# Forms of Mortgage Valuation Inaccuracies and Implication on Real Estate Development Finance in Nigeria

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***Abstract*:** Pledging of collateral is a necessary requirement for loan advancement, lenders grant loan based on forced sale value of collateral. Earlier studies on valuation inaccuracy in Nigeria established that valuation inaccuracy is prevalent in the country. It was also established that valuation inaccuracy pose threat to real estate finance in Nigeria. This study examines the forms of valuation inaccuracies in Nigeria and their implications on real estate development finance. The study populations are: Valuers, Developers and Banks. Questionnaires were administered to the study populations to sample their opinion on the most prevalent valuation in accuracy in Nigeria and the implication of valuation inaccuracy on real estate development finance in Nigeria. Descriptive method of statistics and relative importance index were employed for the analysis. It was discovered that overvaluation is the most prevalent form of valuation inaccuracy in the study area and the implication of overvaluation is that it put lenders at risk. Also, the implication of undervaluation is that it denies borrowers the required amount needed for property development. The risk associated with overvaluation make lenders to take different measures that consequently impede accessibility of loan for real estate development purpose. Recommendations were made on how to improve the quality of the services rendered by Estate Surveyors and Valuers in order to reduce rate of valuation inaccuracy in Nigeria.

***Keywords* -** Mortgage, Valuation, Inaccuracy, Estate Development, Finance, Nigeria

## Introduction

Real Estate investment requires huge amount of money which is rarely available to developers. Therefore, developers result to credit facilities granted by financial institutions. Availability and accessibility of credit has been frequently described as the most important factor in real estate development. However, property valuation of collateral is fundamental to banks or financial institutions lending decisions (Lovell and French, 1996). Financial institutions usually require pledge of collateral for loan advancement and credit is granted based on the value of the collateral pledged. Therefore,

valuation is necessary to ascertain the value of collateral pledged for loan advancement. As a result of the importance of valuation to loan advancement, it became imperative for valuation reports to accurate and consistent.

Ajibola (2010) posited that poor property valuation has a domino effect and can lead to corporate financial crises, which can in turn result in severe crisis within national economies. The effect of a poor valuation on mortgage assessment cannot be over emphasized. It leads to valuation inaccuracy which consequently negatively affects the mortgage institution in securing loan granted. Aluko (2004) revealed that Estate Surveyors and Valuers in Nigeria are not interpreting the property market with high degree of accuracy which is obtained in the developed countries. Ojo (2004) in another study, lend credence to Aluko's submission by stating that there were complaints from financial institutions on the accuracy and reliability of mortgage valuation figures supplied which they considered under representing values of foreclosed collateral security.

Previous studies on valuation accuracy were able to assert that valuation inaccuracy is a common phenomenon in developed and developing nations. In the United Kingdom, researchers such as Hager and Lord (1985), Matysiak and Wang (1995) and Hutchison et al (1995) were able to establish the presence of valuation inaccuracy in valuation exercise in the country. Also in Nigeria, scholars such as Ogunba (1997) who due to absence of data resorted to the approach of requesting thirty Lagos based practicing estate surveying and valuation firms to carry out valuations of two residential properties earlier sold located at Victoria Island and Ikoyi respectively. The valuation estimates subsequently arrived at by the valuers was subjected to a number of statistical tests such as range, inter-quartile range, mean deviation and regression/correlation analysis was able to show that valuations were not a good proxy for market prices due to the following reasons: the average variance between valuations and prices was far in excess of his adopted margin of error of +/-5 %, the intercept in the regression equation was statistically distinguishable from zero and the slope statistically distinguishable from 1;and third, the range and inter-quartile ranges were unacceptably wide. In addition, other scholars like Aluko (2000), Adegoke (2008), Ogunba and Iroham (2008) were able to establish presence of valuation inaccuracy in Nigeria.

Ayedun et al (2012) asserted that question about accuracy and

consistency in valuation practice has been subject of interest to the academicians, professionals and users of valuations not only in Nigeria or developing countries but also in the developed countries of the world such as UK, USA, Canada and Australia. The scholars, employed survey method in conjunction with interview of members of Nigeria Institution of Estate Surveyors and Valuers in practice and academic institutions in Lagos Metropolis, to study the factors contributing to inaccuracy and variance in valuation estimates. The study revealed lack of market data, poor educational background and lack of experience as the causes of valuation inconsistency and inaccuracy in the study area.

Valuation inaccuracy can be in form of over-valuation or under-valuation (Mallinson and French 2000). The causes of these two forms of valuation inaccuracies are enormous ranging from Valuers negligence and client influence. Hoffman (2005) established that over valuation is the major cause of sub-prime mortgage crisis experienced in the United State of America. Similarly, between 1991 and 1996, when the number of distressed banks in Nigeria increased from 7 to 57 out of the 115 banks (NDIC, 2002), the situation was said to be partially caused by delinquent loans and inaccurate value judgment (Aluko,2004). Idowu et al (2012) posited that scholars have generally discovered that clients have been disappointed at the figures they were advised by different valuers. The scholars attributed wideness in the opinion of values and inaccuracy as the causes of the disappointment. In the light of this, this study wishes to examine the most prevalent form of valuation inaccuracy and implication on real estate development finance in the study area.

**Valuation Accuracy in Nigeria: Methodology and Findings**

From the 1980's, literary (albeit non empirical) comments began to be made on the accuracy of valuations in Nigeria. A past President of the NIESV, Udo-Akagha (1985) in his foreword to the first edition of the Guidance Note on property valuation posited that "there ought to be reasons why two or more valuers, valuing the same interest in a property for the same purpose and at the same time should not arrive at the same or insignificantly different results if they make use of the same data and follow the same valuation approach. But very often this is not usually the case and in some of these unfortunate cases, the profession is thrown into considerable embarrassment"

The above quotation captures the growing concern among valuers

and their clients at the same time. Estate Surveyors and Valuers were faced with increasing allegations of wide variations in the valuation estimates supplied them. Similar comments was made by Igboko (1992) who while researching into the investment method of valuation in Nigeria, at the instance of NIESV, observed what he described as a "weak grasp of valuation" amongst the valuation practitioners. He came to conclusion that many of the investment valuations conducted were actually "mis-valuations and guesstimates". He did not however provide any credible empirical statistical basis to justify his conclusion.

