

*Original Research Article*

# Challenges of mortgage valuation in Port Harcourt, Nigeria

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**This paper examined the continuing challenges confronting Mortgage Valuation in Port Harcourt, Nigeria. Accordingly, this paper critically analyzed the nature, causes and types of challenges faced while carrying out Mortgage Valuation. It also tries to draw out solutions from theory and practice for implementation by three major stakeholders; the academia, practitioners and the regulatory institutions. Questionnaire was administered to (30) estate surveying firms randomly selected in the study area, while 27(90%) was retrieved and used for the study. Presentation and analysis of data was done using frequency tables and percentages. The findings of the study revealed that there is total neglect of valuation guidelines by valuers' is major challenge that confronts mortgage valuation. Furthermore, the study revealed that most estate surveyors assigned for valuation inspections are not properly supervised. On the strength of the findings, the study recommends that estate surveyors and valuers' should have updated property vending desks in their offices.**

**Key words:** challenge, mortgage, valuation, property.

## INTRODUCTION

To carry out valuation exercise on real property is indeed a herculean task. Real property itself possesses essential characteristics of which also affects the purpose for which they are valued; Mortgage Valuation is not an exception. The major reason why any property owner may resolve to mortgage his property is that the capital requirements for property development is very high, so his equity fund is insufficient for him to solely take care of the overall cost of developing a property.

Valuations are undertaken for several purposes, which could either be for; sales, purchase, balance sheet, compensation, insurance, and mortgage to mention only but a few. The valuer's main aim in carrying out mortgage valuation is to determine the price of a property if a forced sale becomes necessary. The reason being that, in such circumstances it is not always possible to put a property in the market at favourable time.

Valuers are generally advised to be very cautious on the amount which might be obtained in adverse conditions. The final worth of the property in this instance may

considerably differ from that applicable to a valuation for sale which in most cases could be obtained through transaction at favourable times.

From the above comments mortgage value is simply a value that would be acceptable to a willing vendor who is under duress. The pressure on the vendor to sell the property (collateral security) to redeem the loan plus interest, will force him to give it at a price almost equivalent to "a give - away - price". It requires that the net income from the property be estimated on a sound basis and also making provision for all the accruing interests from the loan. Before the Valuer will finally arrive at his opinion of value, the effect of the risk of future depreciation will be considered using the following yardsticks; age of property, neighborhood, type of property, maintenance cost, market, the geology of site, neighborhood characteristics and physical conditions of the property.

Having considered all the above the valuer would then arrive at the forced sale value, which in most cases ranges between 65% - 75% of the Open Market Value, as the case

may be.

### **Problem statement**

Due to the fact that there is no generally accepted method which valuers apply in valuing properties for mortgage purpose in Port Harcourt, according to Kuye (2000), "Some Valuers have often over valued some properties being pledged as security for loans and advances. This is caused mainly by valuers considering the cost methods of valuation without making reference to the income approach". Other errors contributing to this problem are; dearth of rental evidence and inaccurate capitalization rate. To worsen the situation, some valuers abandon the correct procedures of arriving at opinion of values and resort to satisfying the mortgagor's demand in terms of value by way of demanding and accepting gratification from the mortgagors. All these results to wrong opinion of Values/Value estimates.

### **Aim and objectives of the research**

This research is aimed at critically analyzing the challenges encountered while executing mortgage valuation.

The objectives to be achieved are;

1. To examine the various purposes of valuation.
2. To look at the techniques employed in mortgage valuation.
3. To highlight the challenges confronting mortgage valuation exercises in the study area.
4. To make useful recommendation on the way out of the challenges confronting mortgage valuations.

### **Literature review**

#### **The concept of valuation**

Webster dictionary defines Valuation as "the act of valuing, or estimating value or worth, specific act of setting or determining the price of something-, as land or commodity by its market value.

Millington (2006), defines Valuation as "the art or science of estimating the value for a specific purpose of a particular interest in property at a particular moment in time, taking into account all the features of the property and also considering all the underlying economic factors of the market, including a range of alternative investment.

Baum and Mackmin (1996), defines Valuation as "the art or science of estimating the value of interest in property". But as explained by Ifediora (1993); "Valuation is an answer to a problem". The approach to the solution of a problem may take many forms. On one hand it can be systematic and procedural; on the other hand it can be adhoc and unconditional. The systematic approach to problem solving lies in its systematic process. Valuation is

both an art and science. It is science because it adopts the scientific process of establishing facts, making observations and drawing conclusion from practical data. It is an art because it is not only a mathematical process but depends on experience of several factors that affects value in a specific locality.

