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The Influence of Real Estate Enterprise Information Disclosure on its Asset Value under the Income Method

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Abstract

As the real estate industry is one of the important industries in China, the asset valuation of real estate enterprises is gaining more and more attention. This article examines the impact of information disclosure by real estate enterprises on their asset valuation under the income method, and also suggests that enterprises should pay attention to information disclosure in order to obtain more accurate asset values.

Keywords

Income Approach; Real Estate Companies; Asset Valuation; Information Disclosure.

1. Research Background

1.1. Real Estate Enterprise

A real estate enterprise is an economic organization that engages in real estate development, operation, management and service activities, and operates independently for profit and accounts for itself. Its main assets are real estate, i.e., land, buildings and the inseparable parts of land and buildings and the various interests attached to them.

1.2. Adopting the Income Approach to Asset Valuation

The income approach to asset valuation is a general term for various valuation methods that determine the value of an asset by estimating the expected future earnings of the asset under valuation and converting them to present value. It is one of the more scientific and reasonable valuation methods in asset valuation and one of the most commonly used tools in real estate valuation.

The income approach has three prerequisites. Firstly, the expected future income of the asset being valued can be predicted and measured in monetary terms. Secondly, the risk borne by the owner of the asset in obtaining the expected income can also be predicted and measured in monetary terms. Finally, the profit life of the asset being valued can be predicted. For real estate, it is generally applicable to the valuation of real estate with income and not applicable to public places such as government offices, hospitals, schools, etc. Therefore, this paper selects real estate of real estate enterprises for asset valuation under the income approach. On this basis there are three other important parameters in the income approach, namely the amount of return, the discount rate and the period of return, which obtain a basic formula regarding the income approach under the income approach

$$P=\sum Ri/(1+r)^i$$

Among them, P is the value of the assessed asset, Ri is the expected annual return, r is the discount rate, and i is the income period. The basic formula has different specific calculation formulas according to the actual changes in the amount of income.

2. The Impact of Disclosure by Real Estate Companies on Property Valuation under the Income Method

2.1. The Formula for Valuing the Assets of a Real Estate Business under the Income Approach

The formula for calculating the value of a property under the income approach is

$$\text{Real estate values} = \text{Net real estate income} * (P/A, r, n)$$
$$= \text{Net real estate income} * \{[1-1/(1+r)\,\hat{}\,n]/r\}$$

The net real estate income is the objective net income of the property after all expenses have been removed, which can be calculated by subtracting the objective gross expenses from the objective gross income. Objective gross income is all the income received by the property being valued during the year. Objective gross costs are the normal expenses that must be incurred to generate gross income. (P/A, r, n) is the common annuity present value factor, where r is the capitalization rate or discount rate and n is the number of years.

2.2. Factors Influencing Real Estate Valuation

The main influencing factors of real estate valuation are the net real estate income and the capitalization rate (discount rate). Therefore, the next part of this paper will analyze the impact of information disclosure by real estate companies on these two factors separately.

2.2.1. Impact of Information Disclosure on Net Real Estate Income

2.2.1.1 Impact on the Objective Gross Income of the Property

Net real estate income depends primarily on objective gross income and objective gross costs. Objective gross revenue is the revenue obtained after excluding special and contingent factors in revenue. It is generally the product of the revenue level of similar local properties and the area rented or sold. It also has a certain relationship with the vacancy rate of housing. Ren Zeping once made a summary of the factors influencing real estate prices, "house prices look at finance in the short term, land in the medium term and population in the long term". In fact, the basic principle behind this statement is Fisher's transaction equation M*V=P*Y. The money supply M, the velocity of money circulation V and total output Y all have an impact on the price level [1]. Macroeconomic conditions and political reasons are less influenced by the disclosure of information by individual firms. Therefore, the next analysis will look at social, consumer psychology and regional factors of real estate to find the impact of disclosure on these important factors of real estate prices.

(1) Impact of information disclosure on society

Corporate disclosure can reflect the macro social environment of the area, in particular the security of the community, i.e. the security of property in relation to real estate transactions. The most obvious vehicle for the disclosure of information about real estate companies is the real estate information contained in interim corporate planning reports. For example, a real estate advertisement that advertises "one shop for three generations, commercial and residential investment" reflects that local social security is guaranteed. It also reflects that the house can be passed on safely for a long time [2]. In addition, the property management of the real estate project is well organized and the overall social environment is better. For example, the advertisement of a property says: "Gold medal property - health housekeeping - experience the soundness of sports and leisure, and take care of health." These disclosures through advertising indicate the social environment in which the property is located. A better social environment makes consumers more willing to buy, which can reduce the vacancy rate of a property and increase its unit price.