Ogunba (1997) undertook an empirical step at addressing the question of accuracy and variance in investment valuations in Nigeria using Lagos metropolis as the study area. In the absence of data base of property valuations and sales, he resorted to the approach of requesting thirty Lagos based practicing estate surveying and valuation firms to carry out valuation of two residential properties earlier sold located in Victoria Island and Ikoyi respectively. The result of the empirical study showed that valuations were not good proxy for market prices.

On the other hand, Aluko (2000) carried out an accuracy study on a larger scale with a focus on mortgage valuations and subsequent sale prices of such mortgaged properties used as collateral securities. In his study, bank records of mortgage valuations conducted by fifty nine (59) estate firms in Lagos metropolis were examined. The sale prices of the properties were compared with their earlier valuation estimates and analyzed by means of regression/ANOVA. He came to a conclusion that valuation in Nigeria are a good proxy for price and that despite the anecdotal evidence to the contrary, the mortgage valuers are doing a very good job of price prediction. Although the study sample size is larger than that in Ogunba and Ajayi (1998) study, the size is considered small for drawing generalizable conclusion in addition, the sale prices of collaterized properties adopted for cross-checking the result of the prior valuations were forced sale values which do not meet the definition of open market value.

Ogunba (2003) expanded the coverage area of accuracy studies to a consideration of property valuation estimate and sale prices in the state of south western Nigeria. The approach adopted in the study was similar to the one adopted in his earlier work. A total of 171 estate and valuation firms which constituted 75% of the sample of sample frame of estate surveying and valuation firms were employed for the

study. The author confirmed his earlier work that valuation estimate were no good proxy for sale prices and that valuation estimate of one firm was not good proxy of other firms. The study also extended to an examination of the causes of valuation inaccuracy under topics such as the conduct of valuation, educational and practice structure and valuation industry etc.

Adegoke (2008) investigated valuers behavior in Nigeria when valuing properties in localities that they lack substantial prior experience in Nigeria. He sampled 122 estate surveying and valuation firms in Lagos metropolis. He used quasi-experimental and survey methods for the study. The researcher employed simulated valuation method in carrying out valuation of a single commercial office property located in a city that the participants/respondents were not familiar with. The study revealed a wide variance of valuation outcome from the mean which showed that the valuation outcomes were not reliable.

Babawale (2008) in his study identified valuers knowledge and experience, valuation approach and individual characteristics of valuation firms as the most significant contributors to the problem of inaccuracy of residential property valuation in the Lagos metropolis. Data for the study was gathered from 250 firms of Estate Surveyors and Valuers. The analysis was done by a combination of descriptive and inferential statistics including factor analysis and correlation/regression analysis.

Ayedun (2009) examined accuracy and consistency of investment method of valuation in Lagos metropolis. He sampled the opinion of 127 estate surveying and valuation firms, the 25 mega banks and 132 institutional property companies all in Lagos state. The findings showed that valuation estimates were neither good proxy for realized sale prices of real properties nor proxy for valuations of other firms. Empirically, he came up with an acceptable margin of error (+/-10.2%) as agreed by the sampled stakeholders (estate surveyors and valuers, banks, property companies and courts amongst others) and he confirmed that valuers in Lagos metropolis were not operating within the margin.

In the United Kingdom, valuation accuracy (or inaccuracy) debate was triggered off by Hager and Lord (1985)'s work wherein they conducted a small sample survey of ten Surveyors who were invited to value two properties. In one case the range of valuations was +/-10.6% and in the other, it was +/-18.5% suggesting a relatively low level of valuation accuracy relative to the +/-5% benchmark adopted. Brown (1985) conducted a larger and

much more rigorous study on a sample of 29 properties for which there were transaction prices and recent prior valuation figures. In the study, independent valuation firms were made to carry out the valuations of the subject properties. Both valuations and sale transactions took place between 1975 and 1980. In addition, both the valuations and the sale transactions were based on the RICS definition of Open Market value, which excludes special purchases, forced sales etc. The author used regression analysis to compare valuation estimates and sale prices on the 29 sampled properties. The scholar was able to established high level of valuation accuracy.

To a large extent, the studies have confirmed the existence of valuation inaccuracy using various methodology and approaches. It has been established more often than not that valuations in Nigeria are not good proxy for transaction prices. The interlink between valuation and real estate finance have variously been mentioned in passing but no in-depth evaluation of the impact of inaccuracy in valuation on real estate finance was conducted in any of the studies. Inaccuracy in valuation impact on finance differently depending on which form (over or undervaluation) is identified but none of the studies available attempted to find out which form of inaccuracy is most pronounced and its effect on finance. While the present work looks in this direction, it also attempts to identify the mitigating measures adopted by lenders to cushion the effect of valuation inaccuracy.

### 2.6 Valuation Accuracy as a Real Estate Loan Requirement

Ajayi (2003) noted that increased valuation accuracy and consistency are the demand of the more sophisticated and enlightened clients in the emerging property market of today and the property market has seen remarkable changes within the past forty years. Europe and the United States have witnessed the emergence of institutional investors, the management of investment on portfolio basis and the recent advent of new property finance methods including securitization and unitization. Clients are now getting much more sophisticated and analytical in their decision making approaches and therefore increasingly require more accurate and consistent valuation estimates from their consultant valuers.

The real value of security is one of the most important elements, if not the most important in real estate finance. For this reason, the appraisal of real property as a security for loan plays a central role in real estate finance (Wooley, 1994). However, as the importance of the role of appraisal

increases, so do the harmful effects of appraisals which do not accurately reflect the true value of the subject property.

Appraising is, by its nature, an imperfect science. An appraisal must consider several variables and make several assumptions when determining the value of real property. Thus, valuations are often only highly educated estimate of the value of the subject property. The result is that one can never know for certain whether an appraisal is "inaccurate" because there are few benchmarks for determining the accuracy of the appraisal. Yet when an appraisal is "inaccurate", the consequences of relying upon that appraisal can be severe. This lack of accuracy inherent in producing a valuation report is the primary weakness in the appraisal industry (Wooley, 1994).

