# DO VALUATIONS ASSIST RESIDENTIAL PROPERTY INVESTORS PRIOR TO PURCHASE? AN INDUSTRY PERSPECTIVE

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**A survey of seven professions confirms support for the use of valuation advice by residential property investors and their investment advisers prior to purchase. The survey is in contrast to literature which raises doubts about the quality, format and information currently provided in valuation advice and its appropriateness and usefulness in serving the investment objectives of residential property investors.**

The Productivity Commission (2003) and the Reserve Bank of Australia (2003) have noted an increase in residential property investment with a 132 percent increase in the debt-to-asset ratio for residential investment property between 1992 and 2002. Residential property investment is largely a process driven by an investor's perceived understanding of their financial needs, their ability to select a suitable investment property and to pay a market price for a property.

The investment process commences with the decision to make an investment, followed by the decision of what to invest in. These options may include, shares, property, or a fund with exposure to a diversity of share or property investments, which may include a property trust. Investment advisers licensed through the Australian Securities and Investment Commission (ASIC) are in the best position and qualified to assist investors make the decision as to what investment best suites them.

In cases where direct residential property investment is determined to be the best investment, property investors are confronted with a number of key considerations. The two most important are, which property to invest in and the price that should be paid. In addressing these questions, Mangioni surveyed seven professions including property conveyancers, accountants, valuers, financial planners, real estate agents, buyer agents and mortgage lenders.

Despite the incorporation of residential investment property into retirement planning and as a means towards achieving financial independence, not all residential investment property is suited to the objectives of investors.

This issue is coupled with the price paid for some residential investment property which is in excess of its market and investment value. As the necessity increases for individuals to provide for their retirement, unstructured superannuation assets are being accrued through a variety of means, of which direct residential property investment is one.

## Caveat emptor and financial literacy

Despite the best efforts of regulators and consumer protection agencies, there is no substitute for common sense and business prudence. The imperative of obtaining advice in relation to property investment is weighed against the quality of advice provided by financial and investment advisers. In addition to consumer education in financial literacy, a major review of the qualifications and basis for granting investment adviser licenses in property-based products needs to be undertaken by regulators. Whilst the necessity for the consumer to engage common sense and recognise the importance of paying for advice exists, investment advisers and their motives in the advice they provide should be questioned at times.

Common sense cannot be attained through legislation; however, the creation of a framework for an investor to choose an independent adviser seems not to be beyond the capabilities of regulators, even if it is beyond their will. A further dimension in addressing the needs of residential investors is achieved through financial literacy. The ability to develop financial literacy skills cannot be achieved within one generation, and will need to commence at high school. At present, a financial literacy gap exists for many adult working Australians.

**Regulatory implications**

The provision of property investment advice, like investment advice for other financial products, has come under the scrutiny of ASIC. So significant is the impact of the quality and appropriateness of investment advice that a separate regulatory regime has identified its importance as a stand-alone profession. This thesis has identified two flaws relating to the regulation of investment advisers:

1. A holder of an investment adviser's license does not require the adviser to hold a qualification in the investment vehicle which is recommended to the client. Qualifications in property (valuation and agency), stockbroking and banking are construed as qualifications that dictate the process of the transaction only. The knowledge and experience attained in the course of conducting property-related services are not recognised to include the provision of advice relating to the merits of the investment itself. The missing requisite skill has been identified as the absence of client knowledge and focus by property professionals who are primarily asset focused, and has relegated the property professional to the role of a process service provider.

2. The ability of an investment adviser to take a commission from both client and the party to which they have recommended their client allows investment advisers to obtain double fees and commissions when making property investment recommendations. As was highlighted in the Westpoint case, consumers are still exposed to the moral hazard of double fees and commissions, which unduly cloud the judgement and role of the investment adviser.

The final regulatory matter addressed is unregulated property investment seminars and their use as a conduit for the sale of investment property. It is clearly evident that a regulatory distinction must be drawn between what may be marketed as a seminar, its purpose and objectives and its separation from the sale of property itself. The primary issue facing attendees of investment seminars is that their initial interest in attending the seminar is for information. In some cases this then begins to blur into the sales process and finally the purchasing of property itself. A practical solution for the approval and monitoring of property investment seminars conducted by non educational institutions is for approval to be sought from ASIC. ASIC may then seek the services of an appropriately qualified panel of experts to review the seminars. This would provide a level of quality control and rigor to the presentation and also allow the veracity of the material covered to be reviewed.

**Property investment and valuation advice**

In assisting property investors determine the value and purchase price of property, valuation has been proven to provide important information to investors.

Property valuation has evolved since early settlement of Australia from the alienation of land, its compulsory acquisition, rating and taxing and for mortgage lending purposes. The transformation of valuer from employee to contractor by lending institutions over the past two decades has been at the peril of the valuation profession as a whole  and greatly assisted by its primary master, mortgage-lending institutions. This has been further compounded by greater pressure being placed on valuers to write the value of property at the purchase price and the progressive erosion of valuation fees for mortgage-lending purposes. In the mortgage-lending domain, the valuation profession must consider the merits and risks associated with acting as a rubber stamp for writing loans for lending institutions.

Setting aside the specific issues of mortgage valuation work, and focusing on the valuation itself and the service, information and usefulness it provides an investor, the key issue and gap confronting the valuer is that valuations are property or asset-focused. From a consumer perspective, they fail in linking the specific attributes of a property to the specific investment objectives of the investor. The provision of a value, rental, rental return expressed as a yield and information pertaining to the growth prospects of a property are property-focused and generic to the performance of the asset itself. This does not suggest that information relating to the property is not important and, in cases where it is provided, does assist the investor in relation to specifics about the property. At present, a residential valuation by reference to past property transactions (direct comparison method) serves the purpose of providing a point-in-time value of a property, which does little to assist a prospective property investor who in many cases requires additional information about the property, including rental returns and their stability, growth prospects and what that value means and how it may be used, together with its limitations or parameters.

Trust, however, has been placed in the valuation profession by government and authors who understand and recognise the benefits of obtaining independent valuation advice. The ability for the valuation profession to live up to the expectations placed upon it lies within the means and at the will of the profession itself. The valuation profession will progress further when the valuation of property is tailored to meet the needs and objectives of property investors. It is the consumer who buys, sells, develops, invests, finances and transacts in property; the property itself is the commodity.

Central to the key issue is whether investment advisers provide valuation advice, or whether valuers provide property investment advice. The alternative is whether advisers and valuers can co-exist and consolidate their respective areas of expertise in serving the needs of residential property investors.

In the event of valuers and their advice being tailored to assist the property investor, a number of fundamental reforms are needed:

1. Educational standards within property courses to re-focus on the needs of the investor in the valuation of property being sought for investment purposes.

2. Industry practice guidelines that assist the valuer to understand the requirements of the investor who requires the valuation for the purposes of assessing the attributes of the property against their specific investment needs and objectives. Valuers would include an investment valuation, providing details of the return from an investment property as a secondary or check method of valuation.

3. A public awareness campaign highlighting the services and benefits of the property valuer and their present use by lending and other institutions for their protection; and the potential benefits available to investors when confronted with property investment decisions.

This research clearly demonstrates through survey results that valuations do assist residential property investors prior to purchase and that there is strong professional peer support for valuers and the use of valuations by residential property investors.

The valuation profession can be integrated within the investment process and the valuation profession has a significant role to contribute to residential property investors in formulating the purchase price of property.