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A study of valuation clients perception on mortgage valuation reliability

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The effect of overvaluation and undervaluation cannot be over emphasized in any economy. Valuation opinions are very crucial to the operations and business dealings of the clients that seek valuer's advice in decision making. Wrong opinion of value has caused strain in many business dealings. This paper studies the perception of clients on reliability of mortgage valuation in Nigeria. A sample size of 50 lending institutions was randomly chosen representing 57.5% of the target population in Lagos State, the study area. The study used descriptive statistic to analyse the data. The study reveals that clients are of the opinion that valuations produced by valuers were not reliable. This is as a result of the experiences they were having with large disparity between the final opinion of values of those properties on default mortgage that were foreclosed and the final sales price. The study therefore concludes that the estate surveyors and valuers in the country owe their clients a duty of care by presenting accurate and reliable valuation reports since other stakeholders of the real property investors depend on these reports for their investment decisions.

Key words: Nigeria, mortgage valuation, reliability, perception.

INTRODUCTION

In developing countries, the re-examination of valuation practice is either non-existent or just beginning. However, the clients to valuation profession around the world have been getting much more sophisticated and analytical in their approach to investment. Accountants, stockbrokers, and other financial analysts have progressively refined their financial techniques to meet changing clients' expectations. Unfortunately, in many developing countries like Nigeria, it seems that the real property professsional has been slow to respond to this process of change. There is the danger that the profession in these parts of the world may become a leftover in global changes. In Nigeria today, the disparity in valuation opinion of valuers has been an object of discussion in real estate profession. The competence of the valuer as well as the reliability of valuation report has been paramount in these discussions. Ogunba (1997) study was based on valuation and pricing practices in the residential property market using two residential properties that were valued by 30 different estate surveyors and valuers. He used regression statistical method of analysis and then concluded that valuations outcome of one firm is a good proxy for the other. However, this has been faulted by Ogunba and Ajayi (1998) using the same method of analysis, data size on the same study area. Aluko (2000) studied the appropriateness of mortgage valuation for institutional lending in Nigeria. The study showed among others, blind adoption of cost approach method of valuation among valuers and inadequacy of current mortgage valuation practice in reflecting marketability of a collateral property. Boyd and Irons (2002) study focused on valuation accuracy and negligence. He examined if

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reasonable care that is necessary in valuation practice was being achieved or not. The results of the findings showed that in Australia, the crucial issue is the identification and correction of errors in valuations. The study therefore concluded that there was an urgent need to improve professional practice and ensure a reasonable standard of care is attained and maintained.

Havard (2001) and Adegoke (2006) examined commercial valuation practices and procedures in United Kingdom and Nigeria, respectively. Their studies revealed that the normal behaviour of valuers and the procedures followed by valuation firms lead to a higher risk of an unreliable valuation being reported to a client under certain circumstances, namely where valuers are working in relatively unfamiliar areas. Amidu (2006) focused on the examination of the prevalence of client influence and the impact on valuation in Nigeria. The study revealed that nearly 80% of estate surveyors and valuers attested to the client influence which made valuation outcome unreliable.

According to Havard (2001), the valuation profession in the United Kingdom is mature with a well-developed theoretical and practical base. The profession is regulated by the Royal Institution of Chartered Surveyors (RICS). The ‘Red Book’ (RICS, 2000) provides rules and guidance to valuers, and a number of quality control mechanisms exist. The value-tion market is competitive; clients dissatisfied with the quality of service received can go elsewhere or pursue actions through the court. Despite this, research has shown that commercial property valuations in the UK exhibit a relatively high degree of variance (Hager and Lord, 1985; Crosby et al., 1998, 1999). The effect of overvaluation and under-valuation cannot be over emphasized in any economy.

Figures obtained during valuation exercises are very crucial to the operations and business dealings of the clients. Wrong opinion of value can cause strain in business dealings. For example, various banks have suffered losses by granting loans in excess of actual value, and many company owners have been led to believe that they were making profits in assets while actually they were running at loss. In addition, many were being led into businesses that were perceived to be profitable while in fact they were not viable.

The problem of overvaluation and undervaluation has resulted in dispute over large amount of money that sometimes run into several millions of Naira. It has also led to cases of bankruptcy, investment failures and grant of loans in excess of collateral value. This problem has being the stand point or cause of disagreement. Therefore, the claim as to the reliability of valuation figures and the degree of accuracy of estimate/worth as given by the valuer has come under scrutiny. It is also been questioned by market participants especially the clients who are individuals, corporate bodies, banks and government agencies. This is due to the effect been colossus and therefore requires thorough investigation in the form of researches.