Accurate and reliable valuations serve an increasingly important function as a decision making tool (TienFoo, 2002). They are essential not only in loan origination context, but in broader realm of the public perception of and confidence in a nation's property investment related institutions and industries. By way of credence, Babawale (2006) mentioned that a prerequisite for reliable measurement of the absolute or relative performance of commercial property investments is that valuation provides a reliable proxy for transaction prices. While accurate and reliable valuations could significantly contribute to the financial well-being of the clientele, faulty and fraudulent valuations have seriously damaged, and/or contributed directly to the insolvency of several financial institutions and real estate investors (Wooley, 1994). By providing wrong signals to participants, inaccurate valuation will also erode confidence in the operation of property market and jeopardize the future of the property industry which leads in the long run to mis-allocation of resources and distortions in the property market (Babawale, 2006).

Ajibola (2010), said with the establishment and multiplicity of industrial and commercial economic activities and coupled with prime role property holdings play especially as collateral for the release of production of capital funds, the corresponding role of valuation, as the basis for transaction figure, should not be compromised.

The appraisal report is one of the most important documents in a loan file because it supports the underwriter's determination of whether there is sufficient and appropriate collateral to back any mortgage transaction.

Beyond mortgage loan, a real estate investor may wish to dispose of its land, building or

both to use the proceed realized to fund a new real estate project and therefore, professional advice may be sought to have an accurate assessment of the property in order to determine the prevailing market price. Valuation may as well be required to determine the value of a proposed project to determine the rental value for the purpose of forward letting or sales in order to attract finance.

In most, if not all sources of real estate development finance, valuation is required at one point or the other as a pre-requisite for measuring the absolute or relative performance either by the project financier or the developer as it (valuation) is expected to provide reliable proxy for prices (Bowles, 1999) upon which investment decision is taken.

However, where valuation is thus inaccurate, the appraised value creates a credit risk because the loan-to-value ratio is understated or overstated and the collateral may not adequately support the finance transaction. In declining markets, the possibility of overvaluation increases, which makes it even more critical to use current market data. It is important to thoroughly review the appraisal report and make sure that the appraised value is credible and fully supported by the information analysis provided within the appraisal report.

## 2.7 Causes of Valuation Inaccuracy

Hudclips (2007) mentioned that accuracy in valuation depends on the quality and adequacy of supporting data and the degree of proficiency with which the data items are analyzed. Incorrectness or inaccuracy of valuation as noted by Wyatt (2003) can enter into valuation process at any stage from inception. According to Hudclips (2007), valuation inaccuracy results from various sources such as: Misconception of the objective and purpose for which valuation estimation is made, Lack of judgment and experience, Haste and carelessness, inadequate data or data of poor quality, Incorrect interpretation of data, Incorrect method of valuation, Faulty application of correct method, Influence on appraiser

The valuation process as we are aware requires gathering, analyzing and interpreting a great volume and variety of data. Inaccuracy may occur where an appraiser fails to exercise necessary caution by merely corroborating a predetermined unsupported conclusion. Also, because the necessary data are gathered piecemeal a valuer out of mistake, may assign greater importance to some of the data than they are rightly entitled to receive, thus reaching a conclusion which is premature and unsound.

As emphasized by Babawale (2006), the list of potential reasons for inaccuracy in commercial valuation is inexhaustible owing to its complex nature. He also pointed out factors and circumstances commonly identified as contributing to the disparity between valuations and subsequent transaction price, some of which were also emphasized by Hudclips in the list. Others reasons mentioned by Babawale (2006, 2008) include: Nature of property market, Valuation assumptions, Integrity of individual valuers; and Type of property amongst others.

## 2.10 Implications of Valuation Inaccuracy on Real Estate Funding

The two possible forms of valuation inaccuracies are overvaluation and undervaluation (Mallinson and French, 2000). Overvaluation implies that an appraised value is inflated and the collateral may not support the transaction, thereby creating a credit risk if relied upon (Freddie Mac, 2009). Where the opposite is however the case (i.e. undervaluation) it implies an over protection of the provider of finance at the detriment of the user of fund (developer). At the instance of the latter, the collateral's potential is underestimated, ultimately reducing fund available to developer. For instance where an investment appraisal considered to attract finance is undervalued, the potential returns will be underestimated and therefore renders it less attractive to investors (financiers) and vice versa. On the other side, where a sale value of a proposed project is over bloated in a forward sale/letting arrangement, the subscribers will not be able to recoup the invested capital within an expected period and where it is financed by loan, the returns from the letting /sales of the project may not be able to service/offset the loan due to inaccurate cash analysis developed from the initial valuation.

The contribution of secondary mortgage institution to real estate finance cannot be overemphasized. Nubi (2003) established that mortgage system cannot work effectively without a functioning secondary mortgage institution. The success of secondary market in the U.S has led both private and public sector officials in many countries to recommend its creation as a way of enhancing the flow of fund to housing. However, Lea (2002) emphasized that it is not possible to have a sustainable secondary mortgage market unless there is a healthy and well developed primary mortgage. Furthermore, he added that without an accurate valuation, the dream of a functioning secondary mortgage market will remain a mirage.

Therefore, accuracy of property valuation determine functionality and sustainability of the mortgage system.

Also, in an event where investment in real property is to take the form of 'sale and leaseback, the principle here involve the outright sale of one's interest in a real property as a means of obtaining finance. The same property sold is then taken on leasehold basis by the seller. This method has the advantage to the seller in the sense that he can get enough funds for his project and at the same time secure occupation. He can also obtain higher fund than in a mortgage transaction. Meanwhile, if the selling price of the land is derived from an inaccurate valuation (say under valuation), it will reduce the amount that will be paid by the buyer and the fund which will be available to the seller for the project.

