ESTIMATION PRINCIPLES OF INVESTMENT VALUE FOR INDIVIDUAL AGRICULTURAL INVESTORS

ESTIMAREA PRINCIPIILOR VALORII INVESTITIONALE IN CAZUL INVESTITORILOR IN AGRICULTURA

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Abstract: *The present study tries to focus on the analysis of valuation principles of agricultural property, which are recommended to estimate the real significance of already existing investments. Our database originates from the survey which has been made among farmers in South Great Plain Region in Hungary operating primarily medium- and large-scale agricultural enterprises. Cash flows and costs are to be estimated over the period that the investor is expected to hold the property, taking into account all factors that could affect them. The application of DCF method can be crucial in some cases because the general prospective profitability of the activity which the enterprise deals with and the specific income generating capacity at the given farm can be much more important in the determination of property value than their registered net value.*

Keywords: *property value, investment, cash flow, financial performances*

INTRODUCTION

The Commission White Paper (2007) emphasises the importance of common European standards for property valuation. European Valuation Standards (2009) apply to the assessment of the maximum price that an investor might pay to purchase a property, taking account of the benefits the specific investor will receive by holding it and his operational objectives. Market value means the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of the property, is available for the negotiation of the sale (Directive 91/674/EEC). Our recent investigation

has been implemented aimed to characterize the main conditions of innovation sensibility of farmers. The present study tries to focus on the analysis of valuation principles of agricultural property which are recommended to estimate the real significance of already existing investments.

MATERIAL AND METHODS

On the basis of European Valuation Standards and EU directives assessing the relevant results of our recent investigation dealt with agricultural entrepreneurs' sensibility for innovation some general advices have been formulated. Our database originates from the survey which has been made among farmers in South Great Plain Region in Hungary operating primarily medium- and large-scale agricultural enterprises. Small-scale farms or in other words family farms were intentionally underrepresented in the sample because the majority of innovation activities belong to larger companies. The work was based on primary data coming from the collected 265 questionnaires.

RESULTS AND DISCUSSION

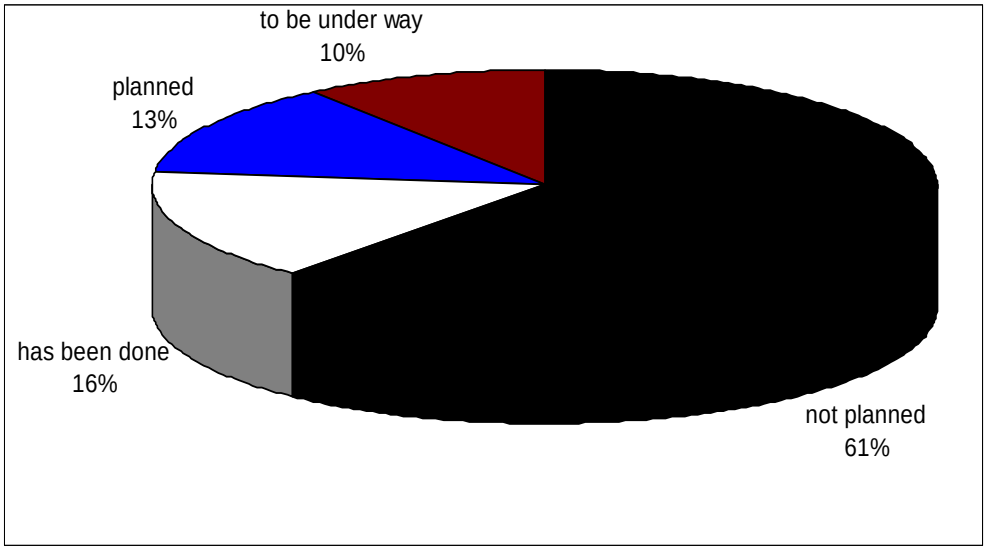


Figure 1 **Proportion of different investment stages at the farms surveyed**

Three different situations must be distinct in connection with investments. According to our results 39% of the surveyed companies are concerned in investments in total. There is 16% whose investment has already been implemented. Other 13% wants to carry out investments and 10% is just implementing a certain type of development (Figure 1).

Furthermore the types of investments planned also have been examined. It can be stated that the biggest segment of Figure 2 belongs to the expansion of land territory. Farmers want to raise their equity and liabilities almost to the same extent. Both 10% plans the purchasing of new estate and the improvement of soil.