In the continuation of worldwide concerns on the ways to ensure not only valuation reliability (Ogunba, 1997; Brown et al., 1998; French and Mallinson, 2000; Ogunba and Ojo, 2007; Ayedun, 2009; Bretten and Wyatt, 2001; Boyd and Irons, 2002; Amidu, 2006), but also a better and quality valuation reporting to clients (Crosby et al., 1998; Newell, 1999; Aluko, 2000; Newell, 2005; Lorenz and Lützkendorf, 2008; Oluwunmi, 2008; Olawunmi et al., 2011) in a recent study on clients' perception of the quality of property valuation reports, the results revealed that 62% of the banks (clients) were at least satisfied with the overall content of the valuation report they received from valuers. However, the results still showed that clients wanted some aspects of the valuation reports to be improved upon which includes; general information on comparable, valuation calculations and uncertainty in valua-tion figures. The foregoing has led to the investigation on the perception of users of valuation reports on the reliability of the opinion of value from estate surveyors and valuers.

PREVIOUS STUDIES

Previous researches into the valuation process have increasingly led to the conclusion that valuation is a very imprecise activity, much less precise than valuers would have the users of valuations believe. The imprecise nature of property valuation is borne out of a number of studies into valuation accuracy and variation. These studies have led to a number of conclusions concerning the probability of a valuation being within certain parameters of a sale price (valuation accuracy) and within another value’s valuation (valuation variation). Crosby et al. (1998) estimate that valuation variation studies suggested only a 2 in 3 chance of valuers getting within 10% of each other.

Brown et al. (1998) suggested that there is only a 1 in 5 chance of a valuer getting within 10% of a sale price. Within the courts, valuers have sustained the view that an acceptable margin of error or bracket is around +/- 10 to 15%; no expert valuer has ever argued for a bracket of more than +/- 20%. The valuation variation evidence suggested that 1 in 10 valuations are outside this margin (Adegoke, 2006). However, the research into valuation accuracy is predicated on the assumption that valuations and prices are independent of each other. This should not be the case as investors are generally increasingly sensitive to the predictive accuracy of valuations, especially with the advent of portfolio property perfor-mance measurement where property valuations are used as a proxy for property sales (Newell and Kishore, 1998). Also, Waldy (1997), Havard (1995) and Brown and Matysiak (2000) stated that on the average, the expectation of investors is that valuations should be a reasonably good proxy for prices. If this failed to happen;

Table 1. Period of establishment.

Age in years	Response frequency	Percentage of response
≤10	-	-
11-20	15	33.33
21-30	8	17.78
31-40	7	15.56
41-50	6	13.33
51-60	6	13.33
≥61	3	6.67
Total	45	100

Source: Field survey (2005).

property advice based on valuations would be invalid and performance measurement based on valuations would be meaningless.

Baum et al. (2000) stressed that valuation accuracy is the heart of client confidence and the profession needs to keep its house in order. It is for such reasons that the topic ‘accuracy of valuation’ has been sustained in UK academic and professional cycles ever since the mid 1980s. This has resulted in long series of investigative publications (Hager and Lord, 1985; Brown, 1985; IPD/Drivers, 1988; Cullen, 1994; Matysiak and Wang, 1995). It is also noted that comparable studies have taken place in the US (Cole et al., 1986; De Vries et al., 1992; Webb, 1994; Fisher et al., 1999). However, beginning from the late 1990s, some other researchers have begun investigations within their countries on valuation accuracy and variations. These types of investigations have spread to countries like Australia (Parker, 1998; Newell and Kishore, 1998) and Nigeria (Ogunba, 1997; Ogunba and Ajayi, 1998; Aluko, 2000; Adegoke, 2006; Amidu, 2006; Oluwunmi et al., 2011). There have been so many researches to address this issue but researches in this field have examined valuation with respect to methods of valuations, risk analysis, database from which valuers obtain valuation parameters. This paper is on perception of clients as the end user of valuation reports.

If we agree with Baum (op. cit.), that accuracy is the heart of clients’ confidence and that we are to become organized then, the implication is that we must investigate into the opinion of clients about the reliability of valuation outcome.

