

Valuation Inaccuracy: An Examination of Causes in Lagos Metropolis

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Abstract

Valuation plays essential roles in the property market either for loan purposes, sale transactions, and portfolio management or performance measurement. Previous studies had established that there was valuation inaccuracy everywhere in the world, including Nigeria. This study examined the causes of such inaccuracies. Survey approach was used in carrying out the study. 150 questionnaire was retrieved out of 300 questionnaire (i.e. 50%) administered on the respondents selected from the Nigerian Institution of Estate Surveyors and Valuers' Directory and this was used for the analysis. Descriptive statistics was employed in the analysis of the data collected. The study revealed that valuation inaccuracy in Lagos Metropolis result from dearth of market evidence (data), use of outdated valuation approach and clients' influence. The study established that Valuers in the metropolis engaged in general practice. The paper recommends that Nigerian Valuers should join hands in providing centrally organised databank which will reduce the level of inaccuracy in valuation.

Keywords: Firms, Information, Price, Property Market, Valuer

1. Introduction

Property market and real estate valuation practice in Nigeria evolved through various stages right from independence due to growth and development in the nation's economy. Prior to what operate now, and before mid 70s status symbol and prestige were the main focus of property ownership hence real estate was not considered as investment opportunity. The result therefore was there were few transactions that require valuation assignments

However, with urbanisation resulting from economic growth and oil boom, unprecedented demand for all forms of accommodation to meet space requirements for the increasing spate of activities and population growth became a serious issue to grapple with and this resulted in change of focus. Property is now seen as a good investment vehicle which requires proper pricing so as to ensure that parties involved in any transaction are not economically short-changed. To achieve economic sustainability in property transactions requires proper assessment of the value through accurate valuation.

"The principal issue in valuation accuracy is standardising the information set to ensure that all Valuers are equally informed. Valuations are a function of information. The better the information set the better the valuation. If a group of Valuers each have a different view of the market then the distribution of valuations would have a wider variance than those which are based on similar information... The spread of valuations will depend upon the completeness of the information set. In fact it is the difference in interpretation of the information which leads to possible transactions." (Brown, 1992). Ajibola (2006) observed that unlike other markets such as equity and gilt markets, where the market price of security can easily be determined based on the prices of similar assets traded in the secondary market, the property market, by nature, is characterized by heterogeneous commodities coupled with the fact that there is no centralized market for real property and this makes it difficult to determine the market price of real property since there are no given prices hence the quest for valuation. In other words, the property market is characterized by high level imperfection and this has given rise for variation. Because of the imperfections of the real property market and the need for Valuers to assume efficient pricing, consistency among valuations, usually is not one of the attributes claimed for the valuation profession (Aluko, 1998)

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/production of capital funds, the corresponding role of valuation, as the basis for transaction figure, should not be compromised. However, since most interactive human endeavours are fraught with disputes, claims and counterclaims, the valuation practice is no exception. So, more often than not, occasions arise when valuation figures become suspect as clients find it difficult to realise the appraised value when eventually the property is sold. On the other hand, some clients still suffer from the inconsistency if their properties got disposed at values in excess of appraisal.

It need be pointed out that in Nigeria; there had been incursions by other professionals into the realm of property valuation. The Engineers, in the past had claimed to be the best placed professionals to value plant and machinery. Also, the Accountants and Bankers believe that the conventional valuation methods are shrouded in mystery and indefensible. The average layman, these days, sees Valuer's advice as driven by the quest for higher fees. While it has been agreed that valuation is imprecise hence, some level of inaccuracy and variation expected, it is equally important to ensure that valuation is close to the sale price due to the essential roles it performs in

property market. For example, it provides advice on prospective purchase and sale, and supply material information to underpin the property lending decision. Also valuation plays important role in the internally generated revenue (IGR) of any economy. The various taxes on property are usually based on the value of the property under consideration. With these pertinent roles, it is therefore important that valuation figure(s) should not result in economic loss to all parties involved.

