



## Valuation of Urban Commercial Properties in Nigeria for Secured Lending: Issues and Developments

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### ABSTRACT

Valuation for secured lending is required when an interest in real property is used as security for a loan. The outcome of such valuation will help the lending institution to achieve commercial prudence in lending as well as avoid taking undue risk. This paper examines the issues and developments in the valuation of urban commercial properties in Nigeria for secured lending purposes. It argues that due to the volatile nature of the Nigerian economy, coupled with the linkage between the economy and commercial property markets, the maximum amount of loan to be granted by lenders in the country using interest in commercial property as collateral should be based on the Mortgage Lending Value (MLV) and not the Market Value (MV) of the property, although the market value should also be reported in the valuation. A case study is used to demonstrate the valuation. It further contends that since the inputs for determining the MLV of a commercial property must be derived from long-term trends in the property and financial markets, it is more stable than MV when used to determine the maximum amount of mortgage loan to be granted by a lender. It concludes that the stability of the MLV makes it more reliable than the MV in achieving commercial prudence in mortgage lending as it fits into the long-term nature of mortgage loan repayment.

## 1. Introduction

Valuation is an opinion of the value of an asset or liability on a stated basis, at a specified date (RICS, 2017). It is usually provided by a professional valuer after the asset has been properly inspected and due consideration is given to the nature of the asset and the purpose of the valuation. The purpose of the valuation is the reason for which the valuation is required by the client. Clients rely on valuations to support their entry into property transactions (Blake & Eves, 2011). One of such transactions is secured credit transaction. Thus, valuation for secured lending purpose is valuation for a prudent lender who does not want to take undue risk. Lenders are key players in any financial market. They need accurate valuation of the assets to be used as security for loans to be granted by them. This is very necessary in order to achieve commercial prudence in lending (TEGoVA, 2016). Hence, the role of valuations in the operation of the financial and property markets cannot

be overemphasized. In the property market, buyers require valuation to know how much to pay to acquire properties of their choice while sellers require valuation to ascertain how much to accept for the sale of their properties. In the Nigerian financial market, lenders often require interest in real property as collateral to secure mortgage loans. The valuation of such interests for secured lending purposes has continued to attract the attention of key participants in the financial market due to the fact that lending institutions had lost substantial amount of money to bad mortgage loans. On the other hand, valuers have been sued for negligence in valuation by their clients (mostly lending institutions) and third parties who experienced financial losses as a result of reliance on professional valuations to grant mortgage loans. In most of the negligent valuation cases, particularly in the UK, Australia and Canada, the valuers were held liable. It is on this note that this study was undertaken to examine the issues and developments in the valuation of urban commercial properties in the country

for secured lending purposes. The specific objectives of the study are (1) to empirically distinguish between Mortgage Lending Value and Market Value, through a case study; and (2) to establish the extent to which valuers in Nigeria apply valuation standards in secured lending valuations.

## 2. Issues in Secured Lending Valuations

The value of any real property to be used as security for mortgage loan must be adequate in monetary terms to pay off the mortgage debt in case of default (Odudu, 1999). Every professional valuer engaged to carry out secured lending valuation strives to ascertain whether the value of the security can cover the mortgage debt with a positive difference. There are several issues involved in secured lending valuations. Principal among these have been identified by a plethora of studies (Crosby, 2000; Aluko, 2007) to include the use of wrong valuation bases, data and methods, resulting in inaccurate property valuations. The nature of these issues in the context of secured lending valuations are discussed as follows:

### 2.1 The Basis of Valuation

RICS (2017) defines basis of value as a statement of the fundamental measurement assumptions of a valuation. It states in Section 5.1 of its Valuation Practice Guidance Applications 2 that:

*“Market value is the basis of value widely used for valuations or appraisals undertaken for secured lending. However, in some jurisdictions alternative bases may be recognised or expressly required, for example, as a result of statute or regulation, ‘mortgage lending value’ being one example. These alternative bases may, and often do, involve prescribed approaches or assumptions and may therefore result in a value for the purpose of secured lending that is quite markedly different from market value”*

Similarly, the European Valuation Guidance Notes 2, Sections 4.1 and 4.2 (TEGoVA, 2016) identify the bases of value for lending purposes as market value and mortgage lending value. It is important to note that it is a statutory provision in the European Union Law (Capital Requirements Regulation) that mortgage lending value must be assessed in every secured lending valuation in its member states by an independent valuer. The essence of the assessment is to provide a basis for the calculation of the risk-weighted exposures of credit institutions secured by mortgages on immovable property (TEGoVA, 2016). The Nigerian Institution of Estate Surveyors and Valuers

recognizes market value as the basis of valuation for secured lending purposes and also accepts mortgage lending value as the alternative basis of value (NIESV, 2006). From the foregoing, it is evident that the basis of valuation for secured lending purposes is market value while the alternative basis is mortgage lending value.