METHODOLOGY

Study area

The study area is Lagos State, Nigeria. Although, Lagos State is the smallest state in Nigeria, with an area of 356,861 ha of which 75,755 ha are wetlands, yet it has the highest population, which is over 5% of the national estimate. As at 2006, the population of Lagos State was 17.5 million (based on the parallel count conducted by the state during the National Census) with a growth rate of 3.2%, the state today has a population of over 21 million. The state is located in the South West Geo-Political Zone of the country. Until December 1992, Lagos was the capital city of Nigeria. It still remains the economic nerve centre of the country with the largest concentration of industries, financial institutions and major sea ports and is housing the headquarters of several banks, industries and commercial enterprises. It has been noted that over 50% of estate surveyors and valuers have their head offices located in Lagos State because of a very active property market (NIESV Directory, 2009). In summary the study will be limited to Lagos state majorly due to the concentration of financial institutions which are the bodies responsible for mortgage financing in Nigeria. The research study population is the lending institutions in Nigeria. As at year 2005 when the research was conducted, there were one hundred and three (103) banks to the exclusion of the Central Bank of Nigeria; 69 Commercial Banks, 28 Merchant Banks and 6 Development Banks out of which 87(84.5%) of them have their head offices situated in Lagos State (NICAPACO, 2002). Therefore, the data needed was obtained from lending institution actually involved in mortgage work within Lagos State.

The study administered questionnaires to the executives representing the mortgage department within these institutions. A sample size of fifty Institutions was randomly chosen representing 57.5% of the target population in Lagos State. Out of the 50 questionnaires administered, 45 were properly filled and returned representing 51.7% of total population of banks in Lagos State. This is a satisfactory for the study. The study used descriptive analysis to analyze the data collected.

RESULTS

The questioned was asked as to the period of establishment of the institutions. As shown in Table 1, 33.3% was established between 10 to 20 years, 17.78% was established between 11 to 20 years while 20% was established 51 years and above. There is none of the institutions that were below 10 years age in mortgage operation. This shows that they were all matured in operation and have adequate knowledge of business activities in their area of domain. Question on the average number of valuations commissioned within the last six months was asked and Table 2 reveals that majority of the respondents (55.56%) commissioned an average of 41 to 60 within every 6 months. It can be rightly assumed here that a bank is commissioning an average of 100 valuations per annum in Lagos. This shows that many people are using real property as

Table 2. Number of valuations commissioned.

No. of valuations commissioned	Response frequency	Percentage of response
1-20	3	6.67
21-40	5	11.11
41-60	25	55.56
61-80	10	22.22
81-100	2	4.44
100+	-	-
Total	45	100

Source: Field survey (2005).

Table 3. Percentages of mortgage foreclosed.

Percentages of mortgage foreclosed (%)	Response frequency	Percentage of response
1-10	26	57.78
11-20	8	17.78
21-30	5	11.11
31-40	4	8.89
41-50	1	2.22
51-60	1	2.22
61-70	-	-
71-80	-	-
81 and above	-	-
Total	45	100.00

Source: Field survey (2005).

Table 4. Valuers' opinion of values equating to sale prices.

Valuers' opinion of values equating to sale prices	Response frequency	Percentage of response
Strongly agreed	1	2.22
Fairly agreed	20	44.44
Weakly agreed	16	35.56
Not agreed	8	17.78
Total	45	100.00

Source: Field survey (2005).

collateral security in the course of their businesses. When asked about the percentage of the mortgage foreclosed out of the valuations that were commissioned within the study period of six months, the respondents' responses as can be seen in Table 3 shows that only 2.22% of respondents' banks foreclosed mortgage deals between 51 to 60%, 40% respondents' banks foreclosed between 11 to 50%. 57.78% respondents' banks foreclosed 1 to 10% while none of the respondents' banks foreclosed between 61 to 100%. This shows that majority of the valuation clients foreclosed between 1 to 10% mortgage deals within a period of six months. This can be regarded as been reasonable. However, with this foreclosure, they have to carry out revaluation of the property foreclosed; their experience on the closeness of the valuation to sales price was sought. The question was now further asked on the closeness of valuers' opinion of values to sales price. Table 4 reveals that only 2.22% strongly agreed to fact that valuers' opinion of values is close to sales price, 44.44% fairly agreed to the statement. Also, 35.56 and 17.78% of the clients respectively weakly agreed and did not agreed to the statement. Overall, one can see that the total percentage of those that weakly agreed and did not agreed formed the majority that is, 53.34%. This may be sending wrong signal to clients about valuations being produced by valuers.

Question was asked about client's perception concerning the valuation reliability. 66.67% partially agreed to the

Table 5. Perception of clients on valuation reliability.