The principal issue in valuation accuracy is standardizing the information set to ensure that all valuers are equally informed. Valuations are functions of information. The better the information set the better the valuation. The spread of valuations depend upon the completeness of information while only the difference in interpretation may lead to possible transactions (Brown, 1992)

In Tanzania, Sanga (2004) identified that there is low level of lending in the country despite financial institutions cash reserve (loanable funds). Also noted that lenders prefer increasing level of interest rate (on lending) and this bears noticeable relationship to lending pattern. He noted financial institutions (lenders) have largely criticized Land Act 1999 and lack of reliability on valuation of collateral as a disincentive to lending, hence the use of high interest rate and other regulatory measures. The level of interest rates was compared and contrasted to a number of registered mortgages for a period of 1999-2002 and there is a negative correlation between interest rates and number of registered mortgages.

In conclusion, the implication of valuation inaccuracy depends on the nature of the valuation inaccuracy. Overvaluation negatively affects lenders thereby discouraging granting of loans. Also, undervaluation reduces the accessed loans to the borrowers' thereby reducing available fund for property development. In this study, the opinion of the banks, valuers and developers on the possible effects of the two type of valuation inaccuracy will be sampled. The following parameters will be adopted for sampling the opinions: possibility of overvaluation creating credit risk, exposing lenders to financial

loss, causing lenders to discount FSV for cover, lenders granting loan regardless of knowledge of overvaluation, lenders giving loan lower than FSV where the is knowledge of overvaluation, overvaluation not having effect on loan availability for real estate finance, and overvaluation discouraging loan advancement for fear of risk.

Also, the effect of undervaluation will be measured based on the following criteria's: lending institutions increasing loan beyond FSV where undervaluation is detected, reduction in access of borrowers to adequate loan, undervaluation over protecting the lenders fund at the detriment of borrower's needs, and lenders bending their policies in favour of borrowers where under valuation is identified.

## 3.0 Materials and Method

The study population for this study includes Estate Surveyors and Valuers, Property Development Companies and Commercial Banks in Lagos, Nigeria. The sample frame of Estate Surveyors and Valuers was based on the directory of the Estate Surveyors and Valuers (2009) which pointed to a total of 270 firms in the study area. The sample frame of commercial banks was based on the list of commercial banks in Nigeria published by Central Bank of Nigeria as at December, 2012 where the total banks in Nigeria are 24 but 22 had their head offices in Lagos, Nigeria which is the case study. The sample frame of Real Estate Developers in Nigeria (REDAN) is based on the list of REDAN members on the website of the association. There 875 registered members of REDAN but 239 member companies are based in Lagos while the remaining 636 spread across other states of the federation and the federal capital territory.

The sample size of the study includes all the twenty-two (22) commercial banks which have head offices in Lagos. This will be possible since they all concentrated within 4 locations in the state. The 22 commercial banks represent 92% of the population of commercial banks in country. Also, 130 Real Estate Development Companies in Lagos will be sampled. The 130 REDAN members are the members with addresses in the 5 main commercial areas where Estate Surveyors and Valuers were sampled. This is done in order to reduce the cost and stress associated with the survey.139 Estate Surveying and Valuation firms will be the sample size of Estate Surveying and Valuation firms to be sampled. These are the Estate Surveying and Valuation firms in the 5 main commercial areas of Victoria Island/Ikoyi, Ikeja,Yaba/Ebutemetta,

Apapa/Ijora and Lagos Island. The sample size of Estate Surveying and Valuation firms was achieved through stratified sampling techniques.

Descriptive statistics is used in analyzing the non-parametric data. This includes relative importance index and frequency distribution table. The frequency distributions will be employed in generating the distribution characteristics of the variables and data made use of in the subject statistical analysis of the data. Relative importance indices will be used to assess the level of significance of forms of mortgage valuation inaccuracies and their implications on real estate development finance in the study area.

### 4.3.1 Profile of Estate Surveyors and Valuers

#### 4.3.1.1 Response Rate of Estate Surveyor according to Location

A total number of 139 questionnaires were administered to estate firms which represented approximately 52% of the 270 estate surveying and valuation firms operating in Lagos metropolis. Out of 139 questionnaires administered, a total of 84 questionnaires were retrieved and found useful for analysis. Questionnaire distribution and response rates by locations are as contained in Table 4.3.1.1

**Table 4.3.1.1 Response Rate of Estate Surveyors and Valuers according to Location**

| Location | No. of firms/location | Administered Questionnaires | Retrieved Questionnaires | Retrieval Rate % |
|---|---|---|---|---|
| Ikeja | 49(18.41%) | 26 | 20 | 77% |
| EbutteMetta/Yaba | 27(10.8%) | 14 | 6 | 43% |
| Victoria Island/Ikoyi | 47(17.5%) | 24 | 18 | 75% |
| Apapa/Ijora | 24(8.77) | 12 | 4 | 33% |
| Lagos Island | 69(25.50%) | 35 | 12 | 34% |
| Others | 54(19.50%) | 28 | 24 | 86% |
| Total | 270 | 139 | 84 | 60% |

**Source: Author's field survey, 2013**

Table 4.3.1.1 showed the number of questionnaire administered in each zone. This was 60% of the population of firms in each stratum. Lagos Island has the highest number of firms while this is followed by estate firms scattered in other location i.e 'others'. Next is Ikeja and Victoria Island and so on. This perhaps may be due to the fact that business activities are so intense in these regions. Head offices of insurance companies, banks and other business concerns are concentrated in the locations while Ikeja is also the state administrative headquarters. The services of the surveyors and valuers are mostly required in

such regions and so may account for the concentration of the firms in the zones

Details of respondents' estate surveyors and valuers with respect to academic qualification and professional qualification and age of firms are as contained in Table 4.4

**4.4 General Characteristics of Respondents Estate Surveyors**

**Table 4.4.1 Educational and Professional Qualifications**

| Qualification | Frequency | Percentage | Academic Qualification | Frequency | Percentage |
|---|---|---|---|---|---|
| OND | 5 | 6.0 | Probationer/Graduate | 51 | 61 |
| HND | 31 | 36.9 | ANIVS | 31 | 37 |
| B.Sc | 39 | 46.4 | FNIVS | 2 | 2 |
| M.Sc | 9 | 10.7 | | | |
| Total | 84 | 100 | Total | 84 | 100 |

*Source: Author's field survey, 2013*

6% of the respondents are National diploma holders, 83% are degree holders while 11% are Master's degree holders. 37% are Associates of the Nigerian Institution of Estate Surveyors and Valuers, 2% are fellow of the same institution while 61% are probationer members. The respondents are either principal partners or head of valuation sections of the sampled firms and the information sought there from are considered reliable for the research. The data deduced from the respondents therefore afford appreciable degree of reliability for the in-depth knowledge which respondents seemingly possess.

