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An Evaluation of the Appropriateness of Methods of Valuing Residential Properties in Sub-Urban Areas of Ondo State, Nigeria

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Abstract: The study examined the approaches often adopted for the valuation of rural residential properties of Nigeria using Ugbe and Arigidi Akoko areas of Ondo State, Nigeria as the case study. The study was set out to determine which of the method(s) of valuation is the most appropriate for valuing residential properties in rural areas in the developing economy such as Nigeria. To achieve the aim of the study, the physical inspections of two residential properties were carried out, one in Arigidi Akoko and Ugbe Akoko in Ondo State. The data collected via the inspections were used in calculating the values using different methods. The study reveals that of all the methods of valuation, investment method is the most appropriate because the value derived is a function of the rent. Comparative method is inappropriate because property rarely changes hand in the rural areas while the cost method jack up property values to a level that the market cannot support. The figure of year's purchase which is a multiplier is difficult to calculate because the yield which determines the years purchase is a function of analysis of sales transaction which is rare. There is little difference in construction cost in rural and urban areas whereas values between the two show wide disparity. The study recommends even distribution of projects by governments, organisations, religious bodies etc. Development projects act as catalyst which speeds up the rate of development which brings about influx of people thereby resulting in upward movement of rent and property values.

Keywords: Valuation, residential properties, Arigidi Akoko, Ugbe Akoko, Ondo State

1. Introduction

Among the attributes of landed properties is fixity of location. It is one of the unique characteristics of real estate. Estate Surveyors and Valuers being the only professional legally recognised to carry out the valuation of such properties for various purposes, are more often than not commissioned to undertake the exercise in whatever location; urban, semi urban and rural. Values of properties are directly related to the location of such properties as corroborated by Knaap (1998) who observes that location of property and value are strongly interrelated.

Ogunba (2013) describes valuation of landed property or real estate appraisal as a process of establishing an opinion of value for an interest in landed property/real estate. The Royal Institute of Chartered Surveyors (2006) describes valuation as 'a professional individual's opinion of the capital or rental price or value of a property on a defined basis'. Valuation according to Millington (1982) can be defined as the estimation of the monetary worth of an interest in landed property for a specific purpose and at a particular point in time having in mind all the features of the property and the underlying economic factors of the property market with the range of alternative investments. Ajayi (1998) citing Baum and Crosby (1988) describe valuation as 'the estimation of the open market value or the prediction of the most likely selling price'. Analysis refers to the 'estimation of worth to an individual'. It may be expressed as a price or alternatively a rate of return on outlay necessary to secure the acquisition of an investment property. Appraisal covers both aspects. It is 'an assessment of a particular property's potential cash flow to determine the suitability (at any given price) to a particular investor or purchaser. It should closely predict selling price or assess worth to an individual correctly. Baum and Mackmin (1989) describe valuation as 'The art or sciences of estimating the value of interests in property. International Valuation Standard (2011) views valuation as the estimated value (valuation conclusion) or to refer to the preparation of the estimated value (the act of valuing). Richmond (1985) defines valuation as the estimation of the capital or rental value of land and / or buildings at a certain time. An estate surveyor and valuer will need to know the purpose for which the valuation is required and the intentions and circumstances of the client or employer on whose behalf it is being prepared. This information is essential, because it will affect the calculation of value. Ifediora (1993) explain valuation as both an art and science that solve problems by undergoing rational and measured investigation and reasoning, in addition to the systematic collection and analysis of data and the application of the result to reach a conclusion or decision. Wikipedia defines property valuation or land valuation as the process of developing an opinion of value, for real property which is usually market value. The American Institute of Real Estate Appraisers (AIREA) equates valuation to appraisal which can be described as an estimate, an opinion of property values. In the opinion of Babcock (1963), he views valuation as appraisal which is 'The determination of the monetary value, at some specific date, of the property rights encompassed in an ownership' Real estate transactions often require appraisal because they are carried out infrequently and every property is unique (especially their condition a key factor in valuation), unlike corporate stocks which are traded daily and identical. However, location also plays a key role in valuation. However, since the property cannot change location, it is often the upgrades or improvement to the home and the environment that can change its value.