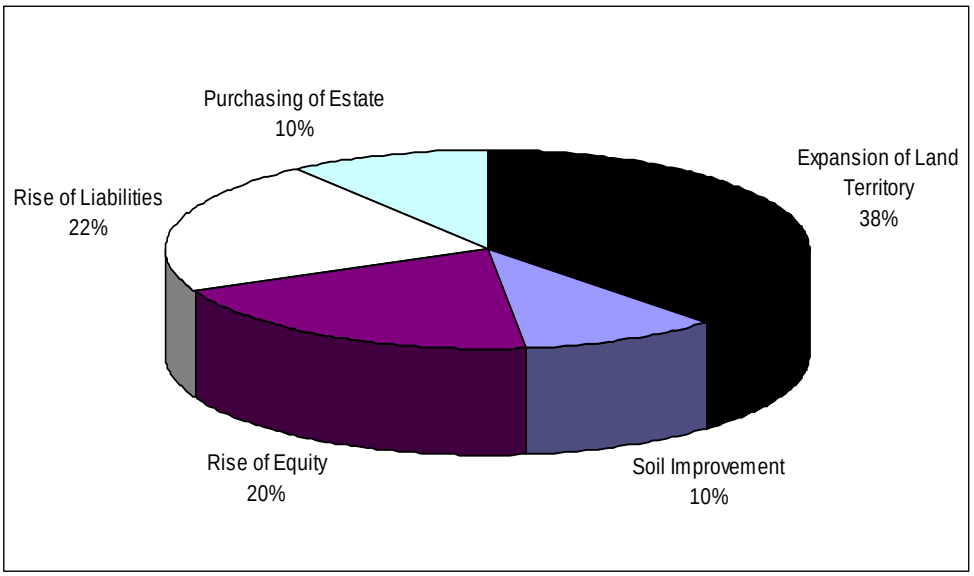


Figure 2 **Proportion of investments planned among farmers surveyed**

Analysing the fields of investments, which have already been implemented (Figure 3) it can be found that almost one third of the enterprises is willing to increase their own sources while less than 20% can undertake the rise of liabilities. Each fifth farmer has purchased some kind of agricultural estate while soil improvement and expansion of land territory have smaller significance (16% and 15%).

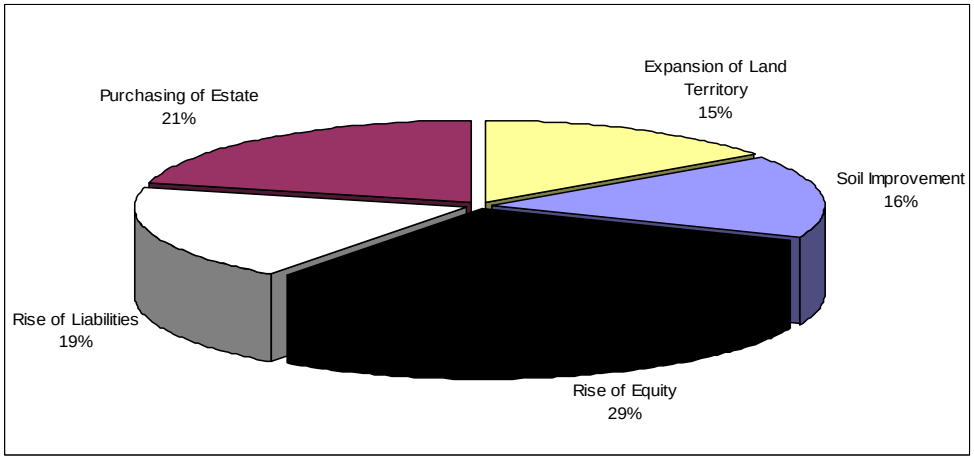


Figure 3 **Fields of investment have already been implemented at the farms surveyed**

The third possibility concerning investments is the different kind of developments being under way. This part can indicate farmers' intention for the future development directions and their financial capability for realization of them as well (Figure 4).