**Table 4.4.2 Age of the company**

| Year | Frequency | Percentage |
|---|---|---|
| 0-5yrs | 28 | 33.3 |
| 5-10yrs | 30 | 35.7 |
| 10-15yrs | 14 | 16.7 |
| 15yrs and above | 12 | 14.3 |
| Total | 84 | 100.0 |

**Source: Author's field survey, 2013**

Majority of the firms (67%) are over 4 years of age and are assumed to possess substantial experience to provide good information upon which valuable deductions can be made. It can be deduced that newly inducted valuers are taking up employment with existing real estate firms.

### 4.5 Perception of Estate Surveyors and Valuers

**Table 4.5.1 How often do you do valuation for mortgage purposes?**

| Rate | Frequency | Percentage |
|---|---|---|
| Very often | 38 | 45.2 |
| Often | 40 | 47.6 |
| Fairly Often | 6 | 7.1 |
| **Total** | **84** | **100** |

**Source: Author's Field Survey, 2013**

About 93% of the respondents said they often or very often do valuation for mortgage purposes. This purpose is seemingly the commonest reason estate surveyors carry out valuation and why banks are considered the largest users of valuation services.

**Table 4.5.4 Valuation bias mostly reported in lending transactions in Nigeria?**

| Valuation bias | Frequency | Percentage |
|---|---|---|
| Overvaluation | 69 | 82.1 |
| Undervaluation | 15 | 17.9 |
| **Total** | **84** | **100** |

**Source: Author's field survey, 2013**

To further ascertain their perception, the respondents were requested to give opinion on the type of bias which they considered mostly reported in lending transactions in Nigeria. 82% said overvaluation is prevalent while 18% said undervaluation.

### 4.6 General Characteristics of Respondents Banks

**Table 4.6.1 Educational qualification of bank staff**

| Qualification | Frequency | Percentage |
|---|---|---|
| **HND** | **6** | **35.3** |
| **B.Sc** | **6** | **35.3** |
| **M.Sc** | **4** | **23.5** |
| **MBA** | **1** | **5.9** |
| **Total** | **17** | **100** |

**Source: Author's Field Survey, 2013**

The least educational qualification possessed by the respondents is first degree (either HND or B.Sc.). 70.6% of the respondents fall within this bracket while 23.5% have M.Sc. degree and 5.9% are MBA degree holders. The level of educational attainment of bankers can be attributed to the level of sophistication of modern day banking system.

**Table 4.6.2 Professional Qualification of bank staff**

| Qualification | Frequency | Percentage |
|---|---|---|
| ICAN | 4 | 23.5 |
| CIB | 6 | 35.3 |
| CIGMA | 2 | 11.8 |
| ACIB | 5 | 29.4 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

Table 4.6.2 shows that all the respondents are members of one professional body or the other. 64.7% are at least Associate members of Chartered Institute of Bankers, 11.8% are members of CIGMA, 23.5% are Associate members of Institute of Chartered Accountants of Nigeria. More so, they are senior officers in the property/loan recovery and legal sections of the banks whose experiences are considered dependable and of great advantage to the study.

**Table 4.6.3 Age of the company**

| Year | Frequency | Percentage |
|---|---|---|
| 0-5yrs | 0 | 0 |
| 5-10yrs | 0 | 0 |
| 10-15yrs | 0 | 0 |
| 15yrs and above | 17 | 100 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

None of the banks is less than 15 years of age and least has minimum of 200 branches nationwide while some have as high as 700 branches. This show the banks have wide coverage and are very accessible to developers who may which to locate them to meet their financing needs.

**Table 4.6.4 Rate of granting loan for real estate development purpose**

| Rate | Frequency | Percentage |
|---|---|---|
| Very often | 4 | 23.5 |
| Often | 8 | 47.1 |
| Fairly Often | 3 | 17.6 |
| Rarely | 2 | 11.8 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

Table 4.6.4 shows that 23.5% of the respondents grant loan very often for real estate development purposes, 47.1% of the respondents grant loan often, 17.6% fairly often give loan for same purpose while 11.8% rarely advance loan for real estate development purposes.

**Table 4.6.5 Types of collateral accepted by bank**

| Collateral | Frequency | Percentage |
|---|---|---|
| Real Estate | 12 | 70.6 |
| Shares certificate | 3 | 17.6 |
| Bond Certificate | 2 | 11.8 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

Table 4.6.5 shows that 70.6% of the respondents said their banks accept real estate as collateral for loan while 17.6% said they accept shares certificates and 11.8% said they accept bond certificate.

**Table 4.6.6 Rate of request for valuation report in loan transactions**

| Rate | Frequency | Percentage |
|---|---|---|
| Very Often | 12 | 70.6 |
| Often | 4 | 23.5 |
| Fairly Often | 1 | 5.9 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

From Table 4.6.6 70.6% of the respondents require valuation report for their loan transactions very often, 23.5% require valuation report often, and 5.9% require valuation report fairly often. This shows that the document is important in loan transaction judging from how often it is required.

**Table 4.6.7 Level of satisfaction/reliability on such valuation**

| Level of Satisfaction | Frequency | Percentage |
|---|---|---|
| Excellently satisfied | 5 | 29.4 |
| Fairly satisfied | 12 | 70.6 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

Table 4.6.7 revealed that 29.4% of the respondents are excellently satisfied with valuation services rendered to them by Estate Surveyors and Valuers, 70.6 % are fairly satisfied with the services.

**Table 4.6.8 Does your bank grant loan facility based on FSV/MLV?**

| Yes/No | Frequency | Percentage |
|---|---|---|
| **Yes** | **17** | **100** |

**Source: Author's field survey, 2013**

All the banks grant loan facility based on forced sale value advised by valuers. None of them is neither familiar with mortgage lending value nor base their decision to lend on it.