2. Literature Review

Studies in valuation accuracy first surfaced in the 1980s in response to a number of events when companies were the subject of privatisation or take-over/merger. Valuations of the same assets by different valuation surveying firms acting for various interest groups showed substantial discrepancies and assets of privatised companies were sold off at prices substantially in excess of their valuation (Crosby, Lavers, Foster, and Williams 1997). Questions about valuation accuracy was triggered of by the work of Hager and Lord (1985) when a small sample survey was conducted on ten Surveyors who were invited to value two properties and in one case a range of valuation was $\pm 10.6\%$ and in the other was $\pm 18.5\%$ suggesting a relatively low level of valuation accuracy. However, according to Reid (1985), the information and instructions given to the Valuers and the quality of their response given the absence of a fee could have contributed to the level of accuracy observed in Hager and Lord (1985) study. In 1988, Investment Property Databank in conjunction with Drivers Jonas (Drivers Jonas/IPD 1988) used their data base to identify a sample of 1442 properties with sale prices between January 1982 and March 1988 and at least two professional valuations in the previous two calendar years prior to the sale. Care was taken to ensure that the price was not known at any of the valuation dates used in the analysis. Valuations were therefore carried out at least 4 months and with an average of 9.7 months before the sale date. The result was an R^2 of .93; the valuation predicted 93% of the eventual sale price. However, the result also indicated a conservative bias in valuations.

In 1990, Drivers Jonas and IPD updated and extended the study, including 2,384 transactions and assessing results year by year between 1982 and 1988. Over this period, the number of valuations falling within $\pm 10\%$ of the sale price was 30%. The number of valuations falling within $\pm 20\%$ was 67% therefore 33% or one-third of valuations fell outside the 20% bracket. Since 1992, the proportion of valuations within 20% of the sale price has increased to 80% (this is also true for the unpublished 1995 transactions). Between 1982 and 1991 the number of valuations within $\pm 20\%$ averaged only 63%. As expected in rising market between 1988 and 1989, Drivers Jonas/IPD found that the number of valuations within 20% of the sale price reduced considerably, 56% in 1988 and 52% in 1989. Matysiak and Wang (1995) used a database of 317 sales between 1973 and 1991 from the JLW Property Performance Analysis System. The valuations were conducted between 3 and 6 months prior to the sale. They found that 177 properties were undervalued by an average of 21.1% and 134 properties were overvalued by an average of 11.5%. Additional analysis found that there was undervaluation in the heavily rising market of 1987 and 1988. Although evidence was not conclusive in other rising and falling markets during the period under review, tentative conclusions were that Valuers undervalue in bull and overvalue in bear markets. It was also concluded that the probability of achieving a valuation within $\pm 10\%$ of the sale price was only 30%, between $\pm 15\%$ was 55% and $\pm 20\%$ only 70%. Matysiak and Wang suggested that valuations are higher than sale prices when the market is falling and lower than selling prices when the market is rising. Over/undervaluation could pose serious economic problem especially when mortgage transaction is involved. This may discourage lenders from advancing loans on real estate and the resultant effect is underdevelopment in real estate market which will in turn affect economic growth.

The major valuation accuracy study in the US was carried out by Cole, Guilkey and Miles (1986) between 1985 and 1986 using the National Council of Real Estate Fiduciaries database of valuations transaction prices. The study was based on 144 transactions, which took place between January 1974 and June 1984. The lag period was taken into account by adjusting the valuation according to inflation between the date of valuation and the date of sale. The results indicated that the last appraisal value was on average, over 75% (inflation adjusted) different from the sale price. A range of +18.1% to -28% was found. That study also examined the standard deviation of the absolute percentage difference. They found it rather disturbing that the most current appraisals exhibit nearly as great a standard deviation as the more distant appraisals. It was concluded that the overall results do not indicate a high degree of reliability in the individual commercial appraisal product.