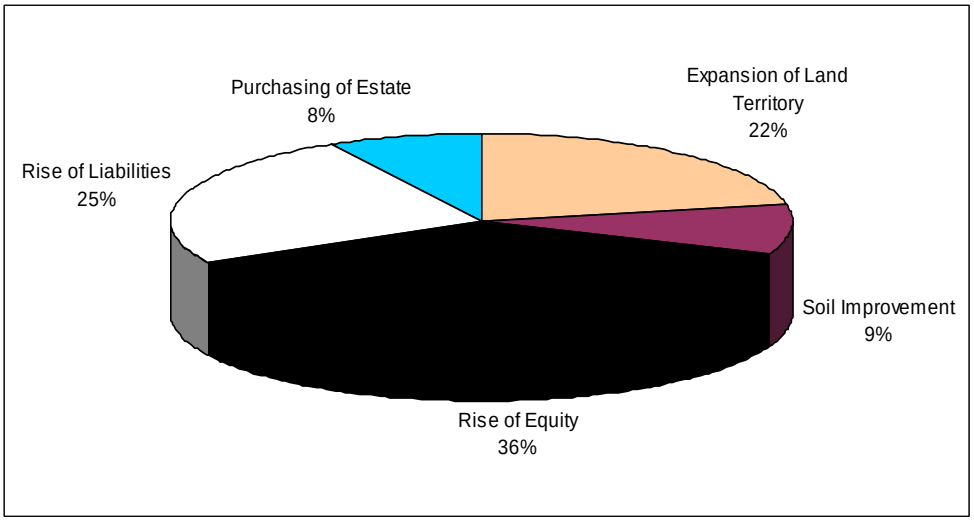


Figure 4 **The fields of investments being under way**

As it can be seen in the case of implemented investments entrepreneurs would like to increase their equity rather than their liabilities in this respect as well. Among the fields of investment expanding the land territory has the biggest importance with 22%, the proportion of purchasing of estate and soil improvement is roughly on the same level (Figure 4).

One of the most important owner interests is to know more or less exactly the value of these kinds of investments. The appraiser needs to obtain the following information from the investor:

- any specific characteristics of his enterprise or investment portfolio that will have any influence on the future cash flows generated by the real property that is being valued
- the investor's investment criteria (such as a target rate of return or the duration of the investment)
- lease contracts
- expected budgets for financial performance
- licences
- land register and cadastral documents
- maintenance costs and, also, usually from others, information as to:
- market data related to the property
- interest rates and expected changes
- potential for disposal of the property
- legal and development control issues affecting the property
- current and prospective inflation.

Investment properties can be assessed in three categories:

- properties held as investments for their performance as an asset for generating income or capital gains;
- properties which are in the course of development;
- properties held for future development.

Properties held as investments will normally include those where construction work has been completed and which are owned for the purpose of letting, producing a rental income. Sometimes, they may be held to produce an income from its direct use by the investor.

Properties in the course of development will include properties that have been acquired with vacant possession letting to a third party irrespective of whether works of repair or improvement are required. Apart

from properties where work is actually in progress, this category will also include any property where the start of work is imminent, all the appropriate consents and permits have been obtained and a building contract made.
Properties held for future development will include those acquired with the intention of redevelopment at some future date (with or without any other properties which have not yet been acquired) and which are not in either of the other two categories.

To assess investment value, the appraiser would usually use the Discounted Cash Flow (DCF) method or equivalent techniques. Cash flows and costs are to be estimated over the period that the investor is expected to hold the property, taking into account all factors that could affect them. Having assessed the income and costs with the risks for both, during the period when the property is to be held by the investor, the final item in the cash flow will be:

- for buildings held for leasing to third parties or for the investor's own use, the investor is expected to have a receipt on the final sale of the property, or
- if the property is to be held by the investor until the end of its useful life, an assessment of the future market value, less selling costs, of the underlying land at that date where there are sound reasons (rather than unsubstantiated expectation) to suppose that changes in circumstances will lead to a change in its value in the market place, or
- if the property is to be sold by the investor before the end of its useful life, an assessment of its expected market value at the date of the future sale less selling costs.

Where a property is being or will be developed, the appraiser will have to form a view as to the dates when permissions will be obtained, construction completed, the property let and the first rents achieved. Determination of the most suitable time for investment is outstandingly important. According to Wiltbank (2005) venture capital firms avoid investing too late, where equity prices are likely more in line with overall market expectations as the uncertainty surrounding the venture and its opportunity declines. The discount rate applied to future income and costs will be that chosen by the investor, reflecting his requirements.

Lending institutions rely on sound valuations not simply for obvious reasons of commercial prudence in lending but also under the rules following the Basel II agreement governing their credit structures (as applied to credit institutions in the EU by Directive 2006/48/EC).

CONCLUSIONS

Before an agricultural company starts to realize an investment besides the prospective calculations regarding its turnovers it also must be estimated how the development will affect the value of the existing and planned property. Based on European Valuation Standards in such cases when properties do not have real marketing estimation of prospective income generating capacity is highly recommended. In present investigation we can see that 38% of enterprises want to buy additional lands. They should apply DCF method to assess the market value originated by expected cash flows. The calculation basically depends on the duration of property utilization. The application of discussed methods can be crucial in some cases because the general prospective profitability of the activity, which the enterprise deals with and the specific income generating capacity at the given farm can be much more important in the determination of property value than their registered net value.

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