**Table 4.6.9 How often do you suspect inaccuracy (undervaluation or overvaluation) in the FSV advised by your accredited valuer in the valuation of your collateral?**

| Degree | Frequency | Percentage |
|---|---|---|
| Very Often | 1 | 5.9 |
| Often | 9 | 52.9 |
| Rarely | 7 | 41.2 |
| **Total** | **17** | **100** |

**Source: Author's field survey, 2013**

59% of the respondents said they often suspect inaccuracy in the FSV advised by their accredited valuers and 41% rarely suspect inaccuracy.

### 4.8 General Characteristics of Development Companies

**Table 4.8.1 Educational qualification of Development Companies Officers**

| Qualification | Frequency | Percentage |
|---|---|---|
| OND | 6 | 7.5 |
| HND | 35 | 43.8 |
| B.Sc | 31 | 38.8 |
| M.Sc | 8 | 10.0 |
| **Total** | **80** | **100** |

**Source: Author's field survey, 2013**

7.5% of the respondents are National diploma holders, 82.5% are degree holders while 10% are Master's degree holders. The professional qualification of the respondents were not analysed because they are not considered relevant to the information required. However, information were sought from senior/management staff and Finance Manager, where available, as they are believed to understand the modalities for loan procurement and its correlation with valuation. The information sought there from is considered reliable for the research.

**Table 4.8.2 How often do you seek commercial loan for real estate?**

| Rate | Frequency | Percentage |
|---|---|---|
| Very Often | 41 | 51.2 |
| Often | 27 | 33.8 |
| Fairly Often | 12 | 15.0 |
| **Total** | **80** | **100** |

**Source: Author's field survey, 2013**

85% of the respondent said their companies often seek loan from financial institutions to undertake real estate projects while 15% seek loan less frequently. All the respondents said they use real estate as collateral for loan procurement

**Table 4.8.3 How often are you satisfied with the value ascribed to your collateral by the valuers employed for the exercise?**

| Level of Satisfaction | Frequency | Percentage |
|---|---|---|
| Always satisfied | 19 | 23.8 |
| Satisfied most of the time | 38 | 47.5 |
| Rarely Satisfied | 21 | 26.2 |
| Never Satisfied | 2 | 2.5 |
| **Total** | **80** | **100** |

*Source: Author's field survey, 2013*

## 4.9 Prevalent Valuation Inaccuracy and its Effects

In the section below, relative index analysis is employed to analyze the data collected.

The respondents were required to indicate their level of their agreement with the questions given five options to choose from and their responses are weighted on a five – point scale using a weighted average score. The options and their corresponding ratings are as follows: Strongly agree = 5, Agree = 4, Indifferent = 3, Disagree = 2 and Strongly disagree = 1.

**Table 4.9.1a Forms of bias considered most prevalent based on experience Banks**

| VARIABLE | Weight | | | | | Sum of weighted frequencies | RII |
|---|---|---|---|---|---|---|---|
| | 5 | 4 | 3 | 2 | 1 | | |
| Overvaluation (A) | 5 | 10 | 2 | - | - | 71 | 0.835 |
| Undervaluation (B) | 2 | - | 1 | 14 | 2 | 43 | 0.506 |
| None (C) | - | - | - | - | - | - | 0 |

**Source: Author's field survey, 2013**

**Table 4.9.1b Forms of bias considered most prevalent based on experience Valuers**

| VARIABLE | Weight | | | | | Sum of weighted frequencies | RII |
|---|---|---|---|---|---|---|---|
| | 5 | 4 | 3 | 2 | 1 | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Overvaluation (A) | 32 | 39 | 6 | 7 | - | 348 | 0.8286 |
| Undervaluation (B) | 11 | 38 | 7 | 22 | 6 | 278 | 0.6619 |
| None (C) | - | - | - | - | - | - | 0 |

**Source: Author's field survey, 2013**

**Table 4.9.1c Forms of bias considered most prevalent based on experience - Developers**

| **VARIABLE** | **Weight** | | | | | **Sum of weighted frequencies** | **RII** |
|---|---|---|---|---|---|---|---|
| | **5** | **4** | **3** | **2** | **1** | | |
| Overvaluation (A) | 4 | 55 | 21 | - | - | 303 | 0.7575 |
| Undervaluation (B) | 1 | 6 | 42 | 31 | - | 214 | 0.5350 |
| None (C) | - | - | - | - | - | - | 0 |

**Source: Author's field survey, 2013**

The result from the Tables 4.9.1a, b and c displayed for the responses of Banks, Valuers and Developers indicate that majority of the respondents (**RII = 0.835, 0.829 and 0.7575)** responding are of the opinion that **overvaluation** is the most prevalent form of valuation bias in Nigeria. The index for the developers is lower than the other two classes of respondents because a considerable few agreed or strongly agreed with option of undervaluation as most prevalent.

**Table 4.9.2a Effects of valuation inaccuracy on availability of loan advancement for real estate funding**
**Banks**

| **VARIABLE** | **Weight** | | | | | **Sum of weighted frequencies** | **RII** |
|---|---|---|---|---|---|---|---|
| | 5 | 4 | 3 | 2 | 1 | | |
| **Effect of overvaluation** | | | | | | | |
| Overvaluation create credit risk (1) | 8 | 6 | 2 | 1 | - | 72 | 0.8470 |
| It exposes lenders to financial loss (2) | 9 | 7 | 1 | | | 76 | 0.8941 |
| It causes lenders to discount FSV to afford them extra cover against loss(3) | 4 | 10 | 2 | | 1 | 77 | 0.9059 |
| Lenders give loan base on FSV regardless of knowledge of overvaluation(4) | | 4 | 2 | 8 | 3 | 41 | 0.4824 |
| Lenders tend to give loan lower | 1 | 15 | | 1 | | 67 | 0.7882 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| than FSV where there is knowledge of overvaluation (5) | | | | | | | |
| Overvaluation does not affect availability of loan for real estate finance (6) | | 3 | 4 | 8 | 2 | 42 | 0.4941 |
| Overvaluation discourages advancement of loan for fear of risk | 6 | 8 | | | 3 | 65 | 0.7647 |
| **Effects of Undervaluation** | | | | | | | |
| Where identified, lending institutions may increase loan beyond FSV | | 2 | 3 | 5 | 7 | 34 | 0.4000 |
| It reduces access of borrower to adequate loan | 2 | 13 | 2 | | | 68 | 0.8000 |
| It over protects lenders fund at the detriment of borrowers needs | 7 | 9 | 1 | | | 74 | 0.8706 |
| Makes lending institution bend their policies in favor of borrower where identified | 1 | 3 | | 1 | 12 | 31 | 0.3671 |

