

## Objective Value and Subjective Value



**By Brian Madigan**

Sometimes these two distinct concepts are difficult to interpret. You might look at the concepts of fact and fiction for purposes of comparison. After a period of time, you might wonder which is fiction and which is fact.

So, let's start out with the concept of **objective value**. This is a **fact**. This is an arithmetical computation of the total costs of a real estate project or undertaking. All the costs are to be taken into consideration:

- Acquisition of the land
- Construction of the building
- Improvements to the land
- Financing costs and charges
- Carrying charges
- Legal fees and consulting expenses

Anything that is an actual cost should be added to one of those categories, since all costs are to be tabulated. This objective value is a fact. For example, it is a fact that the Skydome cost about \$680 million to build.

**Subjective value** is a little different. It is a perception. It is an **opinion**. It is a view of what the property is worth in the minds of the buyer and the seller. And, these two values could be quite far apart. Just because the Skydome cost \$680 million to build, doesn't mean that anyone is going to pay that much for it (perhaps, only the taxpayers).

The subjective decision about value is an opinion of what the property is worth at the present time and in the future to a buyer. So, you need to consider both the present use of the property as well as its future use. In the case of the Skydome, it's a sports entertainment facility and it should continue to be used for that purpose in the future. That's its "**highest and best use**".

Appraisers will use three distinct methods to value property:

- Cost approach
- Income approach
- Comparative sales approach

Obviously, the cost approach favours a fairly objective tabulation of costs. What did it actually cost to build? The income approach is based on the effective yield from the property. How much can you get for it in rent? And, comparative sales is based upon what other people have paid for similar properties.

An appraiser will use all three methods to come up with a value. It will be an opinion. So, in that sense, it is entirely subjective.

Let's go back to the Skydome example. On the basis of various valuations and the actual income that it would produce annually, the first purchaser paid about \$120 million. That seemed like a real "steal" since it cost \$680 million to build. However, the next purchaser paid \$27 million. This was an even better deal!

So, let me ask you, what's the Skydome worth? Easily, you could come up with three separate numbers:

- Cost approach.....\$680 million
- Income approach.....\$120 million
- Comparative sales approach.....\$27 million

As you can readily imagine, the original cost really has nothing to do with it anymore. With some reasonable degree of independence one might conclude that based on the income that can be generated annually by the Skydome, it would be fair to pay \$120 million. But, what about one more step in the process? Someone paid \$27 million, is that just a very good deal or is that what it's really worth? I don't think you'll ever see it on the market for that price!

Objective value starts out as a fact. Then, once you know it, that doesn't matter anymore. At this point, two different views of the perceived value take over, in the minds of the buyer and the seller.

**Real property valuation** is much more of an "art" than a science.

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