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5 Ways to Maximise the Chances of getting a Commercial Valuation On Your HMO

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Introduction:

Commercial Valuations, or Yield Based valuations as they are also known, have become one of the most misunderstood parts of HMO investment.

Get it wrong and your property investment journey could be halted in its tracks, or worse, you may be unable to pay back joint venture partners or bridging finance.

Get it right and you could fast track your investment goals and make your investment pot go much further!

Not only have we been investing in HMOs personally for over 10 years, but we have assisted many of our clients with refinancing their HMO properties on a commercial basis, even facilitating and sale and purchase of HMO's at their commercial value.

We have spent a significant amount of time talking to brokers, surveyors and commercial lenders to understand the criteria they use and to try and turn what is a very grey area, at least a little more black and white!

This guide summarises 5 key things we've learnt over the past 10 years and will help you decide whether commercial finance is the right option for you.

What You'll Learn:

- The necessity of applying for commercial finance
- Realistic property valuation estimates
- Key questions surveyors consider
- Risk factors from a lender's perspective
- The importance of comparable properties

Tip 1: Apply for Commercial Finance to Get a Commercial Valuation

This may seem obvious, but some investors and even some mortgage brokers do not understand this. Commercial finance is not the same as a traditional Buy-to-Let mortgage. Everything from the application process, to the fees and even the conveyancing is different with commercial finance.

You do not necessarily need to understand all of the differences, but knowing that you need to start with a broker who specialises in commercial finance is a good start. Many brokers who only do residential and Buy-to-let mortgages will not have access to the full range of commercial finance options. In some cases, Buy-to-Let brokers will act as introducers to Commercial brokers in order to be able to access these products. This is fine, but ensure that having additional people involved isn't going to jeopardise your chances through miscommunication or misunderstanding.

We work closely with a commercial broker who thoroughly understands the HMO market and has looked after many of our clients too, so feel free to get in touch if you would like an introduction.

Tip 2: Be Realistic with Your Estimated Valuation

There is a misconception about how a commercial valuation is calculated. It's often taught that you simply total up your rent for the year and multiply by ten. It is more complex than this.

Essentially the surveyor will take the gross annual rent and then use a multiplier (yield percentage) based on their interpretation of the local HMO demand and any external factors which may affect demand. Depending on the lender, there then may be a percentage deduction for operational costs (this could be a fixed percentage or based on your actual costs) before they arrive at a market valuation.

If a realistic commercial valuation is around £300,000 and you push this to the extreme in your estimate, the surveyor is going to turn up on the day of the valuation with your estimated figure in front of him and no way of making the numbers add up to achieve it. This could backfire and lead to a significantly lower valuation.

Tip 3: Can You Replicate Next Door?

One of the key questions a surveyor will ponder is, "Could I buy the property next door and replicate this investment for less money?"

If the answer is yes, your valuation might take a hit. For instance, if you bought your property for £150,000 and spent £100,000 on refurbishments, claiming a valuation of £350,000 might be a stretch.

Unique features, planning permissions, and other factors can add value and make your property stand out. If your property is an end terrace with a unique layout compared to others on the street, you needed planning permission to turn it into a 7-bed, all ensuite HMO with an extension on the side to increase the communal space, I couldn't replicate this with next door. It clearly commands a premium and this would stand you in good stead for a commercial valuation.

Tip 4: Are You a High-Risk Prospect for Lenders

A lender's main concern when looking at you or your business as a prospective mortgagee is,

"Will I get my money back?"

If this is your first ever HMO project and you have no prior experience and have used multiple Joint Venture partners to fund the development, you're going to be a riskier prospect. Imagine you're the underwriter for a moment. If someone with your profile approached you to do a Joint Venture and they wanted you to put all of the money in, with them providing the expertise, would you lend?

This doesn't mean it's not possible, but if it is your first investment then consider the measures you can take along the way to offset the lack of experience. One such way is to work with a trusted partner who can form part of your application and valuation pack to give the lender peace of mind. Also, if you're working with multiple joint venture partners, then consider how this will be structured at the very beginning and involve your broker in this process. When it gets to the final stages of the application and you're having to answer lots of questions about movements of money from different people, it just creates uncertainty in the lender's mind.

Tip 5: Comparable Properties Are Your Best Friend

Let us assume that the surveyor has visited and they agree with your estimated valuation based on the rents and his understanding of the area etc.

They now have to provide justification for this because the report does not go directly to the underwriter in most cases. It goes via a "valuation panel" to be checked and this is completely data driven, so if most lenders use it, then the hundreds of valuations being carried out on their behalf will pass via this valuation panel. This means they will have hundreds, possibly thousands of valuations in their system for a given area and therefore, if the valuation submitted is vastly different to everything else in the area, it'll be flagged for review. Surveyors do not want this because it may affect their ability to gain future instructions.

If you do plenty of due diligence yourself in comparable properties, then it helps the surveyor, especially if they're from out of the area. It will also allow you to check your own estimated value, because if you can't justify it based on comparable properties, then the surveyor is likely to struggle too!

Conclusion

Navigating the complexities of HMO commercial valuations can be challenging, but armed with these five tips, you're well on your way to making informed decisions.

Remember that a commercially valued HMO will usually end up in a valuation significantly higher than the vacant possession value, so thinking about an exit strategy is vital. If something were to negatively impact the HMO demand in your area, you could be left with a portfolio of over-leveraged properties. Always consider paying down the debt, or at least creating some diversity within your portfolio.

Ready to take the next step in your HMO journey?
Contact us for an introduction to a commercial broker who specialises in the HMO market.

01623 460830 purseglove.co.uk hello@purseglove.co.uk

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