The first known valuation accuracy study in Australia was carried out by Newell and Kishore (1998). The study was conducted on the accuracy of commercial property valuations as an effective proxy for sales using the commercial property monitor (CPM) database, MSW value-General records and the Independent Property Trust review transaction details. A total of 218 commercial property sales (consisting of 101 office and 117 retail properties worth \$15.5 billion from Sydney over the period of 1987-1996) were examined for the study. They adopted the regression-based procedure used in Matysiak and Wang (1995). Having accommodated the time lag between valuations and subsequent sales of the properties as well as the differences on the market conditions by introduction of dummy variables, the resultant regression equation portrayed that valuation generally on average are an effective proxy for sales particularly after necessary adjustment are made for timing and the state of the market.

3. Nigerian Studies

The first known study into valuation accuracy in Nigeria was carried out by Igboko (1992). This was followed by Ogunba and Ajayi (1998), the study examined the accuracy and variation in investment valuations in Nigeria using Lagos metropolis as the study area. The findings revealed that valuations are not a good proxy for market prices, since the results obtained from the statistical calculations demonstrated a dispersion of values far in excess (33.43% - Victoria Island property and 36.47% for Ikoyi property) of the accepted norm of $\pm 5\%$. However, the fact that only two (2) properties were considered for the study made the eventual conclusions arrived at suspect just like what happened to Hager and Lord (1985) study, where the sample size was considered small as a result of which it was considered unrepresentative. Secondly, the study used properties located in Lagos Island axis to the detriment of other parts of Lagos metropolis, hence the conclusions arrived at cannot be said to be the true reflection of what happens in other parts of the metropolis and hence the need to expand the scope of this study with a view to covering a wider part. Expanding the study coverage to the whole of Lagos and increasing the number of properties to three (3), in different locations, Ajibola (2006) got a range of between $\pm 24.82\%$ for Ikoyi and $\pm 51.54\%$ for Ojodu Area. He posits that though there is relative bridging of gap with that of Ogunba and Ajayi (1999), the valuation is still not a good proxy for sale (transaction) prices. From all the studies mentioned above, it is clear that valuation inaccuracy is a stumbling block for meaningful economic development in the field of real estate in Nigeria.

4. Courts' Opinion

Outside Nigeria, the courts had equally been involved in the determination of the acceptable margin of valuation inaccuracy. Watkins J in *Singer & Friedlander Ltd v John D Wood & Co* [1977] 2 EGLR 84: ruled that "The valuation of land by trained, competent and careful professional men is a task which rarely, if ever, admits of precise conclusion. Often beyond certain well-founded facts so many imponderables confront the valuer that he is obliged to proceed on the basis of assumptions. Therefore, he cannot be faulted for achieving a result which does not admit of some degree of error. Thus, two able and experienced men, each confronted with the same task, might come to different conclusions without any one being justified in saying that either of them has lacked competence and reasonable care, still less integrity, in doing his work ... Valuation is an art, not a science. Pinpoint accuracy in the result is not, therefore, to be expected by he who requests the valuation."

Similar pronouncements from UK Courts of Appeal are in tandem: "Valuation is not an exact science; it involves questions of judgement on which experts may differ without forfeiting their claim to professional competence" (*Zubaida v Hargreaves* [1995] 1 EGLR 127). And: "Valuation is not a science; it is an art and the instinctive 'feel' for the market of an experienced valuer is not something which can be ignored" (*Craneheath Securities Ltd v York Montague Ltd* [1996] 1 EGLR 126).

It is however important to note that the courts are mindful of the use to which a property is put before deciding on the size of range to apply to bring a valuation within the permissible accuracy bracket. Watkins J in *Singer & Friedlander Ltd v John D Wood & Co* (1977) 2 EGLR 84 accepted $\pm 10\%$ in respect of valuation of a large rural site intended for residential development while there are examples of higher "brackets" adopted in commercial properties as in *Corisand Investments Ltd. v Druce & Co* (1978) 2 EGLR 86, where the plaintiff agreed to $\pm 15\%$ on the valuation of an hotel; *Mount Banking Corporation Ltd v Brian Cooper & Co* (1992) 2 EGLR 142, where the plaintiff accepted 17.5% on a residual valuation.