2. Purposes and Methods of Valuation

Prior to the consultation of an Estate Surveyor and Valuer to carry out valuation of a landed property, a client must have it in mind the purpose of that valuation exercise. Aluko (1999) describe purpose as the client's objective of the valuation exercise; and, this determines what value is to be sought. It will also assist the valuer to determine the appropriate basis and method(s) of valuation to be adopted. As soon as a valuation purpose is ascertained, it makes no difference to the valuer what use the client makes of the value conclusion. There are different purposes or reasons of carrying out a valuation exercise. A single property may have a whole range of different values at a particular moment depending on the purposes of valuation. The purpose of valuation determines the method of valuation. Purposes of valuation include for sale, purchase, rent determination, mortgage, insurance, compulsory acquisition, betterment and worsement charges, balance sheet, probate, acquisition and merger, rating, going concern etc.

Ajayi (1998) opine that there are five standard methods of valuation recognised by most standard textbooks. The methods include: comparative method, investment method, profit method, contractors (cost) method and residual method. This is the traditionally method of classification in the United Kingdom. Both the residual method and cost method would be grouped in the United States under the cost approach. International Valuation Standard framework recognises three approaches in arriving at the valuation figure defined by the appropriate method of valuation. These are sales comparison approach; cost approach; and income approach. They are all based on the economic principles of price equilibrium, anticipation of benefits or substitution. In most cases, the valuer needs to apply two or more methods for crosschecking purpose.

Comparative method is based on noting similarities and the differences with a view to determining appropriate value for the property in question. It is based on comparison of like with like and reliable when properties are: similar and are in the same area; there are sufficient records of many transactions which are fairly recent; the property market is stable; the underlying economic factors underlying the pattern of prices in the property market must be studied; and the properties should have similar income flows. Two properties are hardly similar but each property is unique because of architectural design and style; age and condition; amount of floor space; number and arrangement of rooms; size of plots; position; tenure; purpose and time. The method is limited in application because of special characteristics of each property and the hindrance these pose in adopting the method.

The investment method is applicable in some properties where ownership and occupation are separated. The properties are for residential, industrial, commercial etc. The properties are majorly occupied under a contract by the occupier in return for the rent paid to the owner. This is attractive for those who wish to invest capital and obtain a return thereon and the property market is a major source of such investment opportunities. The value is a function of the rent which an occupier is ready to pay in return for occupation and the level of return an investor would require on his capital. Thus, the present capital value (CV) is derived from a future income flow (Y) i.e. CV = f(Y). The equation appears simple but in the real sense of it is complex because of a number of independent, yet intricately interwoven factors such as the present and future income, the expected return on the particular investment, the strength of tenant's covenant, the lease terms and the tenure of the property determine the capital value. Various inputs in the model such as the net income, the full rental value, taxation and capitalisation rates need to be understood before the mechanics of the equation is appreciated.

The contractors method is applied in determining the value of property by reference to the cost of replacing or producing an acceptable substitute. The method comes handy in valuing some properties which are used for special purpose to meet specific requirements which are outside the general range of commercial and residential uses e.g. churches, town halls, schools, police stations, hospitals, fire stations, chemicals and oil plants. These types of properties hardly change hand in the property market. Therefore, there are neither investment market activities nor comparable to draw inferences from. They are referred to as no market properties. The approach consists of: estimating the replacement cost of the building; deduct allowances for age and obsolescence; add the value of land thereon. This produces a total figure which represents the value of land and building.

The profit test or account method is used to value properties used for productive trade and do not change hands very often to generate market evidence. Examples of such properties include hotels, restaurants, cinemas, theatres etc. They scarcely have, if any, market comparison with other properties and are not commonly available for sale in the market. Therefore, the value of business carried out in the property provides a basis for determining the return, in rental terms, due to the property. The process of valuation involves: estimating the gross earnings of the business for which the property is used; deduct the working expenses of production including interest on capital, if any, assumed provided by the tenant and remuneration for tenant's risk; the residue called divisible balance is the income due to land and building and return to tenant or owner. The applicability of this method depends on accurate and detailed account of business.