Reliability of valuation	Response frequency	Percentage of response
Absolutely	1	2.22
Partially Reliable	30	66.67
Not Reliable	14	31.11
Total	45	100

Source: Field survey (2005).

Table 6. Clients acceptable margin of error.

Percentage of margin of error	Response frequency	Percentage of response
1-5	24	53.33
6-10	14	31.11
11-15	4	8.89
16-20	3	6.67
Total	45	100

Source: Field survey (2005).

reliability of valuation. 31.11% believed that valuation was not reliable at all, while only 2.22% believed that valuation is absolutely reliable. It can be deduced here that clients did not believe that valuations produced by valuers were reliable if only 2.22% had absolute trust in valuation. This cannot be unconnected with past experiences of clients with the degree of closeness of valuers' opinion of values to sale prices. Tables 4 and 5 are very close. The usefulness of these results is that it is showing the general dissatisfaction of banks with appraisals among foreclosed property. This should call for the Nigerian Institution of Estate Surveyors and Valuers to educate the public on what is acceptable range of value in valuation profession. These will make the valuation clients appreciate opinion of values of valuers. When asked about the acceptable margin of error they could take, majority of the valuation clients opted for a margin of between 1 to 5%. The results as shown in Table 6 revealed that in the opinion of respondents, 53.33% of them chose between 1 to 5%, 31.11% chose 6 to 10%, while 8.89 and 6.67% chose 11 to 15% and 16 to 20%, respectively.

It can be concluded that majority (53.33%) wanted valuers' opinion of value be as close as possible to sale price, even between 1 to 5% closeness. One can see that the clients of valuation profession do not even agree with the literature that has specified the margin of +/- 10%. They preferred a margin error of between 1 to 5%.

Conclusion

This study has examined the perception of clients regarding the reliability of mortgage valuation. Valuation practices of estate surveyors and valuers in Nigeria may be suffering from a number of deficiencies, the concern of this study is its inability to meet the requirement of their clients. The study revealed that clients are of the opinion that valuations produced by valuers were not reliable. This is as a result of the experiences they were having with large disparity between the valuations values of properties on default mortgage and foreclosed ones. The results showed that at the time of selling those properties, the sales prices are always far from the valuers opinion of value. The clients were not even satisfied with literature which established a margin of error of +/- 10%. They preferred an atmosphere where they would be able to completely rely on the final opinion of value for their business dealing, with majority of them chosen a margin of error in the range of +/-5%. This development should be of concern to the professional bodies [Nigerian Institution of Estate Surveyors and Valuers and Estate Surveyors and Valuers (NIESV) and Registration Board of Nigeria (ESVARBON)]. However, the absence of sufficient market transaction of a truly comparable nature and lack of databank in Nigeria make pricing somewhat difficult and subjective.

Computer modelling should be encouraged to provide a good database and develop computerised valuation technique. There should be an increasing focus on client needs in the preparation of mortgage valuations. A professional exists to meet his clients' needs. The professional services of the estate surveyors and valuers should be made available to his clients. He owes his clients a duty of care and should avoid misleading his clients by presenting inaccurate and unreliable valuation reports since other stakeholders of the real property investors depend on these reports for their investment decisions. The estate surveyors and valuers should understand what motivate investors (the purpose of invest ing) and be exposed to investor altitudes in order to produce accurate valuations. Moreover, in order to reduce the level of valuation variation by estate surveyors and valuers so that the level of consistency can be improved, the profession has to improve on lay down valuation standards for mortgage purposes and probably for other purposes too. The improve standards should cover the areas like bases, methods and procedure for mortgage and other purposes. The current Guidance Notes on Property Valuation published by the NIEVS in 1985 should be reviewed and be up dated to allow for the improvement and compliance with that of international standards. High ethical standards, independence and professionalism in valuation practice should be encouraged. Failure to do this, situation could pose a serious threat to the credibility and integrity of valuers and even damage the public image of the estate surveying and valuation profession in the nation. This could also lead to the profession being obsolete and encourage incursion of other professionals into this core area of the Estate Management profession.

Already, there is an existing attempt by professionals such as the quantity surveyors, the engineers and accountants, to make in-roads into the valuation profess-sion. This may lead to a substantial loss of business for many valuers as clients may look for other means of appraising property values. This may also increase the valuer's exposure to claims of negligence. Hence, the Disciplinary Committee of the professional bodies in Nigeria should be strong and resolute in punishing erring members who might want to bring the profession into disgrace in the performance of the valuation function.

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