**Source: Author's field survey, 2013**

From the Table above, it can be inferred that overvaluation makes lenders discount forced sale value (FSV) to afford them extra cover against loss ranked 1st with 0.9059 as relative importance index (RII). This is followed by overvaluation exposing lenders to financial loss with a RII of 0.8941, and then followed by overvaluation creating credit risk with a relative importance index of 0.8470. Over valuation making lenders to give loan lower than forced sale value ranked fourth with a relative importance index of 0.7882. Discouragement of loan advancement due to fear of risk ranked 5$^{th}$ with a relative importance index of 0.7647 and overvaluation not having any effect on loan availability for real estate finance ranked 6$^{th}$ with a RII of 0.4941. Lenders giving loan based on forced sale value regardless of effect of overvaluation ranked 7$^{th}$ with a RII of 0.4824. It can be deduced from the above table that overvaluation has negative consequence on loan advancement and it makes lenders to take different precautionary measures so as to guide against risk.

Also, the effect of undervaluation can also deduce from the table 4.9.2 a.It was discovered that undervaluation over protecting lenders fund at the detriment of borrowers needs ranked 1$^{st}$ with a relative importance index of 0.8706. Reduction in borrower's access to adequate loan ranked 2$^{nd}$

with a relative importance index of 0.8000. Undervaluation leading to financial institutions increasing loan beyond forced sale value ranked 3rd with a relative importance index of 0.4000 and the least ranked factor is undervaluation making the lending institution bending their policies in favor of borrower with a relative importance index of 0.3671. It can be inferred that undervaluation protects the lenders at the expense of the borrowers based on the perception of the banks.

**Table 4.9.2b Effects of valuation inaccuracy on availability of loan advancement for real estate funding**

**Valuers**

| **VARIABLE** | **Weight** | | | | | **Sum of weighted frequencies** | **RII** |
|---|---|---|---|---|---|---|---|
| | 5 | 4 | 3 | 2 | 1 | | |
| **Effect of overvaluation** | | | | | | | |
| Overvaluation create credit risk | 54 | 30 | - | - | - | 390 | 0.9286 |
| It exposes lenders to financial loss | 60 | 22 | 2 | - | - | 394 | 0.9381 |
| It causes lenders to discount FSV to afford them extra cover against loss | 12 | 52 | 10 | 10 | - | 318 | 0.7571 |
| Lenders give loan base on FSV regardless of knowledge of overvaluation | 16 | 38 | 6 | 22 | 2 | 296 | 0.7048 |
| Lenders tend to give loan lower than FSV where there is knowledge of overvaluation | 30 | 34 | 10 | 10 | - | 336 | 0.8000 |
| Overvaluation does not affect availability of loan for real estate finance | 4 | 32 | - | 24 | 24 | 220 | 0.5238 |
| Overvaluation discourages advancement of loan for fear of risk | 34 | 36 | 12 | - | 2 | 352 | 0.8381 |
| **Effects of Undervaluation** | | | | | | | |
| Where identified, | 2 | 34 | 6 | 8 | 34 | 214 | 0.5095 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| lending institutions may increase loan beyond FSV | | | | | | | |
| It reduces access of borrower to adequate loan | 30 | 34 | 16 | 2 | 2 | 340 | 0.8095 |
| It over protects lenders fund at the detriment of borrowers needs | 24 | 56 | - | 4 | - | 352 | 0.8381 |

**Source: Author's field survey, 2013**

From the Table 4.9.2b, overvaluation exposing lenders to financial loss ranked 1st with a relative importance index of 0.9381 and overvaluation creating credit risk with a relative importance index of 0.9286 ranked 2nd. Overvaluation discouraging advancement of loan for fear of risk ranked 3rd with a relative importance index of 0.8381 and lenders giving out loan lower than forced sale value whenever overvaluation is discovered ranked 4th with a relative importance index of 0.8000. Overvaluation causing lenders to discount forced sale value to afford them extra cover against loss ranked 5th with a relative importance index of 0.7571 and lenders giving loan regardless of knowledge of overvaluation ranked 6th with a relative importance index of 0.7048. Overvaluation not affecting availability of loan for real estate finance ranked 7th with a relative importance index of 0.5238. Exposure of lenders to financial risk due to overvaluation and overvaluation not affecting loan availability for real estate finance ranking 1st and 7th respectively shows that overvaluation negatively affect loan advancement by financial institutions.

Also, effect of undervaluation was discovered from the Table 4.9.2b It was discovered that undervaluation over protecting lenders fund at the detriment of borrowers needs ranked 1st with a relative importance index of 0.8381. This was followed by undervaluation reducing access of borrowers to adequate loan which ranked 0.8095. Tendency of financial institutions increasing loan beyond forced sale value if undervaluation is discovered ranked 3rd with a relative importance index of 0.5095. It can be inferred from the table above that undervaluation protects the lenders at the expense of the borrowers based on the perception of valuers.