The residual method is used to value property with re-development potentials or a building which has become less suitable for occupiers business for a variety of reasons (which may include functional or physical obsolescence) and which therefore requires redevelopment or refurbishment. The method is used where a change in the use of land or building is being contemplated to release its latent value. The development potential or latent value is present when a property can be improved so that the value will be increased by more than the expenditure. The purposes of residual valuation are to: determine the maximum price payable for a site given acceptable profit margins and development costs; calculate the probable level of profit a product of development where the costs of land are known and total construction costs can be estimated; established a cost ceiling given minimum acceptable profit and land values. The basic approach to residual valuation include: estimating the 'value of completed development' and deduct there-from the 'estimated total costs of development' to arrive at the 'residue'. The residual value represents the maximum amount available for the purchase of the site by a particular developer. The method assumes that optimum development is known and that it is possible to estimate costs of development accurately. This may not be true because demand changes overtime and development cost may exceed the original estimate due to unforeseen circumstances.

3. Methodology

Detailed physical inspection and measurement were employed to ascertain the construction cum technical details, accommodation and details of services whilst clients supplied information on title details and cost/date of acquisition of the properties. A survey of the neighbourhood was undertaken to facilitate the description of the locational details, sketching of the locational plan and carrying out of market survey. The latter was embarked upon to collate information on current rental values, obtain evidence of recent sales of plots/properties and ascertain trends of values in the locality.

Analysis of information/data collected immediately revealed that 3(No) possible methods of valuation come handy in determining the values of these residential properties: comparative, investment and depreciated replacement cost. In assessing the appropriateness of the comparative or market data method for instance, consideration was given to the fact that the information was collected from local practitioners (agent) of the real estate market at Arigidi Akoko and Ugbe Akoko in Ondo State since there was no real estate firm(s) in the town.

Similarly, evidence supplied with respect to sales of plots/properties could not totally be dependable due to the low incidence/volume of sales transactions. In other word, evidence of sales transactions is low. Furthermore, these evidences were not documented whatsoever.

4. The Study Areas

Arigidi Akoko is located in Akoko North West Local Government Area of Ondo State and is rich in cultural values with many prominent spiritualists. The descendants migrated from Benin and settled in the present day Arigidi Town in 1819. There are three major settlements in the town which are Imo Arigidi, Arigidi Oja and Agbaluku. In terms of political composition, Arigidi has two out of ten political wards in Akoko North West Local Government Area namely Arigidi Iye Ward 1 and Agbaluku Imo Ward 2. The people of this town are predominantly farmers. Other occupation of the people include trading, blacksmith, dyeing. The religions being practised by the people of Arigidi include Christianity, Islam and Traditional Religion.

Ugbe Akoko is located close to Oyin Akoko in Ikare Rural District of Akoko North East Local Government Area of Ondo State. It is one of the towns bordering Oka Akoko the administrative headquarter of Akoko South West Local Government in the north. The town belongs to Owo-Akokos, one of the five groups into which Akoko region is sub-divided on the basis of dialectal spoken categories. The means of livelihood of the people in the town include farming, trading and hand craft.

5. Data Analysis and Discussion

The residential properties whose valuation approaches are being x-ray comprise a frontal 4-bedroom bungalow and a rear 3-bedroom bungalow located in Arigidi Akoko and tenement bungalow of 8(No) rooms in Ugbe Akoko all in Ondo State.

