SLIPSTREAM AUSTRALIA

Understanding Valuation

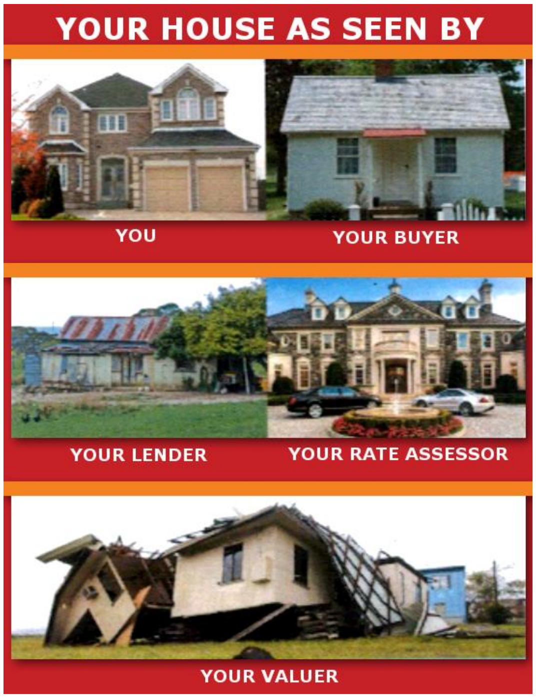
…and what it means to investor

When investing in property most people will obtain a loan from a bank or lending institution. The bank will use the property as security and will agree to lend a percentage of the value of the property, for example 80%or 90%. This is referred to as the Loan to Value Ratio (LVR).

As part of the loan approval process the bank will arrange fa-r a valuation to be conducted on your property. Now, most of us would assume that the purchase price is the 'value of the property - after all, it has been set by market forces and is a true representation of what the market is willing to pay. The bank and its valuers do not necessarily see it this way.

Banks instruct valuers to take a very conservative approach to valuations. They use historical sales to determine value and typically only y look at comparable in a 1km radius. This can be a problem for new property that has no true comparable or property that is superior because of its location, size, finishes, amenities or design. In these cases, it is virtually impossible for a valuer to provide a true valuation as there will be clear lack of comparable sales.

Investors and valuers often have different opinions on property, and it is not surprising - they have different objectives, processes and mindsets. . .



INVESTORS

Are looking forward i.e. Investing based on the potential for growth

Are looking to buy at the bottom of the cycle as this provides the most opportunity for growth

Blue Wealth employs 3 full time staff to assess each project before it is approved. The average period of assessment is 6 weeks

Are investing for the medium to long term to create wealth for them and their families

VALUERS

Are looking forward' i.e. using historical sales to determine value

Tend to provide high valuations at the top of the market cycle (which is a dangerous time for investors to enter the market) and low valuations at the bottom of the cycle

Some valuations are done as a "desk top· valuation, where the valuer does not leave the office, and many are 'drive-bys' where the valuer does not get out of the car

Are doing a job with a short-term focus.

Since the GFC. they have been instructed to be extra conservative, and are under the threat of being sued by the banks

INVESTORS PROFIT FROM RESEARCH

Let's face it: investing in property is a big decision and a valuation shortfall can leave you questioning your decision. In 2003 a valuation shortfall tested the resolve of 18of our clients who were ready to buy house and land in Canning Vale, WA. The average purchase price was $280,000 for a 4-bedroom house and our research identified that this area had potential for healthy growth. The valuations came in 15-18%UNDER the purchase price. This had a financial and psychological impact on our clients. They were going to have to put more money into the transaction, and they were also doubting their decision...and to add to the 'fear' most of them had never been to Canning Vale!

THE RESULT

Eight of the clients pulled out of the investment. The other 10contributed more money (through savings or equity). Three years later their properties wereworth$470,000.

Yes, they had doubts back in 2003 but they followed the research and did not let the fear stop them and in the

space of three years their investment had almost doubled.

PREPARATION – THE KEY TO SUCCESS!

In 2010. 50 clients invested in an off- the-plan project called Eko, in Newington. It is a beautiful project located in one of Sydney's growth regions. This project settled in 2011and the apartments were consistently valuing at

5-6%below the purchase price...but EVERY client settled on the project. WHY? Because they were educated - they knew about the potential risk of a valuation shortfall and they prepared for it. But more importantly they were educated on the growth potential of the project.

They had read and understood our research and why we recommended the project, and the fact that they could borrow less money from the bank was not going to deter these investors!

SO, WHAT' S HAPPENED SINCE 2011

There have been no resales (as our investors are holding for the long term), however, they are receiving 5.2%rental yields - which makes this project very easy to hold - and for some investors it is actually cash flow positive.

SUBJECTIVE AND INCONSISTENT

Recently many of our clients invested in Australia Towers at Sydney Olympic Park. the first residential tower in the Olympic precinct so there truly were no comparable. This was highlighted when two brothers purchased identical apartments. off the plan, just one level apart. The purchase prices were $495,000 and $490,000.

At settlement, the more expensive apartment was valued at $450,000(a10% shortfall l), however. access to equity meant the ability to borrow less funds was not an issue. The second brother had a large investment portfolio, and thought this purchase may stretch his serviceability, so he on- sold the apartment for $585,000, which is a profit of $95,000!

This example is a clear indication of the difficulties faced by valuers and a reminder that the valuation is not necessarily the market value of the property.

WHAT DOES IT MEAN TO YOU

The valuations for most properties welcome near or on the purchase price, however. a valuation shortfall does not mean the bank won't lend you money to proceed with your investment it Just means they will lend you less.

For example, if your investment property was priced at $300,000 and the valuation came in at $290,000. the bank would now only lend you 80/90/95% of the lower valuation amount.

PLANNING AHEAD

Investing in property is about 'Knowing Your Numbers' and managing and preparing for potential risks.
If investing in property 'off- theophany should plan ahead so you can deal with potential valuation shortfall. Strategies include:

- Creating a financial buffer - either savings or equity that you can use if required.
- Do not wait until the last minute to apply for finance
  - in case you need to 'shop around'.
- Work with a good mortgage broker - you don't want to be locked into one lender.

VALUATION SHORTFALL - WH AT NOW!?!

If you are reading this document because you have just had a valuation come in short, don't panic. It is normal to feel stressed and doubt your decision - but the truth is these emotions aren't going to help you. At this time, it is important that you stay in touch with your mortgage broker and Blue Wealth and they will assist you through the process.

Remember, we will have many clients in the same project. so, we will be able to advise which banks are providing strong valuations and which ones to avoid.