BATTLING BANK VALUATIONS

A low bank valuation can retard your ability to add to your investment property portfolio. So what do you need to know about the valuation process to minimise the risk of a low appraisal?

story STUART WEMYSS

What is value and how is it determined? 'Fair market value' is defined as a value at which a property can change hands between a willing and knowledgeable buyer and a willing and knowledgeable seller who are under no compulsion to buy or sell. This means there's no time limit to buy or sell a property. However, the definition of 'value' that banks use will often vary from 'fair market value'. Most banks would prefer a measure of value that reflects the price that would be achieved within a certain period of time, say two months (more on this later).

In undertaking a valuation, most valuers would look for evidence to support their estimate of value.

The valuer would search for completed sales of comparable properties. The property market can be quite dynamic, so the comparable sales would need to have been completed recently, say within the past six months at most. Older sales may no longer provide good evidence of current value.

Valuers can't be influenced by properties that are "on the market". They can only take into account completed sales (i.e. an unconditional sale). When determining if the other properties are comparable to the subject property, the valuer will consider things like location, size of land, size and condition of property, any special features, and so forth.

Two properties are rarely identical, so there's a fair bit of subjectivity in property valuations. In fact, valuations should probably be expressed as a range (for example, value of $300,000 to $330,000) rather than as one figure. Bank valuations generally have an error tolerance range of plus or minus 10 per cent.

Often, valuers have defined geographical areas of responsibilities, so they may (or should) have a good knowledge of the local market. A valuer will normally spend the whole day driving from property to property, taking notes and photos of each subject property. At the end of the day the valuer will return to the office to complete their comparable sales research and to write up their reports. A valuer may have to complete many valuations in one day, so they normally don't spend too much time at each property.

VALUATION TYPES

There are three common types of valuations:

➤ Full – a full valuation involves the valuer undertaking a full inspection of the property, including an internal inspection. This will also normally involve the valuer taking measurements of the land and the internal living area. The valuer may also take internal photos.

➤ Kerbside – a kerbside valuation involves the valuer driving past the subject property but doesn't require the valuer to undertake an internal inspection.

➤ Desktop – a desktop valuation involves a valuer collecting comparable sales data based on a description of the subject property (eg. size of land, bedrooms, etc). This valuation doesn't require any physical inspection or sighting of the subject property.

Sometimes valuations are undertaken by bank staff.

BANK VALUATION POLICIES

The banks are always trying to save money, so they won't always order a full valuation of your property. Generally, if you're purchasing a property for less than $500,000 (depending on the area) and you're borrowing less than 80 per cent, a bank won't perform a valuation. If you're refinancing a loan to a new lender, then a valuation will normally be required.

The valuation type will depend on the proportion of the property's value you're borrowing. If you're only borrowing 50 per cent, then it's likely that the bank will only rely on a desktop valuation. However, almost all loan applications that involve mortgage insurance (which is generally required if you're borrowing more than 80 per cent) will call for a full valuation.

All lenders will have a list of approved valuers. These valuers may vary based on location. For a bank to accept a valuation, it must be completed by one of the bank's panel valuers. The report must state which lender will be using the valuation and whether it will be used for first mortgage purposes.

Not all lenders will accept a valuation that you've commissioned and paid for, even if it meets with the above criteria. Some lenders will still insist on paying for their own valuation.

Most lenders impose a time restriction on property revaluations. Many lenders like to restrict the amount of revaluations because they don't like to track the market too closely. The reason is that if the market dips, they don't come knocking on your door asking for some of the money back.

Most lenders would prefer not to revalue properties more often than once every 12 months. However, if there's a specific reason why the value of a property has altered, for example if you've completed some renovations, then most banks will be open to revaluing the property.

LOW VALUATIONS

There are lots of reasons why low valuations might occur, including:

➤ The borrower has an unrealistic idea of what their property is worth. There's a difference between the best price on the best day and a bank valuation. Obviously, we all want to maximise the value of our property. Bank valuations are always likely to be towards the lower end of the valuation range, while owners' estimates are sometimes towards the higher end of the range.

➤ There are very few comparable sales to assist the valuer in their estimate. If there haven't been many recent sales of comparable properties, it's likely the valuer will be more conservative with their valuation estimate. This can be a real problem. Intuitively, the valuer might think the property is worth more, but unless they have the sales to back themselves up, you'll find they'll err on the conservative side. They don't want to stick their neck out too far, because if they get sued by the lender and they don't have any evidence to support their valuation, then they could be in real trouble.

➤ The average time taken to sell a property could be too long. In some country areas, it can take three to six months to sell a property. However, in the city it would normally take four to six weeks. A lender won't want to wait six months to sell a property, so they'll want a valuer to provide a valuation which reflects a quicker sales period (maybe four to eight weeks). Obviously, that will result in a lower valuation.

