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Impact of Black Money on Valuation for Mortgage

The Valuation of property for mortgage is a cornerstone of the banking sector, offering lenders critical insights into a property's market value to secure loans. However, a pervasive and largely invisible force — black money — undermines the accuracy and reliability of these valuations. Black Money refers to unaccounted, untaxed funds frequently utilized in real estate transactions, bullion, jewelry, shell companies, political funding, bribery, and other activities that remain unreported in official records. Its prevalence in real estate transactions distorts market transparency, making it challenging for appraisers to rely on recorded sale values as true indicators of market value. Consequently, **Valuers often operate without clear evidence to corroborate their findings, leading to discrepancies, underestimations, or overestimations in mortgage valuations.**

This article examines how black money in real estate transactions complicates property valuation for mortgage purposes, highlighting its impact on Valuation accuracy, risk assessment, and the broader economic landscape.

The Role of Black Money in Real Estate Transactions

In many parts of the world—particularly in South Asia, Southeast Asia, Eastern Europe, and Africa—real estate is often regarded as a preferred avenue for investing unaccounted wealth. Black money infiltrates the market when buyers and sellers mutually agree to conduct a portion of the transaction in cash, bypassing formal documentation to evade taxes or legal disclosures. As a result, the sale value recorded with the registrar's office typically reflects only the 'white' or accounted portion of the transaction, while the 'black' or unaccounted portion remains concealed and off the record.

This manipulation of transaction data distorts the true market value of properties. For example, if a property is sold for 1 crore rupees in reality but recorded at only 70 lakhs, the recorded sale price fails to reflect the property's genuine market value. Such practices not only reduce the tax base but also create systemic inaccuracies in official real estate records, challenging the work of mortgage valuers.

Impact on Valuation for Mortgage Purposes

1. Lack of Reliable Market Data:

Mortgage Valuation depends heavily on reliable data regarding recent, comparable sales in the area. When black money is involved in transactions, the prices recorded in official documents cannot be taken at face value, leading to a discrepancy between market reality and recorded data. This unreliable data introduces significant challenges for valuers trying to assess the property's true worth based on available records.

For instance, if all recent transactions in an area are underreported due to black money, the valuer may undervalue the subject property, as the available records suggest a lower-than-actual market rate. Such undervaluation can affect the lending decision, putting the lender at a disadvantage.

2. Difficulty in Corroborating Valuation Findings:

In cases of disputes or legal challenges, valuers are required to substantiate their assessments with evidence. However, when registered sale prices fail to reflect true transaction values due to the involvement of black money, it becomes nearly impossible to corroborate findings with documentary proof. This puts valuers in a precarious position, as their conclusions risk being questioned if they significantly deviate from the reported sale prices of comparable properties.

Furthermore, **in the absence of corroborating evidence, valuers often resort to informal sources or their personal knowledge of market trends. This reliance on subjective judgment may introduce variability in valuations, as each valuer may interpret the informal data differently, leading to inconsistencies in valuations across the industry.**

3. Increased Risk for Lenders:

Mortgage lenders rely on accurate valuations to assess the security cover against the loan or loan-to-value (LTV) ratios, which directly impact their lending risk. If a property is undervalued due to distorted data, a lender might end up under-lending, limiting potential profits. Conversely, if a valuer compensates by inflating values to approximate real market conditions, the lender could end up over-lending. Either scenario poses a financial risk to the lender, especially in the case of defaults, when the lender may have to repossess and sell the property under the provisions of SARFAESI (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest) Act in a market already distorted by black money.

4. Challenges in Risk Management and Compliance:

Compliance with regulations is crucial in the mortgage valuation process. When a valuer suspects underreporting due to black money, they may adjust their valuations based on professional judgment to avoid penalizing the lender with an inaccurate valuation. However, this practice can place the valuer in a gray area of compliance, where they risk falling out of line with strict regulatory guidelines requiring valuations based on documented sale prices. Such conflicts between regulatory compliance and market reality exacerbate the challenges faced by valuers, adding layers of complexity to the risk management strategies of lenders and the broader financial ecosystem.

Solutions and Approaches to Counteract the Impact of Black Money

1. Enhancing Transparency in Real Estate Transactions:

Governments and financial institutions need to take steps to curb black money in real estate transactions. Measures like the implementation of digital payment requirements, scrutiny of transactions, and greater transparency in property registration can help reduce underreporting. Additionally, incentivizing full disclosures through tax breaks or penalties for underreporting may gradually shift practices towards greater transparency.

2. Developing Adjusted Market Analysis Techniques:

Valuers could adopt adjusted market analysis techniques, where they use professional judgment to account for the probable black money component in a transaction. Although such adjustments are subjective, developing standardized approaches – such as adding percentage adjustments based on area-specific data – may improve consistency. Training programs focusing on black money adjustments and risk-based valuation techniques can also help valuers refine these approaches.

3. Legal and Policy Reforms:

Government policies aimed at reducing black money in real estate transactions could include stricter enforcement of the Real Estate (Regulation and Development) Act, and stricter anti-money laundering regulations. Additionally, policies aimed at simplifying property registration processes, making them more accessible, and reducing transaction costs can reduce incentives for underreporting.

4. Educational Initiatives and Awareness Programs:

Raising awareness among property buyers and sellers about the legal implications of black money and the benefits of transparent transactions can gradually shift practices. Financial literacy campaigns and educational initiatives targeting real estate stakeholders could reduce black money transactions, making the market more reliable for valuation purposes.

Conclusion

Black money in real estate is a persistent issue that significantly impacts mortgage valuations. It creates a lack of transparency and reliability in recorded sale prices, making it challenging for valuers to corroborate their findings and leading to inconsistent valuations. As a result, lenders face heightened risks, and the broader market suffers from skewed trends and inaccurate benchmarks. Addressing this issue requires a multipronged approach involving policy reforms, enhanced data analysis techniques, and industry-wide collaboration to promote transparency. By fostering an environment of transparency and accountability, the real estate market can become more trustworthy, allowing for more accurate and reliable mortgage Valuations that reflect true market dynamics.

Only through concerted efforts can the real estate sector mitigate the influence of black money, ultimately strengthening the mortgage valuation process and contributing to a more robust financial and economic landscape.