**Table 4.9.2c Effects of valuation inaccuracy on availability on loan advancement for real estate funding**
**Developers**

| **VARIABLE** | **Weight** | | | | | **Sum of weighted frequencies** | **RII** |
|---|---|---|---|---|---|---|---|
| | 5 | 4 | 3 | 2 | 1 | | |
| **Effect of overvaluation** | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Overvaluation create credit risk | 27 | 53 | - | - | - | 347 | 0.8675 |
| It exposes lenders to financial loss | 31 | 49 | | | | 351 | 0.8775 |
| It causes lenders to discount FSV to afford them extra cover against loss | 8 | 21 | 45 | 6 | - | 271 | 0.6775 |
| Lenders give loan base on FSV regardless of knowledge of overvaluation | - | 62 | 18 | - | - | 302 | 0.7550 |
| Lenders tend to give loan lower than FSV where there is knowledge of overvaluation | - | 53 | 27 | - | - | 293 | 0.7325 |
| Overvaluation does not affect availability of loan for real estate finance | 25 | 9 | 28 | 18 | - | 281 | 0.7025 |
| Overvaluation discourages advancement of loan for fear of risk | - | 27 | 53 | - | - | 267 | 0.6675 |
| **Effects of Undervaluation** | | | | | | | |
| Where identified, lending institutions may increase loan beyond FSV | - | 41 | 30 | - | 9 | 263 | 0.6575 |
| It reduces access of borrower to adequate loan | 18 | 53 | 9 | - | - | 329 | 0.8225 |
| It over protects lenders fund at the detriment of borrowers needs | 6 | 30 | 44 | - | - | 282 | 0.705 |
| Makes lending institution bend their policies in favor of borrower where identified | 21 | 14 | 36 | - | 9 | 278 | 0.6950 |

**Source: Author's field survey, 2013**

From Table 4.9.2c, it was discovered that overvaluation from the developer's perspective ranked exposure of lenders to financial loss due to overvaluation 1st with a relative importance index of 0.8775 and overvaluation creating credit risk for lenders

ranked 2nd with a relative importance index of 0.8675. Lenders giving loan based on forced sale value regardless of knowledge of overvaluation ranked 3rd with a relative importance index of 0.7550. This is followed by lenders tendency of giving loan lower than forced sale value where there is knowledge of overvaluation with a relative importance index of 0.7325. Overvaluation not affecting availability of loan for real estate finance ranked 5th with a relative importance index of 0.7025 and overvaluation causing lenders to discount forced sale value to afford them extra cover against loss with a relative importance index of 0.6775 where overvaluation discouraging advancement of loan for fear of risk ranked 7th with a relative importance index of 0.6675. It can be inferred from the table above that overvaluation pose threat to lenders.

Also, Table 4.9.2c reveals the effect of undervaluation on real estate finance. Undervaluation reducing access of borrower to adequate loan ranked 1st with a relative importance index of 0.8225. Undervaluation over protecting lenders fund at the detriment of borrowers needs ranked 2nd with a relative importance index of 0.7050. This is followed by undervaluation making lending institutions to bend their policies in favor of borrowers with a relative importance index of 0.6950. Lending institutions increasing loan beyond forced sale value where undervaluation is discovered ranked with a relative importance index of 0.6575. It can be inferred from the table above that undervaluation protects the lenders at the expense of the borrowers based on the perception of valuers.

### 5.1 Summary of Findings

The result of analysis undertaken by means of descriptive statistics through the use of relative importance indices and frequency distribution tables, indicates the prevalence of inaccuracy in Lagos state which corroborated the past studies undertaken by Ogunba (1997, 2003), Adegoke (2008), Ayedun (2009) amongst others. It further revealed that the most prevalent form of valuation bias is overvaluation as confirmed by all categories of respondents which were sampled. This discovery negates the assertion put forward by Ojo (2004) that mortgage valuations in Nigeria under represent the value of foreclosed collateral, rather, commercial bank respondents maintained that overvaluation is most prevalent.

The ranking of the effects of overvaluation and undervaluation on real estate development finance are slightly different based on the perspective of the Banks, Valuers, and the developers. The first three ranked

effect of overvaluation according to the bankers are as follows: It causes lenders to discount forced sale value to afford them extra cover against loss, it exposes lenders to financial loss, and overvaluation create credit risk. Also, the first three ranked effects of overvaluation on real estate development finance according to Valuers are the following: It exposes lenders to financial loss, overvaluation creates credit risk, and overvaluation discourages advancement of loan for fear of risk. Lastly, the first ranked effects of overvaluation according to the developers are the following: It exposes lenders to financial loss, it creates credit risk, and lenders give loan based on forced sale value regardless of knowledge of overvaluation.

Also, the first three ranked effects of undervaluation according to the bankers are the following: It over protects lenders fund at the detriment of borrowers needs, it reduces access of borrowers to adequate loan, and lending institutions increase loan beyond forced sale value where undervaluation is detected. According to the Valuers, the first three ranked effects of undervaluation are: It over protects lenders fund at the detriment of borrower's needs, it reduces access of borrowers to adequate loan, and lending institutions increase loan beyond FSV where undervaluation is detected. Lastly, the effects of undervaluation on real estate development finance are the following: It reduces access of borrowers to adequate loan, It overprotects lenders fund at the detriment of borrowers needs, and it makes lending institutions bend their policies in favour of borrower where identified.

### 5.2 Recommendations

- It is recommended that Estate Surveyors and Valuers should always improve their knowledge and skills by attending Mandatory Compulsory Professional Development programmes and other self-development workshops so as to improve the accuracy of services rendered.
- Banks and other clients should always provide all necessary data to Estate Surveyors and Valuers when consulting them for property valuation so as to minimize valuation inaccuracy.
- Estate Surveyors and Valuers should always keep themselves abreast of the provisions of the valuation standard so as to improve the quality of their work.
- All Estate Surveying and Valuation firms should put in place quality control measures in their practice so as to improve the reliability of their valuation reports.

- Estate Surveyors and Valuers Registration Board of Nigeria should always commission researches on property valuation accuracy and look for means to adopt the findings of such researches in the valuation standard so as to improve quality of valuation services rendered by members.
- Symposiums should be organized from time to time to bring together bank operators, valuers, developers and other valuation service users for discussions on issues bordering on valuation and client satisfaction. Effective policy decisions can be made through this medium and aid in restoring confidence in the profession. It is envisaged that this can make the lending institutions to ease up on the stringent measures they take to avoid risks emanating from valuation inaccuracy.

### 5.3 Conclusion

The study has shown that overvaluation is prevalent in the study area and the decision of lenders to mitigate the imminent credit risk which can result from this is impacting negatively on real estate finance. The contribution of the study to valuation and real estate finance literature is in the area of identifying the prevalent form of bias in valuation, mitigating measures and the effect on finance.

It is hoped that the recommendations put forward for ameliorating the problems of inaccuracy in valuations and real estate finance will show the required way forward from the present shortcomings in the profession to the achievement of client confidence.

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