Having effectively completed the above actions, the conclusions reached by the valuers in valuation analysis are communicated to the client in a valuation report.

According to Udechukwu (2008), "Professional Valuers are required to conduct their valuation activities in compliance with the requirements of the Standards of Professional Valuation Practice, and Institution members must adhere to the organization's code of Professional Ethics.

#### **The purpose of valuation**

According to Udechukwu (2006); "the purpose of valuation defines the use to which the valuation is to be put or the problem to which valuation would provide the solution. Consequently, it is the client who determines the purpose for which a valuation is undertaken.

According to Millington (2000), in his definition of valuation stated that it was the art or science of estimating the value for a specific purpose." Specific purposes expresses the fact that properties may be used for a whole range of different reasons. However, the real significance is that there can be wide variety of reasons (purpose) for requiring a Valuation. Key among the purposes of valuation are; Sales, purchase, mortgage, rating and taxation, compulsory acquisition, insurance, probate etc among others.

#### **The methods of valuation**

The process of estimating market values is referred to as valuation. The valuer's task is to give advice on value in monetary terms for an interest in real estate, having regard to the purpose for which the valuation is required and the factors affecting value.

The factors adopted by valuers to accomplish this depends on evidence available, the nature of interest being valued and the purpose for which the valuation is being carried out.

The method of valuation is defined as the various approaches which an experienced Estate Surveyor and Valuer adopts in arriving at his valuation opinion; Kuye (2000).

The six basic methods of valuation are;

- (a) Direct Comparison Method
- (b) Investment Method
- (c) Residual Method
- (d) Contractors Method
- (e) Profit (or account method)

(f) Discounted cash flow technique.

### **The concept of mortgage**

Olaley and Adegoke (2007), said that "Mortgage can be described as the process of using a property as security for borrowing so as to purchase or develop a property. It is essentially a transfer of an interest in property as security for loan. It is a conveyance by a borrower of his legal or equitable interest in property to a lender as security for loan with a provision for redemption upon the payment of the loan.

Also, Wikipedia (2008) defines mortgage as "the security created on the property, by the lender, which will usually include certain restrictions on the use or disposal of the property (such as paying any outstanding debt before selling the property)". A home buyer or builder can obtain loan either to purchase or secure against the property from any financial institutions, such as a bank either directly or indirectly through intermediaries. The features of mortgage loans such as the size of the loan, method of payment of the loan, and other characteristics can vary considerably. The mortgage lending also take into account the perceived risk of the mortgage loan which means the likelihood that the funds will be repaid (usually considered a function of the credit worthiness of the borrower); that if they are not repaid, the lender will be able to foreclose and recoup some or all of its original capital; and the financial, interest rate and time delays that may be involved in certain circumstances.

### **Classification of mortgage**

Generally, mortgage is categorized into two;

#### **Legal mortgage**

The legal mortgage gives the mortgage right against the property of the mortgagor apart from any personal action against the mortgagor (borrower) the mortgage gets a legal estate in the property and has a lot of rights which can be afforded at the mortgagee's instance.

A legal mortgage prior to 1978 can be created in the following ways;

#### **By demise**

In case of fee simple interest, the mortgagor conveys the whole of his interest to the mortgagee, and at the same time entering into a covenant for the repayment of the loan with the provision that the mortgagee would on the repayment of the loan on the date stated re-convey the fee simple interest to the mortgagor.

#### **By sub-demise**

In case of a lease where the mortgage either conveys a

sublease of his leasehold interest to the mortgage for a term less by one day at least than his own terms, or the mortgagor may assign the whole of his unexpired term to the mortgagee; a legal mortgage exist.

### **Equitable mortgage**

An equitable mortgage is the type that the mortgagee has no right against the property but only a personal right against the owner; that means the right to participate in the proceeds of sale of the property when sold and a right to enforce the mortgagee's claim by invoking the aid of the court. The mode of creating equitable mortgage in Nigeria is uniform.

