The conclusion is that for most actors, a strict interpretation of the wording in the IVS 2013 paragraph 32 will render a market value concept that is not relevant for most actors.

## **7. CONCLUDING REMARKS**

The choice of words in IVS 2013 paragraph 32 “will reflect” might be interpreted in different ways. Other standards lay more or less weight on the reference to HBU, of which the EVS 2016 lays least weight.

There are several markets where a significant portion of the buyers bases their willingness to pay on a future use that is not fully legally permissible. In those markets, a strict interpretation of the wordings in paragraph 32 will lead to a state where the valuer cannot use the comparison method, because the prices of the comparables might be significantly influenced by the purchaser’s intent to use the property in a way that is not quite legally permissible. Furthermore, it would lead to a definition that might be clear, but it will be difficult to know what the market value is. Finally, and more important, a strict interpretation will lead to a market value concept that is not relevant for most actors on those markets.

The “legally permissible” – condition might be seen as a relic from the times when the valuer told the market what the “true” market value was, regardless of what the market actually paid for the property. Nowadays, the valuer usually observe the market and estimates values accordingly. In markets where a significant portion of the buyers bases their willingness to pay on a future use that is not fully legally permissible, we would probably be better off if the IVS 2013 paragraph 32 was interpreted as an observation in markets where properties are used in a legally permissible way, not as a restriction in the market value definition to legally permissible use in other markets.

## **REFERENCES**

Appraisal Institute. (2013). The appraisal of real estate (14 ed.). Chicago, IL: Appraisal Institute.

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Solve Bærug (Norway)

FIG Working Week 2017

Surveying the world of tomorrow - From digitalisation to augmented reality  
Helsinki, Finland, May 29–June 2, 2017

- Appraisal Institute of Canada. (2016). Canadian Uniform Standards of Professional Appraisal Practice. Ottawa: Appraisal Institute of Canada.
- Australian Property Institute. (2016). Australia & New Zealand Valuation and Property Standards. Retrieved from <http://anzvps.api.org.au/>
- Damsgaard, O. (2007). Second homes in Denmark. *Journal of Nordregio*, 7(3), 19-21.
- Eriksson, K., & Lind, H. (2005). Vad vet vi om hyresregleringens effekter? *Ekonomisk Debatt*, 33(4), 31-44.
- International Valuation Standards Council. (2013). International valuation standards 2013. London: International Valuation Standards Council.
- International Valuation Standards Council. (2016). IVS 2017 Exposure Draft. London: International Valuation Standards Council.
- Johnson, I. R., Atwood, K. E., & Walther, L. (2010). Incorporating Highest and Best Use into Accounting Standards Expands Opportunities for Appraisers. *Appraisal Journal*, 78(2).
- Johnson, I. R., & Walther, L. (2010). Interpreting 'Legally Permissible' in Applying Fair Value Guidelines. *The CPA Journal*, 80(12), 28.
- Lind, H. (1998). The definition of market value: Criteria for judging proposed definitions and an analysis of three controversial components. *Journal of Property Valuation and Investment*, 16(2), 159-174. doi:<http://dx.doi.org/10.1108/14635789810212922>
- OECD. (2008). Agricultural Support, Farm Land Values and Sectoral Adjustment - The implications for policy reform: OECD Publishing.
- Payne, G., & Durand-Lasserre, A. (2012). Holding on: security of tenure—types, policies, practices and challenges. Paper presented at the Expert group meeting on Security of Tenure convened by the Special Rapporteur to Brazil.
- The Appraisal Foundation. (2015). 2016-17 Uniform Standards of Professional Appraisal Practice. Washington, DC: Appraisal Foundation.
- The European Group of Valuers' Association. (2012). European Valuation Standards 2012 (7 ed.): TEGoVA.
- The European Group of Valuers' Association. (2016). European Valuation Standards - EVS 2016 (8 ed.): TEGoVA.
- The Royal Institution of Chartered Surveyors. (2013). RICS Valuation - Professional Standards January 2014 : RICS Professional Standards, Global ["the Red Book"]. London: RICS.
- Wikipedia. (2016). Radar detector. Retrieved from [https://en.wikipedia.org/wiki/Radar\\_detector](https://en.wikipedia.org/wiki/Radar_detector)

## BIOGRAPHICAL NOTES

Sølve Bærug is associate professor at the Norwegian University of Life Sciences, Department of Landscape Architecture and Spatial Planning. He also holds a position in a private company in which he develops automated valuation systems for the Norwegian housing market. He has previously been working with land acquisition on behalf of the Norwegian Armed Forces.

## CONTACTS

Associate professor Sølve Bærug  
Norwegian University of Life Sciences  
Department of Landscape Architecture and Spatial Planning Institution  
POB 5003  
1432 Ås  
Norway  
Tel. + 47 91721941  
Fax +  
Email: [solve.barug@nmbu.no](mailto:solve.barug@nmbu.no)  
Web site: [www.nmbu.no/ilp](http://www.nmbu.no/ilp)

---

Legal, Tolerated, Illegal: IVS Market Value Definition and the “Legally Permissible” (8559)  
Sølve Bærug (Norway)

FIG Working Week 2017  
Surveying the world of tomorrow - From digitalisation to augmented reality  
Helsinki, Finland, May 29–June 2, 2017