(2) The impact of information disclosure on consumer psychology

Consumer buying behavior is largely influenced by the individual psychological environment. Personal psychology also has a direct impact on real estate market sales [3]. The preference for well-known real estate companies to purchase real estate is influenced by the company's ability to operate and the level of operations of the real estate company in question. Better company performance and industry position will show people the strength of the company and reduce the risk of purchasing real estate. Companies will therefore selectively disclose information that will help build a good image of the company and increase consumer trust, thus achieving a better revenue profile.

(3) The impact of information disclosure on property location

Many real estate companies promote the concept of the "XX New Town" in their own disclosures. By disclosing their large-scale real estate construction plans, they attract a change in the location of nearby properties. The construction of a new city as an independent city requires a more integrated urban function. The development pattern of independent new cities is driven by the overall renewal of the industrial system, which promotes the overall construction of the population's work and life [4]. Therefore, the disclosure of information by real estate companies in this regard will attract industries related to commerce, transportation, public infrastructure and urban construction, which can improve the local location disadvantages and thus create better location conditions to attract consumers

2.2.1.2 Impact on the Objective Gross Costs of the Property

The total objective costs of real estate mainly consist of real estate construction costs, financing costs, management costs, maintenance costs insurance costs and other related taxes and fees. These costs are mainly affected by the level of local economic development and prices, etc. The level of economic development is determined by the objective level of development of a region which is less relevant to the disclosure of information by enterprises. Therefore, the next step will be to analyse the financing costs and related manufacturing costs of the enterprise.

(1) The impact of information disclosure on the cost of financing for real estate companies

Financing costs are the costs incurred in raising capital, such as the interest that needs to be paid. Positive disclosure of environmental information as a strategic act can make investors believe that a company has good prospects for growth. It can thus bring positive economic benefits to the company. Corporate environmental information disclosure not only improves the public's positive judgement of the business situation and eliminates public concerns about the environmental risks of a company, but also reduces the cost of equity capital and the cost of debt financing for the company. Thus, it helps enterprises to obtain lower-cost capital relatively easily [5].

(2) Impact of information disclosure on related manufacturing costs

Information disclosure can build a good corporate image, help companies to occupy a market position and win more partners. patten et al. (1991) argue that laws have a positive effect on corporate disclosure of social responsibility information. Corinne Cortese (2017) argues that the quality of social responsibility information disclosure is beneficial to the company's reputation [6]. Improving a company's reputation and building a good corporate image helps the company to gain the trust of other companies such as building materials, construction teams to establish long-term cooperation with them. To a certain extent, it can reduce raw material costs and labor costs. In addition, information disclosure can increase information transparency and reduce additional expenses caused by information asymmetry. According to Dan (2014), the higher the transparency of information, the lower the cost of doing business and the better the level of performance of the company [7]. It can be seen that an increased level of information disclosure can significantly reduce manufacturing costs and bring more profits to the company.

2.2.2 Impact of Information Disclosure on Capitalization Rates

The capitalization rate is the discount rate. According to the findings of Zhu Menglan (2020), the discount rate is mainly influenced by the average level of market returns, economic growth, inflation, industrial policy and monetary policy [8]. These are all determined by macroeconomic policies and the economic environment. Therefore, the behavior of individual real estate companies does not have a significant impact. This paper does not specifically discuss the impact of information disclosure on the capitalization rate (discount rate).

3 Conclusion

Overall, information disclosure has an impact on the valuation of real estate assets under the income approach. This is mainly in terms of the impact on the objective total revenue and objective total cost of real estate. By demonstrating their good business capability and corporate status through specific information disclosure, companies can reduce vacancy rates, increase objective gross real estate income and reduce objective gross real estate expenses, which result in higher net real estate income. Better asset valuation results will therefore be obtained. In addition, in Zhu (2021)'s study, the improvement of the technical level of real estate appraisal and the accuracy of appraisal results relies heavily on the reasonableness and accuracy of appraisal parameters. It is crucial to continuously enrich, update and improve the data support system serving the selection of relevant parameters in appraisal. Therefore, it is also important to select reasonable information for asset valuation of real estate. There is a need to further improve the quality of information disclosed by companies to strive for more accurate valuations.

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