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THE VALUATION PROBLEMS CREATED BY THE SECTIONAL TITLES ACT

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Much has been written on the subject of Sectional Title, Condominiums Cluster Housing, Duplex Development, all basically to attempt to clarify the many facets of ownership of a living unit, albeit a flat on a 10th floor or a unit with definite contact with mother earth. The advantages and pitfalls have been fully aired at symposia and by articles. The man in the street is being bombarded with attractive advertising media - own your own flat or duplex etc. - but one facet has remained undiscussed and neglected. To my mind a most important aspect - namely "how do you value the beast?"

Sectional Title was considered by the authorities because of the high cost of housing and it was thought that the "Sectional Title" exercise would alleviate the housing problem by providing housing via the ownership of a "unit" of property, which in theory should be cheaper to buy or produce than the traditional home. This principle has been proved overseas and it is possible in most countries to purchase an apartment or unit at a lesser price than a house, but alas in South Africa the trend appears to be just the opposite. What started off as a solution to the housing problem has now degnerated into a society trend, namely, own your own unit but at a price, in most cases higher in cost than the equivalent accommodation house-wise. In fact, most developments appear to be designed to cater for the well-to-do. To get back to the basic question of valuation, the Act states that the development shall be valued as though a building on a single piece of land and that is where the problem starts.

Let us take a valuation for Rating purposes - most Rating Ordinance's require a land value, presumably at market value and an improvement value, in the Transvaal at market value via the "income approach" and in other provinces at replacement cost depreciated.

In the Transvaal the correct approach is to value the land "as though vacant." The improvement value should be the "building residual" or what is left after the land value has been deducted from a capitalized net income. It is my view that of the two components of value, namely "land" and "improvements" only land has an intrinsic or reasonably constant value. The variable component being the improvement value which is dependent on income and the viability of the building.

Now, for the Transvaal problem number one! The Rating Ordinance No. 20 of 1933, as amended, requires land to be valued at market value "as though vacant" - no problem at all - but when you come to the improvements the Transvaal Ordinance states: "the improvements are the "added value" but the value of such improvements should not exceed what it would reasonalby cost to replace such improvements."

In most cases if you multilpy the number of units by the selling or asking price a value is achieved which exceeds reasonable replacement cost even if a pro-rata allowance is made for the common property i.e. land, swimming pools, lifts, tennis courts etc. What is the value of such improvements? - what it would reasonably cost to replace or a figure 'guesstimated' as a value of a unit which if multiplied by the number of units exceeds reasonable replacement cost? Even if the market responded and resales were constant or even higher per unit, this market evidence could not be used because of its not having any solid basis for value.

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It is ludicrous to envisage a situation where a building is being sold off piece by piece, the total selling price bing much nigher than it would take to reproduce a similar development next door. There is one obvious solution - increase your land value to make up the difference between reality and pure explortation, this would mean higher taxes and even higher selling prices to make up the increase.

I can see the situation arising where owners of units will object to improvement values being too low via the Body Corporate having resale in mind and an objection to land values, having pro-rata rates in mind. This group of objectors will add to rent-controlled property owners who object similarly but with a different motive, namely to increase improvement values for a higher rental determination.

However, there are problems with the theory of jacking-up land to make up the deficit because there is no justification from the market via vacant land sales of property with similar rights.

Municipal Valuations will have to reflect what is implied in the various Rating Ordinances, namely "Replacement Cost Depreciated" for the improvement value and a land value as thogh vacant for Natal, the Cape Province and the Free State, and "market value" in terms of viability in the Transvaal, namely land as though vacant (at market value) with the improvement value the residual variable in terms of viability of rental potential. Initially there will be "hybrid" properties with some units sold and others let, in this hybrid phase the improvement value will be based on the rental pattern of the unsold units but when all the units are sold the improvement value ceiling will be the "added value" which should not exceed what it would reasonably cost to replace all the improvements, taking into account factors such as the reaction of the market on resale and viability.

As regards value for purposes other than rating, various methods have been suggested and are commented on as follows :

1. <u>MARKET VALUE</u> :

This glib phrase is used completely out of context. A market value implies a market action and "subsequent" action to the availability of a marketable object. In other words the market value will only become a trend pattern after the units have been resold or offered for sale whereupon a trend will appear. The initial sales do not constitute a market value - for a market value to become a market value it must have a history of transactions over a period of time. From some of the first time selling prices advertised it is certain that difficulty will be encountered to "break-even" on resale and a downward price is envisaged.

2. <u>REPLACEMENT COST</u> :

This phase is used but must be treated with caution. A 20 year old building should not be valued at current building costs unless such costs are objectively depreciated. In some of the developments on the market prices asked are out of all proportions in respect of replacement cost and in some brand-new developments this aspect is even more evident. The prices asked are much higher than current replacement cost. This method can provide a basis for value but again only the resale action will provide a trend.

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It is evident that less should be paid for a sectional unit than would be paid for a similar amenity in the conventional dwelling, and this would become a comparative criteria.

3. RENTAL VALUE:

The Rental Value approached implies a viability assessment. What rentals must be used? The rental of a similar flat let but not sold, or the amount charged for monthly bond redemption after the payment of a deposit? In the case of a hybrid rent-controlled property a unit purchased cannot be sub-let at a higher rental than the rental determination by the Rent Board which obviously could not produce a return to justify most of the asking prices, and to a lesser degree it would also be difficult to produce a return on comparable rentals in uncontrolled developments to justify the asking prices.

4. INSURANCE VALUE:

This is normally a value for insurance purposes and should be a realistic current "Building Cost" replacement value and for obvious reasons should not be used for individual units but for the entire project for insurance purposes, such as fire damage, storm damage etc. and as such should have no relationship to viability, selling prices or market trends.

Basically the main current valuation problem is that of valuation for mortgage purposes for without suitable financing, based on realistic criteria the entire "Sectional Title" exercise would fall flat. Sectional Title in its various forms is basically a method of providing homes for various income groups at a lesser price than similar accommodation of the single dwelling category. Until this message is accepted by the Developer and the Buyer and the true perspective of the situation clarified the problems that have manifested themselves will continue. Unfortunately a large number of the pioneer buyers of the "own a unit" trend will burn their fingers.

Unless the public generally and developers and building societies accept as a basis the criteria that a unit of a certain amenity should sell for less than the same amenity in the single-house category of a similar type, ridiculous prices will be asked and achieved, but the resale phase will prove that virtual communal living with lack of privacy, shared outside amenities, body corporate problems etc., must be worth less than similar accommodation of the traditional single dwelling with its more expensive advantages.

Only then will the mortgage loan pattern of consistently granting 75% of realistic selling prices and valuations be achieved where, by means of a smaller deposit than on a house, comparable accommodation can be obtained with an obviously lower monthly bond redemption payment. Only at this stage will the "Sectional Title" exercise serve the purpose for which it was created.

The two largest transactions an individual is involved in are the purchase of property, and a motor vehicle. In the case of property the idea of a loss on selling is not considered, a profit is always envisaged - capital appreciation, bank in land etc. However, with a motor vehicle one accepts a loss and when selling a vehicle an attempt to reduce the loss is always attempted but there is always a loss.

The present conditions I regard as a motor transaction climate - you will have to minimize your loss, or wait long enough to just break-even. The correct climate is that of investment, buy wisely, do not be blinded by fads, gimmicks, cute or character buildings, but compare what you are buying with what you could get in a similar house. Compare the financial implications and only then will you be able to appreciate your "castle in the air".

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