The fact that courts of competent jurisdiction lend their voices to need for valuation accuracy, albeit reasonable margin for inaccuracy, is a pointer that if minimum level of inaccuracy is achieved, there will little or no course to for legal tussle on real estate investment, while the time and resources committed to prosecuting such cases could be economically used for the sustainability of real estate sector of the economy.

5. Causes of Valuation Inaccuracy

To date, other than an acceptance that valuation is not an exact science, there has been a lack of convincing explanation for inaccurate or widely differing valuations. Commentaries on negligence cases have concentrated on the extent and the circumstances of Valuer's liability rather than looking for causal patterns. Most research relating to commercial valuations has concentrated on the output of the valuation process. Previous studies have examined the ability of valuations to predict the sale price of commercial properties (IPD/Drivers Jonas, 1988 and 1997; Matysiak and Wang, 1995; McAllister, 1995) or the variability or reliability of commercial valuations in the UK (Hager and Lord, 1985; and Hutchinson et al, 1996). Crosby et al (1998) did examine a number of cases, particularly on the difference of opinion between expert witnesses. They examined the degree of variance between experts in the cases and looked at the accuracy achieved in different kinds of valuation instructions (e.g. residential valuations, commercial instructions, etc.), but they did not try to examine the root causes of variance in each case. Harvard (2001) identified causes of valuation inaccuracy to include among others: errors in survey, insufficient depth of investigation, errors in procedure, differences arising out of different methodologies and client pressure or influence. The accuracy of valuations is shown to be partially dependent on local variable factors such as the extent of information, the variability of local cycles and the heterogeneity of the stock. Baum,

et. al. (2001) identified the influence of Valuers (the use of heuristics) and clients' influence as the main causes of valuation inaccuracy.

6. The Relationship between Real Estate Valuation and Sustainability

The lack of evidence demonstrating the financial benefits of sustainability in real estate is preventing a more significant investment in sustainability; as stakeholders are hesitant to invest capital in initiatives that do not demonstrate a clearly positive effect on market value. Sustainability has a multi-faceted list of benefits; however the drivers in the property market are focused upon the financial viability of an investment. Although there are many theoretical financial benefits Valuers have struggled to identify and verify the connection between sustainability and market value in commercial property (Warren, Bienert, & Warren-Myers, 2009).

Property valuation and the services that property Valuers provide are critical for the functioning of property markets, interconnected financial markets as well as of national economies. Poor property valuation has a domino effect and can lead to corporate financial crises, which can in return result in severe crisis within national economies. Property Valuers are the independent axis around which property information flows. They touch every aspect of development from feasibility studies in the beginning of a project to the determination of value when an asset is to be taken by the government or destroyed to make way for new growth (Motta and Endsley, 2003).

The basic goal of property valuation is to provide a monetary measure of the utility derived through the access to and control of property. The value of property is determined through the flow of services it is capable to provide for the satisfaction of human needs; i.e. the increment in well-being dependent upon it, or – what is the same – the impairment of well-being that its loss must bring about. Since property prices cannot be observed in the marketplace as is the case with the prices of stocks and bonds or other regularly traded homogenous goods, property valuation involves a comparison of past prices (i.e. exchange ratios between money and property) of more or less comparable property assets. But whenever property Valuers compare prices they need to bear in mind that prices are social phenomena brought about by the interplay of constellations of price-determining factors. And there is nothing constant and invariable in these prices or exchange ratios. They are permanently fluctuating.

If conducted appropriately, a property valuation (the attempt to provide a monetary measure of the utility derived through ownership and/or use of property) should be understood by everyone, regardless of whether the end-user of a valuation is committed to sustainable building or even aware of its benefits. Since one form of property valuation – i.e. market valuation – requires estimating the most likely sale price, these valuations need to account for sustainability issues only to the extent to which these issues impact on the competitive position of property assets in the marketplace. Market valuation also implies that only direct monetary benefits or reductions in property-specific risks that are realised by the owner or user of the asset have to be taken into account within the valuation process. Indirect or non-monetary benefits that are realised by society or the environment are not to be considered.

