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Valuation of Assets under SARFAESI Act

Executive Summary

The Valuation of assets under the SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act, 2002, is a crucial element in the mortgage and credit dispensation process in India. This Act empowers banks and financial institutions to recover their loans from non-performing assets (NPAs) without requiring court intervention. The Authorized Officer appointed by the bank has the authority to take possession of the secured assets, manage them, and sell them to recover dues. Given the significant implications of this process, the valuation of these assets must be both precise and comprehensive. This article explores the valuation practices under the SARFAESI Act, emphasizing the importance of including both authorized and unauthorized constructions in the valuation process, as **the entire building—approved and unapproved—is sold on an ‘as is, where is’ basis. Additionally, the asset is handed over to the purchasers without any demolitions, and the stamp duty for registration of the property is levied on the entire building construction, whether authorized or unauthorized.**

Standard Practice in Valuation for Mortgages

In the context of valuing land and buildings for mortgages, particularly at the time of credit appraisal, it is a widely accepted and reasonable practice to value only the portions of the building that are officially approved by the relevant map-approving authority. This conservative approach is rooted in the necessity to mitigate risk.

The rationale is that any portion of a construction that is unauthorized—meaning it lacks the required approvals from local authorities—faces the risk of being demolished in the future due to legal and regulatory actions. This could potentially expose the bank to financial risks if the unauthorized sections are later demolished, thereby reducing the property's value.

Valuers typically adhere to this method to provide a realistic and reliable estimate of the property's market value, focusing solely on the authorized construction. This approach aligns with the principle of prudence, particularly in the lending industry.

Valuation Practices Under the SARFAESI Act

The practice of valuing only approved/authorized construction is also adopted at the time of sale of an asset to recover dues from the defaulting borrower under the SARFAESI Act. However, the approach must be different under this act, considering that banks have the authority to take possession of the secured assets of the borrower, manage them, and sell them to recover the outstanding dues. In this scenario, the entire building, including both approved and unapproved constructions, is sold on an 'as is, where is' basis. This means the property is sold in its existing state, without any modifications or demolitions, regardless of whether parts of the construction are unauthorized.

Therefore, while valuing an asset under the SARFAESI Act, it is essential to consider the entirety of the building construction on the mortgaged land, including both authorized and unauthorized constructions. The reason for this comprehensive valuation is that the entire property, including unauthorized sections, is transferred to the new buyer without any demolition by the bank. Moreover, the stamp duty for the registration of the property is calculated on the total construction, encompassing both authorized and unauthorized areas. Thus, ignoring the unauthorized construction in valuation would result in a loss to the borrower/owner of the asset.

The Importance of a Comprehensive Valuation

A comprehensive valuation under the SARFAESI Act is crucial for several reasons:

- First, it ensures that the bank's recovery process reflects the true market value of the asset, maximizing the potential recovery amount. Since the property is sold as a whole, the inclusion of all constructions, regardless of their authorization status, provides a realistic and market-aligned valuation.

- Second, this approach acknowledges the market realities that unauthorized constructions are, unfortunately, common. Buyers in the market often buy buildings that include additional floors or extensions constructed without proper approval and are willing to take the risk associated with them.
- Lastly, considering the entire construction in the valuation process aligns with the banks' practice of handing over the full asset, including unauthorized parts, to the purchaser without demolishing the unauthorized portion. By including the unauthorized construction in the valuation, the process becomes more transparent and reflective of the actual transaction that will occur under the SARFAESI Act.

Conclusion

In conclusion, while the valuation of assets for mortgage purposes traditionally focuses on authorized construction to mitigate risk, the SARFAESI Act necessitates a more inclusive approach. When valuing assets under this act, it is prudent to consider the entire construction on the mortgaged land, including unauthorized portions. This ensures that the valuation accurately reflects the value of the property as it will be sold, aligning with the banks' recovery process. By adopting this comprehensive valuation approach, banks can maximize recovery, maintain transparency, and navigate the complexities of asset valuation in the context of the SARFAESI Act.