Equitable mortgagees arise where;

i. There is a written agreement between the parties, to create a legal mortgage in favour of the mortgagee.

ii. There is both written agreement deposited of little deeds relating to the borrower's land with the intent to treat the land as security.

iii. There is a deposit of title deed by the mortgagor's with the mortgagee.

iv. A second or subsequent mortgage is created by the mortgagor in respect of the same interest which he has granted a first mortgage.

v. Through an equitable charge of the mortgagor's property in which case no interest is conveyed to the mortgagee.

### **Mortgage foreclosure process**

The term foreclosure refers to the process of seizing control of the collateral for a loan and using the proceeds from the sale to satisfy a defaulted debt. When a borrower fails to make payment or default on other terms of default on other terms of mortgage, the mortgagee's first option is to do nothing but hoping that the default will be cured in the near future and no further problem with the loan will occur. It is customary for lenders to send a defaulting borrower a rather stern letters, warning the mortgagor to cure the default immediately of the property will be foreclosed.

If the warning does not receive the required result the mortgage begins a foreclosure proceeding. It starts by filling a foreclosure suit with a court of competent jurisdiction. He is required to notify the mortgagor and all the other persons who claim an interest in the mortgaged property of the foreclosure proceeding so that they can protect whatever interest they have.

The mortgage will obtain his judgment decree from court at the conclusion of the process. This decree is filed with the court and order for direct sale is given at a public auction, this notice of foreclosure sale is made known to defendant and published in newspapers.

Any successful bidder receives a court certificate (for states having statutory law of redemption) or a deed for other states. If money is surplus after sale, junior mortgage will be paid off in order of priority but if the proceeds are

not able to pay off first mortgage the mortgagee will file for deficiency judgement on the note.

### **Challenges confronting mortgage valuers**

In carrying out valuation practice certain features are responsible for the problem of accuracy and irrationality in Nigeria. They include among others;

#### **Reverse yield gap**

According to Ogunba and Ojo (2007), inflation in Nigeria has resulted in a reverse yield gap situation since the beginning of the recession of the 1980s which has been responsible for the invalidation of rules of thumb previously held in stable market conditions. This has resulted in confusion among valuers as to the ability of the investment method of valuation to produce accurate results.

#### **Using varying valuation methods**

Another cause of inaccuracy in mortgage valuation has to do with the use of different methods of valuation for the same property even when the basis of valuation is open market value.

Ajayi (1998), recommended the use of investment method of valuation by valuers when determining open market value for income producing properties. However, because of the influence of the reverse yield gap which the investment method inadequately account for, many practicing valuers use the cost method as a preferred method to determine open market value of properties.

#### **Application of different valuation inputs**

Inaccuracy in valuation estimate is caused by using different inputs in valuation equation. In investment method, the major inputs for determining capital value are; gross income, outgoing and yield. Ogunba (1997) and Ajayi (2003) noted that the mode of determining the values of these variables in the investment valuation formula differ widely from time to time.

On cost method of valuation, some practitioners source their cost inputs from Quantity Surveyors, others from builders and contractors. The analysis of cost from diverse sources is bound to produce varying result and these would lead to divergent valuation estimates.

#### **Heuristic valuation and client's influence**

A heuristic situation is where a valuer forms a pre-conceived opinion on the worth of a property to be valued and the works as to arrive at that pre-conceived value. Some cases arise where the client is aware of the worth of his property before the actual valuation is carried out.

Where this is the case the valuer will resort to adjustment of the value to arrive at that pre-conceived amount without necessary analytical judgment.

Also the increasing rate of client influence especially in mortgage valuation is very challenging. In this situation the valuation calculation cannot be accurate.

#### **Valuation irrationality**

Valuers' have argued severally, that it is illogical to capitalize the term rent (as fixed amount) at the market derived all risk yield since this yield reflected the income growth expectations of investors. Likewise, the conventional use of the full rental value as at the date of valuation to represent the full rental value as at the date of reversion became irrational as the rental value should reflect rental growth. The problem of valuation irrationality is in connection with situation of rising rental income which made investors to begin expecting income growth which reflects that an appropriate capitalization rate will be applied. This change in investor's expectation was without a corresponding change in valuers investment valuation procedure, resulting to questions surrounding the conventional investment valuation method.

