Know your property valuation types to avoid being led astray

By Schalk van der Merwe

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Today's world is characterised by the availability of information, but with this easy access comes the risk of misinformation and disinformation sending DIY knowledge-seekers astray. The property industry is far from immune to the impact of incorrect or misleading information.

Image source: Gallo/Getty

In fact, one of the most vulnerable areas is also one of the most critical to property owners: valuations.

Most people are aware of the importance of keeping an up-to-date and accurate valuation of their properties on hand. This isn't just for sales purposes: it's also vital for things like monitoring investment growth, assessing the potential for improvements, and making sure you have adequate insurance coverage.

What very few people realise, however, is that there are actually different valuation types and methods designed to give the most useful feedback for each of these cases. Without understanding the difference between these valuations, it's easy to be misled into thinking your property is worth more or less than it actually is on the open market.

Market value

Market value is the most common valuation type, and the one most real estate agents provide to homeowners. It's an estimation of what a property can be expected to sell for on the open market if it were listed at that time.

It's important to understand that market valuations are an art as much as a science – for the most accurate results, you'll want to make sure your real estate agent isn't just using automated data. They also need to take their own in-the-field experience of current market activity into account and provide a well-substantiated document that clearly explains where your property fits into the sales landscape.

Replacement value

Like the name suggests, a property's replacement value is the amount it would cost to replace both the land and the building with materials of comparable quality. This is useful for getting an indication of market dynamics, but has little to do with the amount a seller can expect to get for their property in a sale (its market value).

When replacement value is much higher than market value – in other words, it would cost more to build a home than to buy an existing one of similar quality – it's a sign that the market is leaning in favour of the buyer. If replacement value becomes lower than market value, you can assume the opposite is true and market conditions are favouring sellers. At the moment, we're definitely experiencing the former with replacement values much higher than market values in most cases.

Insurance value

Insurance value is related to replacement value, but excludes the cost of the land, and includes demolition expenses. Essentially, it's what a property owner would need to pay if their home suffered a major fire, for example, and needed to be partially or fully demolished in order to be rebuilt.

This is a very important value to know to make sure you're adequately insured against a disaster, but again, it has nothing to do with market value, and cannot be considered a viable listing price.

Municipal value

Municipal valuations are the least useful – and least accurate – valuation type. Conducted by the local municipality, these valuations are entirely automated based on semi-recent sales statistics. They take none of a property's unique characteristics into account, and can be hundreds of thousands of rand off a realistic market value.

We highly recommend property owners have a market valuation done by their local real estate agent whenever their municipal valuations are updated. We've managed to save some of our clients thousands of rand in rates and taxes by helping them appeal inaccurate municipal valuations. I certainly wouldn't suggest basing listing prices off municipal figures unless you want to risk seriously under- or over-pricing your sale.

Indexed value

The last common valuation type a property owner may encounter is the indexed value. This is a very useful tool for assessing an investment's performance, but again, cannot be substituted for market value.

A property's indexed value is calculated by taking it's most recent sales price – what it cost its current owners when they bought it – and then adding the average property inflation to that for each year until the present. This shows what that property would be worth if it had experienced average price growth over that time. It can then be compared to a current market valuation to see whether the property has matched, over-, or under-performed the market.

Know the difference

While all of these valuation types have an important role to play for property owners, knowing the difference is equally vital.

A good real estate agent will not only be able to provide any of these valuation types, they will also make sure you fully understand their different applications. If you’re ever in doubt and your agent isn’t forthcoming with an explanation, you may want to question their motives and consider finding a new real estate partner.

ABOUT THE AUTHOR

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