Comparative Method Analysis

Serial No	**Location**	**Description**	**Rent p/a (₦)**	**Capital Value (₦)**
1	ARIGIDI AKOKO	4-BDR BUNGALOW	65,000-70,000	1,200,000-1,300,000
2	ARIGIDI AKOKO	3-BDR BUNGALOW	55,000-60,000	1,050,000-1,150,000
3	UGBE AKOKO	8-ROOM TENEMENT	48,000-96,000	920,000-1,800,000

Investment Method Analysis

Actual Rent (4 Bdrm)	70,000	Rent per room/month =	800
Actual Rent (3Bdrm)	60,000	Total number of rooms =	x 8
Gross Rent	130,000		6,400
Less outgoings @10%	x 0.9	No of months in a year =	x 12
	117,500	Gross Rent	76,800
YP for 47yrs @ 5% and 3%	16.67	Less outgoings @ 10%	x 0.9
	1,950,390	Net Rent	69,120
		YP for 47yrs at 5% and 3%	x 16.67
			432,086

Depreciated Replacement Cost Analysis

		₦	₦
<u>4-Bedroom Bungalow</u>			
GFA – 184.71m^2 @ ₦50,000/m^2	=	9,235,500	
Less depreciation and obsolescence @ 40%	=	0.6	
		5,541,300	
<u>3-Bedroom Bungalow</u>			
GFA – 111.18m^2 @ ₦50,000/m^2	=	5,559,000	
Less depreciation and obsolescence @ 40%	=	0.6	
		3,335,400	
<u>External Works</u>			
Fence wall			
Perimeter = 2(L+B)			
2(18.45 + 67.00) = 170.90 meter run			
170.90 meter run @ ₦10,000/meter run	=	1,170,000	
Less depreciation @ 20%		x 0.8	
		1,367,200	
Land Value			
Area (1,230.15) m^2		400,000	
			10,643,900

Depreciated Replacement Cost Analysis

<u>Tenement Bungalow</u>		
GFA – 251.33m^2 @ ₦40,000/m^2	=	10,053,200
Less depreciation and obsolescence @ 40%	=	0.6
		6,031,920
Land Value		
Area (354.48) m^2		115,264
		6,147,184

6. Discussion of Findings

In the process of valuing the case study properties, relevant issues indicating the non-applicability of some of the existing methods of valuation to rural based residential properties arose, hence the need to review the suitability of each method as follows:

a) Comparative or Direct Capital Comparisons Method: entails an analysis of current sales prices of similar properties. The value of property inspected is arrived at by comparing with the price level of similar properties in the neighbourhood adjusting for differences in location, plot size, age and condition, amount of floor space, number and arrangement of rooms, etc. However, the application of this method is hindered by concealment of sale transactions which makes information that leak become doubtful. Also, quacks that are mainly in charge at the local level may be shielded from the conclusion of the transaction and therefore take the asking prices as the final consideration. Furthermore, low incidence/volume of sales makes it difficult to establish trends as conclusions draw from the few and far between transactions may not be very authentic.

b) Investment Method: This method is based largely on current rentals and the current rate of interest and the desired profit of the investor. Each of these factors was obtained from the landlord and financial market sources, which to a large extent conferred authenticity on the figures. The measure of confidence in applying this method to the rural based residential properties was quite high especially where the value derived is a function of the rent. However, the determination of the 'appropriate years purchase' poses challenges in the context of data collected from the neighbourhood. Similarly, the rent to be capitalised is impacted upon by the imperfect property market situation especially in the local areas.

c) Profit or Account Method: This method is used in valuing properties which are specialised and have limited potential for conversion to alternative uses other than for operating a business outfit. It is the trade that is carried on in the premises that is the vital factor, which directly affects its value. The profit method (also known as the account method) is used to value such properties such as petrol filling station, a cinema or hotel premises. Properties, which were inspected and valued in the rural areas of Ondo State, were mainly residential. Therefore, this method is not appropriate due to its limiting/restricting factors.

d) Contractors' or Depreciated Replacement Cost Approach: The cost method may be described as a method of determining the value of property by reference to the cost of replacing it or procuring an acceptable substitute.

