Owners and banks differ on property valuations

There is often a serious disconnect between what a property owner thinks their property is worth and how it will be valued by lenders. Understanding the difference can save time and frustration when looking to raise capital against properties.

Gary Palmer, CEO of independent lender, Paragon Lending Solutions examines the growing valuation disconnect.

The current economic climate is exacerbating the skewed perception of property valuations. The uncertainty around interest rates, a zero growth rate and consumer pressures are taking their toll. These pressures are also shifting the supply in the property market, as skittish investors look for ways to become more liquid and move their money offshore.

Banks are seeing evidence of this distress in their books. As a result, valuers working for the traditional financial institutions are becoming more cautious.

This is often at direct odds with property owners who have an overinflated view of what their property is worth.

Property valuers who work with us have confirmed this. They believe that at least 50 percent of the time, clients think their properties are worth way more than what is considered market related. Sales stats also back this up with price variances (between asking price and selling price) generally between 40 and 50 percent.

Another exacerbating factor creeps in when properties are run as businesses. Specific purposes such as student accommodation or short-term office rentals, storage or short-term industrial rentals, and even AirBnB businesses, can inflate the value in the mind of the owner.

By way of example: A client who runs a short-term office rental business may be letting out space at R220 per square metre as opposed to the average R100 per square metre in the same block or building. They would naturally estimate the value of their property based on their income. When they come to us looking to raise money against that property they are often devastated when the valuer comes back with a number half of what they expected. However, the valuer will cap the number based on what would happen should the property be sold for what it was intended - occupancy - rather than as a business.

The same applies to student accommodation, where the business operation delivers far more return than what it would if it were to be sold for traditional occupancy.

People have been getting creative with their properties to maximize return.

AirBnB is a good example of this. Owners may be leasing out their R2 million property at R1500 per day. By their calculations this would value the property at R3.5 million as a going concern. The property valuations wouldn’t come anywhere near that as the valuer would assume a vacant property and not a short-term enterprise.

Things are no different when it comes to commercial property. Although many commercial property owners have solid long-term leases in place, these may be slightly higher than the market related prices in the area. Again, this will result in a lower than expected valuation.

Similarly, municipal valuations are not realistic benchmarks. These are based purely on the size of erf, the size of the structure, and the median sale price in the area.

It’s important for people looking to raise finance against their property to have a realistic idea of their property’s market value. While it may have all the potential to derive great returns as a going concern, lenders will look at the reality should they default on a loan - and this is always based on a valuation. Understanding that external market forces will come into play ensures you can realistically plan and budget for your future.

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