Valuation is critical to sustainability take-up in real estate transactions because the combined monetary value of the building and land, as identified in the valuation process, remains an important consideration for many stakeholders. These stakeholders include investors and owners who refer to the market value on behalf of their shareholders, as well as financiers who rely on the value for lending purposes.

Real estate Valuers are required to have extensive education, training and experience before they are recognised as professionals, with the majority of valuation assignments focussing on market value (Australian Property Institute; API, 2007). It is essential that a Valuer keeps up-to-date with prevailing market trends and accurately reflects the effect of these influences on the value of sustainable real estate. Sustainability has rapidly become an important influencing factor in the assessment of value, where each building is directly and indirectly influenced by its level of sustainable features (or lack thereof). It is essential that valuation approaches, based on the assessment of market value on the date of valuation, consider the significance of sustainability. Although the concept of sustainability has primarily been linked only to lower operating costs, there are many other valuation components in a commercial building that are affected by its level of sustainability, including maintenance, depreciation and obsolescence, as well as the retention of future value.

The main reasons for immediately and rigorously integrating sustainability issues into property valuation are as follows:

- ✚ more sustainable patterns of behaviour are urgently necessary to sustain the viability of the Earth's ecosystems;
- ✚ a huge untapped market potential exists for sustainable property investment products and consulting services;
- ✚ sustainable buildings clearly outperform their conventional competitors in all relevant areas (environmentally, socially and financially);
- ✚ neglecting the benefits of sustainable design leads to distorted price estimates;

- reflecting sustainability issues in property price estimates is already possible and the validity of this decision depends solely on the valuer's capability and sophistication to explain and justify his/her assumptions within the valuation report.

7. Research Methods

Primary data used for this study was gathered through the use of survey methods, especially questionnaire and personal interviews. There are 500 Registered Surveyors and Valuers in Lagos Metropolis (Nigerian Institution of Estate Surveyors and Valuers NIESV Directory, 2009). However only a total of 300 of them are working in firms of Estate Surveying and Valuation and these were the respondents used for this study, out of which only 150 questionnaires (representing 50%) was returned. The questionnaire was administered to elicit information on the causes of valuation inaccuracy. The data collected were analysed using descriptive statistics. Also, personal interviews were conducted on selected officials of the Nigerian Institution of Estate Surveyors and Valuers and 10 Valuation Lecturers from the three institutions of higher learning within the metropolis, offering Estate Management courses. Secondary data was collected from previous publications such as journal publications, textbooks, NIESV directory, to mention just a few.

8. Data Analysis and Discussion

Information gathered were analysed as shown in tables 1 to 5. Table 1 shows the characteristics of the firms, it can be seen that 78% are in general practice. This shows that Nigerian Surveyors are yet to specialise and this could affect their performance in general and valuation in particular. A follow up in-depth interview with NIESV officials showed that a general practice surveyor may not be able to provide valuation figure with minimum level of inaccuracy and this may affect any transaction based on such figure. Information gathering and application is very important in valuation assignments hence the respondents were requested to indicate the sources of their information. The result in Table 2 shows that 78.7% of the respondents relied on in-house databases for valuation assignments. Reliance on in-house data source indicates that the Valuers use information that may not be properly processed and this could result in valuation inaccuracy. Conducting valuation is predicated on getting accurate market evidence (data). But Table 3 shows that such evidence (data) is not available. According to the Table, 92.7% of the respondents were of the opinion that there was not enough market evidence (data) to produce accurate valuation. Once there is no accurate data, the result would be inaccurate valuation figure which may not favour any economic transaction. The absence of data has been recognized as indicated in Table 3. The question then is how to make the information available. Table 4 reveals the willingness of Valuers – 85.3%, to subscribe to the idea of National Valuation Evidence Data by the Nigerian Institution of Estate Surveyors and Valuers. Table 5 x-rays the factors contributing to valuation inaccuracy. It is evident from the Table that all the factors listed are to be seriously monitored. The range of importance attached to their influence is from 46.7% for the influence of unscrupulous clients to 100% for dearth of market evidence and inexperience in valuation practice. In a situation as this, real estate development could be very risky and the fall-out may be slow and unsustainable economic development.