The method appears to be simple and direct, hence, its being dubbed the 'lazy man's method'. This method ignores a very basic fact that whilst differences in costs of construction in urban and non-urban areas are negligible, the same thing cannot be said of values. For example, a 3-bedroom bungalow at Isolo, Lagos and Arigidi-Akoko, Ondo State may attract almost similar cost of construction of say ₦4.0 million but the differences in values between the two locations may range from ₦6.0 million at Isolo and less than ₦3.0 million at Arigidi-Akoko. Obviously, land value is not the only factor responsible for the disparity. Cost differs from value but there are few instances where cost and value are equal. Our experience showed that this method tends to produces unnecessarily high figure that cannot be supported by the market.

e) Residual Method: This method is appropriate in valuing properties with re-development potentials e.g. bare land or for a building which has become less suitable for the occupier's business for a variety of reasons (which may include functional or physical obsolescence) and which therefore requires redevelopment or refurbishment. This method could not be employed in valuing the case study properties in Ondo and Ekiti States when there was no discernible value that could be harnessed then.

7. Conclusion

The following are the conclusion drawn out from the study:

i) Property hardly changes hand in the rural areas and as a result there is scarcity of data regarding evidence of property transactions that are recent. The only source of data is from the local agents whose data are neither documented nor reliable. Besides, the data is not a true reflection of values in the area. So therefore, comparative or market data technique is less suitable in valuing such properties.

ii) Since an investor is sure of the rent his property commands, the investment method will give him at least a value that is realizable when the net income is capitalized with the appropriate years purchase.

iii) Because cost of construction sourced from our data bank is the same for both rural and urban areas, the depreciated replacement cost method jack up property values in the rural areas to a level that the market cannot support.

iv) Three methods of valuation could be adopted in determining the values of rural residential properties namely; comparative, investment and depreciated replacement cost.

v) The figure of years purchase is difficult to arrive at in case of those properties. This is because the yield, which determines the years purchase, is a function of analysis of sales transaction. However, properties hardly change hand in the rural areas

vi) There is little or no difference in cost of construction in both urban and non-urban settings.

vii) Low incidence/volume of sales makes it difficult to establish trends, as conclusion drawn from the few and far between transactions may not be authentic.

8. Recommendation

The followings are recommended:

i) Development projects which act like catalyst and speed up the rate of development in areas sited should be embark upon by different tiers of government, organisations and religious bodies. Such projects include higher institutions, industries, farm settlements and religious retreat centres which act like magnet and draw people to areas located. This will result in demand for accommodation and thus the springing up of apartments. There will be an upward movement in rent and property values due to influx of people. Transactions in property become frequent resulting in the activation of property market and boosting of property values.

ii) There is the need for centralised body for Estate Surveying and Valuation profession to have a department that will be overseeing the collection of data in respect of sales and letting of properties for both rural and urban areas. Data collection is essential because it enhances sales/rental values projections. It is possible to project into properties' values/rent accurately by studying the trends of past transactions.

iii) There is a wide gap in the construction costs rate available in the market. In actual fact, tenders and quotations of construction companies are unreliable and are made worse by variations, abandonment of project site and non-release of fund. Unreliability of construction costs rate is due to: loading to take care of delays in payment to allow for negotiations to make arrangement for gratifications and the like and also to take care of unexpected price fluctuations and outright demand for bribes; excessive profit expectations; unpredictable prices of construction materials due to fluctuating inflation rates and other economic indicators and poor attitude to work of professionals. The consequence is that construction rates are inflated and may vary widely with actual costs.

iv) Most of the owners of the property are sentimentally attached to them. This is linked to their empowerment. The bond of attachment is strong where development is not being experienced. Where the rate of development is rapid, it will impact positively on property values and thus severe the bond of attachment to property. Because of the big money involved, which is needed to improve their standard of living, the owners of the property will be forced to sell. Furthermore, some people in these areas regard selling of landed property as a taboo or sign of decline fortune.

v) There should be competitiveness between the rural and urban areas in the provision of infrastructure. An area with good infrastructural facilities such as network of good roads, effective communication system, portable water, health facilities, etc. will always attract development ventures. Their availability will provide enabling environment for developments to thrive. This will indirectly impact positively on property values. A good example is Ikorodu in Lagos State which has been playing host to many projects because of availability of infrastructure. Property values/rent has been on the increase too.

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