➤ A poor valuation. Valuation firms are under real pressure. Lenders are constantly demanding quicker valuations for less cost, due to pressure by customers. This could result in some poor quality valuations. Valuers might find themselves in a situation where they could be doing an unrealistic number of valuations in one day to meet agreed service standard requirements. This may result in a valuer not committing the time required to prepare a professional and considered valuation. The valuation industry might not want to think this happens, but it does. Earlier this year, we requested the same firm to revise its initial valuation. The revised valuation came in $700,000 higher than the initial estimate. The initial valuation was clearly undervalued and poorly prepared. That said, I must admit that poor valuations are in the minority.

WHAT CAN YOU DO?

There are a few things you can do to avoid a valuation coming in below your expectations.

The most important thing to do is some research into comparable sales. A good start is to talk with some local real estate agents. You should be mindful that most real estate agents will overvalue your property (i.e. they will give you the "best price on the best day" valuation). In addition, they may cite sales of comparable properties that are in fact not comparable.

In my experience, information provided by real estate agents only gets you halfway. You should then drive by some of the comparable properties to ensure they're actually comparable. This will provide you with a good feeling for what your property's worth. It will also make sure your expectations are in line with the current marketplace.

You could commission your own valuation. Residential valuations normally cost around $400 to $500.

It would be good to choose a panel valuer, tell the valuer which bank you'll be using and that the valuation will be used for mortgage purposes. The benefit of doing this is that you have control of the valuation process – you can speak directly with the valuer and meet them at the property.

Sometimes the bank will still order its own valuations. However, you can be reasonably sure that if they use the same valuer, the report will reach the same conclusion.

When estimating the value of your properties on a lender application form, you should provide a high estimate. You don't want to go too high, because the valuer or lender is likely to totally ignore your estimate. However, there's no point in going too low either.

It would be wise to think about valuation issues prior to selecting an investment property. If your strategy is to purchase property, wait for the property to appreciate in value and then use the equity to purchase another property, then you should consider the likelihood of future valuation problems. For example, a unique property is often good because it creates scarcity value. However, it will be difficult for a valuer to obtain comparable sales. This may then result in a conservative valuation.

Some properties will benefit from a full valuation, particularly if the property is in good condition inside or has been recently renovated. However, sometimes you'll be better off with a kerbside valuation if the property is in poor condition inside because obviously the valuer won't see the inside.

Sometimes, borrowers might manipulate a lender to order a certain valuation. For example, if you want the lender to order a full valuation, you might apply to borrow more than 80 per cent of the property's value (remember, lenders will generally order a full valuation if the application involves mortgage insurance). Once the valuation is completed, the borrower can adjust the loan amount down to 80 per cent. That's one way to get the valuation you want if initial requests for a full valuation are declined.

If you consider the valuation to be low, you could challenge it. To do that, you need to provide the lender (who in turn approaches the valuer) with new evidence to support your estimate of value.

There may be comparable sales that have occurred which the valuer isn't aware of. You could save time by asking the lender to give you a list of comparable sales the valuer used. You can check them to ensure they are in fact comparable. You really have little chance of changing a valuation if you don't have some new evidence that the valuer hasn't considered. Another option is to ask the lender to order another valuation. Some lenders won't do this because they don't want to be seen to be "shopping around" to find the right valuation. That might be seen to be a little contrived. However, some lenders will order a second valuation, more than likely at the borrower's cost.

The last option is to consider using a different lender. It's possible a different lender might use a different valuer or be less conservative with their valuations.

SHOULD YOU BE INFLUENCED BY THE VALUATION?

If you're buying a property and your lender values a property for less than what you've agreed to pay, should you withdraw from the contract or offer?

One school of thought is that the bank valuations are sometimes ultra conservative and should be ignored. Personally, if the bank ever valued a property lower than the proposed purchase price, I'd want to see some strong evidence as to why I should ignore that valuation and continue with the purchase.

There are many properties to buy in Australia. Why should I risk overpaying?

I can tell you that in the hundreds of applications I've been involved in, less than five have had the valuations come in low. That indicates that if you get a low valuation, warning bells should be ringing. Perhaps you might be able to use a lower bank valuation as a negotiation tool. You could tell the agent you're withdrawing from the purchase unless the vendor reduces the price.

I've experienced an increase in valuation issues in the past six months. I'm not sure why. Perhaps valuers are concerned about the property market. Maybe there are fewer sales and therefore less evidence. Maybe I've had a run of bad luck. Whatever the case, it doesn't hurt to know a bit more about the valuation process.

Remember, market research is the key. ■

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