9. Conclusions and Recommendations

The various studies carried out in UK, USA and Australia showed that acceptable range of valuation inaccuracy fall between $\pm 5\%$ and $\pm 10\%$ for UK and USA while Australia has $\pm 10\%$ and $\pm 15\%$. In Nigeria, outrageous figures were arrived by Ogunba and Ajayi (1998) – 33.43% - Victoria Island property and 36.47% for Ikoyi while Ajibola (2006) got $\pm 24.82\%$ for Ikoyi and $\pm 51.54\%$ for Ojodu. In other words, valuation as it is presently carried out, is not a good proxy for sale and mortgage transactions for properties in Lagos. Over and undervaluation would not encourage strong economic development, since parties would be wary of losing their investment. The result therefore is stunted economic growth. Access to market information is difficult and this constitutes a great contributor to inaccurate valuation. Non-availability of data results in Valuers relying on their experiences and unanalysed/unprocessed information for their valuation exercise. The value from such source will be as good as the information available –unreliable values. Data input from external sources such as NIESV databank would help in reducing the level of inaccuracy in valuation and this would go a long way to encourage sales and mortgage transactions in real estate field. Lack of a reliable databank is at the heart of valuation inaccuracy. The time has come when the Nigerian Valuers should be able to use information from centrally organised databank. Inadequate academic training has been identified as an important cause of valuation inaccuracy, Universities and Polytechnics in this country have a great role to play in this direction by restructuring their programmes to include teachings on contemporary techniques of valuation.

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Table 1. Firm's Area of Specialization

Specialisation	Frequency	Percentage
Valuation	5	3.3
Property Development	27	18.0
Feasibility and Viability	1	0.7
General Practice	117	78.0
Total	150	100

Table 2. Sources of Firm's Information

Source	Frequency	Percentage
Use of In-house Databases	118	78.7
Other Local Valuers	11	7.3
Personal Experience	6	4.0
Use of In-house Valuers	3	2.0
Property Press	12	8.0
Total	150	100.0

Table 3. Is there any sufficient Market Evidence (Data) to produce Accurate Valuation?

Evidence	Frequency	Percentage
Yes	11	7.3
No	139	92.7
Total	150	100.0

Table 4. Subscribing to the idea of National Valuation Evidence Data (NVED) BY NIESV

NVED	Frequency	Percentage
Yes	128	85.3
No	22	14.7
Total	150	100.0

Table 5. Ranking of the Factors Contributing to Valuation Inaccuracy in Nigeria

Rank	Very Important	Important	Less Important	Unimportant	Nil	Total
Inadequate academic training.	89 (59.4%)	59 (39.3%)	2 (1.3%)	-	-	150 (100%)
Influence of unscrupulous clients.	33 (22%)	37 (24.7%)	80 (53.3%)	-	-	150 (100%)
Dearth of market evidence.	143 (95.3%)	7 (4.7%)	-	-	-	150 (100%)
Inexperience in valuation practice.	73 (48.7%)	77 (51.3%)	-	-	-	150 (100%)
Laziness on the part of the Valuer.	8 (5.3%)	122 (81.4%)	18 (12%)	-	2 (1.3%)	150 (100%)
Use of outdated valuation approach.	132 (88%)	14 (9.3%)	-	4 (2.7%)	-	150 (100%)
Valuer's over-reliance on agency in Lagos	45 (30%)	60 (40%)	42 (28%)	-	3 (2%)	150 (100%)