#### **The study area**

Port Harcourt is the capital of Rivers State. It is geographically located in the Niger Delta region of Nigeria. The city lies in the flood plain of the coastal region of the State, crisscrossed by creeks and rivers. Its geology and topographical form are depicted by wetlands, marshes and deltaic swamps (mangroves) especially at the southern and western parts of the city. These natural land constraints have a strong bearing on the directions of development and communications cost even though its tourism potentials have not been utilized. Port Harcourt has a tropical climate with a mean yearly temperature of thirty degrees Celsius (30°C), eighty six degrees Fahrenheit (86°F), a relative rainfall of about two thousand and three hundred millimetres (2,300mm) with the highest rainfall in July to May with temperatures of thirty two degrees Celsius (32°C) and ninety degrees Fahrenheit (90°C) or above. However, the climate is moderated by the stabilising influence of the Atlantic Ocean and the humid air over the delta region. With the oil terminal at Bonny and the new port complex at Onne, Port Harcourt constitutes the second largest port complex in Nigeria. It is also the centre of the oil industry in the country and is home to the head offices of multinational oil and gas companies. Thus, the city has a pre-eminent position in the national economy. All these factors have implications for Port Harcourt as an industrial centre and as a zone to which many people migrate to, from around the Country and West Africa with consequential pressure on available resources.

**Table 1.** Method of Mortgage Valuation Used

S/N	Variable	Response	Percentage
1	Investment Method	6	22
2	Comparative Method	5	19
3	DRC Method	16	59
4	Profit Method	-	-
5	Residual Method	-	-
6	DCF Technique	-	-
	<b>Total</b>	<b>27</b>	<b>100</b>

Source: - Authors field survey

**Table 2.** Associated problems with mortgage valuations

S/N	Variables	Responses	Percentage
1	Choosing appropriate yield	14	51.9
2	The impact of mortgagors on mortgage valuation	8	29.6
3	Over valuation	5	18.5
	<b>Total</b>	<b>27</b>	<b>100</b>

Source: Authors field work

## RESEARCH METHODOLOGY

This study employed the survey method in which the simple random sampling technique was adopted to select the sample size. Questionnaires were administered to obtain relevant data from registered estate firms as they were expected to have greater experience of valuation practice and procedure. They are also expected to have greater knowledge base regarding observation of valuation challenges in practice. In particular, they were able to provide a strategic overview of the various challenges that confronts them while trying to execute mortgage valuations. A total of twenty-five (25) estate surveying and valuation firms were sampled in the study area. Data were analyzed with the use of frequency Tables and percentages.

## DISCUSSION OF FINDINGS

From the Table 1 above, the highest percentage of respondents agreed on the use of Depreciated Replacement Cost method (about 59%), while 22% agreed on investment method and 19% use comparative method. It goes further to show that majority of Estate firms in Port Harcourt use the DRC method of valuation for mortgage valuation than the use of other methods.

From Table 2 mortgage valuation has been identified with numerous challenges. Some of the problems include, choosing the appropriate yield for the valuation, the influence of mortgagors on valuation exercise as well as over valuation by valuers based on the clients needs.

Mortgage transactions have been characterized with numerous problems both to the client and the Estate

valuers. Other identified problems include dearth of data on rental analysis which affect market value of properties, unfavorable inflationary trend in property market in Port Harcourt, the use of inexperienced staff with little or no supervision during valuation inspections as well as rise in population which most times result to unrealistic market rents.

## Conclusion and recommendations

It has been established from the findings that mortgage valuation is not an easy one. Moreover, Estate firms in Port Harcourt use different approaches to value properties. For those that use the DRC approach determining an appropriate depreciation rate impose a very great challenge.

Moreover, the data made available to valuers are most often insufficient and unreliable, especially information regarding the subject property(ies).

Having considered the challenges associated with mortgage valuation, the following recommendations are proffered.

1. Estate Surveyors and Valuers should be upright in character to avoid undue influence that will lead to unethical practice due to arbitrary behaviours.
2. Purposes of valuations should be clearly stated on every report and to avoid valuations been done on different basis other than that which it was meant for.
3. It is established by this study that valuers use varying and unethical approaches while carrying out mortgage valuation.

Here, the researcher recommends that Estate valuers

should as a matter of fact adhere to valuation guideline in all their dealing especially as it relates to mortgage valuation.

4. Generally, at the stage of data collection and literature review, the researcher observed that lack of data bank is a major problem in Nigeria real estate industry. The scarcity of data, delay and even frustrates researches. Therefore, it is recommended here that estate surveyors and valuers as well as property analysts should have property data vending desks in their offices.

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