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IMPACT OF THE COVID-19 PANDEMIC ON COMMERCIAL REAL ESTATE VALUATION IN KAZAKHSTAN

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ABSTRACT

COVID-19 pandemic has disrupted many industries around the world. Economic turbulence caused by the outbreak has a significant impact on global real estate valuations (Weir & Grönloh, 2020). The study aims to explore changes in commercial property valuation caused by economic uncertainty during the COVID-19 pandemic.

This impact will be even more apparent in for the commercial property due to the lockdown and social distancing measures. The global financial crisis of 2008 significantly decreased commercial property values (Jones et al., 2018). As for COVID-19 crisis, commercial property sectors (lodging, retail, multifamily, industrial, and office) will experience sector-unique challenges caused by the outbreak (Hendry, 2020; Schellekens et al., 2020). For instance, real estate assets with significant human density (shopping malls, student housing, healthcare facilities, lodging) face the bigger damage than self-storage facilities and industrial facilities (Gujral et al., 2020).

Recent reports from Kazakhstan reflect this trend. According to KMPG (2020), real estate enterprises that run shopping malls and entertainment spaces have withdrawn their expansion plans till the industry recovery and investment in real estate is “frozen”. As a result, the value of a commercial property will be affected by the situation in a respective industry.

The present value of future cashflows reflects the value of a commercial property, that is calculated via (1) discounted cashflow approach (DCF) and (2) capitalisation approach (Schellekens et al., 2020). The former is calculated by “discounting (at an appropriate discount rate) explicit nominal future cashflows to inform value”, while the latter involves “capitalising normalised net maintainable cashflow at an appropriate capitalisation rate (or yield) to inform value” (Schellekens et al., 2020, p. 1).

Valuation of commercial real estate, as a result of economic uncertainty, becomes challenging and unpredictable. Appraisal of commercial real estate was not an easy task even prior to pandemics (Hendry, 2020; Klamer et al., 2018). In this case, novel coronavirus will become “an exceptional factor” that will affect all parties in a transaction (Hendry, 2020). The valuation processes evolve from predictions of more or less certain events in the future (Morri & Benedetto, 2019). As income in commercial real estate is shaped by the business cycle, there are considerable fluctuations in price in the market that can lead to a crisis (Olszewski, 2013).

If the global economy slows down, breakdowns in the commercial real estate will likely to occur (Olszewski, 2013). COVID-19 disrupts the current business cycles, for instance, when tenants cannot pay the lease to investors due to the closure of offices and retail spaces. This poses additional challenges for valuers, who deal with rapidly changing market in the time of COVID-19 due to cashflow uncertainty (Schellekens et al., 2020). Therefore, it is important to reveal how valuers conduct commercial real estate appraisal during the current pandemics.

Literature Review

Valuation aims to provide the estimate of the asset value and involves analyzing the equivalence between a property to be valued and the unit of measurement in terms of money in certain conditions and timeframe (Morri & Benedetto, 2019, p. 3). This judgement often occurs in complex and uncontrolled environment, while real estate valuers navigate ambiguous information, clients' interest in commercial gains, and intransparent market place (Klamer et al., 2018, p. 209). One can hypothesize that the current pandemic will increase the complexity of validation and affect commercial property values.

There is a lack of consensus over the efficient approach for a property appraisal, thus, minimizing the margin errors and reinforcing the property valuation requires justification and reasoning (Morri & Benedetto, 2019). Commercial property appraisal is critical for transfer purposes, financing transactions, tax compliance, investment decisions among others. (Morri & Benedetto, 2019, p. 2). Inaccurate appraisal can threaten the future of the property market resulting in uneven distribution of resources and distortions in the industry (Adegoke, 2016). Moreover, valuation complexity can be situational and prompt valuers to develop different coping strategies (Klamer et al. 2018).

It is important to investigate commercial property valuation at the time of COVID-19 following the lessons learned from previous global crises. More specifically, real estate markets affected significantly the most of global financial crises (Moya, 2016). The financial crises drew attention to property valuation because many of them stemmed from property related transactions (Gilbertson & Preston, as cited in Adegoke, 2016, p. 277). Historically, commercial property has been posing direct risks to financial institutions more than housing and mortgage due to risky construction and development and weak incentives for borrowers (Ellis & Naughtin, 2010, p. 25). In light of COVID-19 disturbance, it is particularly important to address valuation of commercial property as it has been hit the most compared to residential housing, partially owing to construction lags (KPMG, 2020).

As there is no single approach to property valuation, the expertise of a valuator and his or her judgement are instrumental. The problem-solving practice in commercial property valuation develops via knowledge, cognition, collaboration, and professional practice (Amidu & Boyd, 2018). Research also shows that valuation practices also differ based on the mode of employment of valuers. When facing the task complexity, SME valuers, self-employed valuers, and valuers from large organizations develop different coping strategies, for instance, refraining from client contact or arranging for client meetings for valuation instructions (Klamer et al., 2018, p.227). Prior to Amidu and Boyd's (2018) finding on the importance of expert knowledge, Sah et al. (2010) also revealed that experts conducted more cross-checking before making the investment choice compared to novices. More specifically, skills, judgement, crucial data, and valuation methods affect valuation variance and inaccuracy (Adegoke, 2016, p. 20).

Studies above seem to address evaluation practices conducted not in crisis times with the focus on behavior of valuers. Also, given the importance of situational and environmental factors (Klamer et al. 2018), there is need to investigate research on valuation practices across different specialties (Amidu & Boyd, 2018). This pandemic disruption will challenge compliance with date of valuation, willing buyer and willing seller, proper marketing, and knowledgeable, prudent and non-compulsive behavior of each party (Schellekens et al., 2020). It is forecasted that there will be high valuation uncertainty and more downside value estimation errors (Schellekens et al., 2020). Similarly, Weir and Grönloh (2020) urge companies to question and comprehend how valuers deal with current uncertainties. As a result, valuers need to provide thorough enhanced disclosures and report how the valuation was performed with attention to factors involved (Weir & Grönloh, 2020). Therefore, the study will address evaluation practices during the COVID-19-related crisis among different sectors of commercial industry. As commercial real estate valuation depends on market value that is subject to constant changes because of the pandemic, the study will focus on how valuers adjust their valuation processes to COVID-19 turbulence.

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