### 2.2 Methods of Valuation

The method of valuation used by the valuer in the valuation of a particular property for a specific purpose is determined by the basis of valuation. The basis of valuation, in turn, is determined by the purpose of valuation (i.e. the reason for the valuation). The purpose of valuation is determined by the client. Once the basis of valuation is wrong, the outcome of the valuation will be wrong, the appropriateness of the valuation data and methods notwithstanding. Similarly, wrong methods of valuation, coupled with wrong valuation data and assumptions will result in inaccurate valuation (Ogunba & Ajayi, 1998; Babawale, 2006). Oyetunji and Oyetunji-Olakunmi (2017) assessed viability appraisal practice in Lagos and concluded that the application of appropriate modern appraisal techniques is a difficult task for estate surveyors and valuers in the area. Aluko (2007) found that most estate surveying and valuation firms in Lagos were not reflecting appropriate basis, methods and information contents in their mortgage valuation reports. This form of practice will certainly result in inconsistent and inaccurate valuations. The use of inappropriate methods is a major issue in secured lending valuations in Nigeria. Ekenta and Iroham (2014) investigated the challenges of mortgage valuation in Port-Harcourt and found that majority of the estate surveying and valuation firms surveyed (59%) adopt the Depreciated Replacement Cost (DRC) method in mortgage valuation in the city.

It has been argued that cost method is not appropriate for mortgage valuation since mortgage is an investment in the open market (Aluko, 2007). The use of cost method in estimating market value has been extensively criticized by property valuation scholars and researchers over the years. Cost in the investment sense is not value (Ifediora, 2000) and value is not necessarily related to cost, although a layman might sometimes be tempted to think it is (Millington, 1982; RICS, 1995). Okoye (1985) observed that more often, valuers resort to cost approach to value in the presumption that a relationship exists between the cost of creating the property and the value. Wyatt (2009) argued that the market value assumptions do not hold in the case of the cost method and requiring inputs to be based on

market evidence is neither practicable nor sufficient justification to regard the output as market value. He concluded that:

*“Because of an almost complete lack of comparable market transaction information, the method estimates replacement cost rather than exchange price. It does not produce a market valuation (value-in-exchange) because cost relates to production rather than exchange and it is regarded as the method of last resort for this reason.”*

Concerning the appropriate methods of valuation for secured lending purposes, The European Group of Valuers’ Associations in its European Valuation Guidance Notes 2, Section 5.7.4 (TEGoVA, 2016) recommends as follows:

*“Only well-recognized valuation methodologies should be used, most commonly the income capitalization approach (investment method) or the comparative approach. A cost-based approach is frequently used in some jurisdictions (as for single or two family houses), or when limited market information is available. While of assistance to valuers operating in stable markets in which owner-occupiers predominate, this is more appropriately employed as a cross-check rather than a prime valuation method. The need to use a cost approach could indicate a specialist property of a type that is not normally bought and sold and so, potentially, a property which would not be considered suitable for loan (or securitization) purposes.”*

Hence, the cost method is appropriate for the valuation of specialized properties for which no market exists and which are not suitable collateral for loan security. Aluko (2007) maintained that the valuer must value a property used as security on the same principle as for sale, since the lender, in order to realize the security can take advantage of the power of sale. Thus, since mortgage is an investment and the property used to secure it may be sold or let in the future in case of default, it is imperative to state that the income approach to valuation is the more appropriate method of valuation for secured lending purposes for obvious reasons. First, it takes into account the income-earning potential of the property. Second, the data for its inputs are derived directly from the investment market. Third, and most importantly, it provides the values for the computation of very essential lending ratios such as the Rent Cover Ratio (RCR) and Interest Cover Ratio (ICR) that are used for assessing whether a mortgaged property provides sufficient collateral to secure a loan over a stipulated period.

### 2.3 The Income Approach to Secured Lending Valuations

In order to properly handle the issues of rental gearing and rent reviews in the secured lending valuation of the property in the case study, a variant of the income approach (real value/equated yield technique) is adopted. This is the valuation method that is appropriate for the valuation of the subject property for secured lending purposes, based on the recommendation of TEGoVA (2016). The valuation is done in two parts. The first is the market valuation and the other is the mortgage lending valuation. Since the interest under valuation is leasehold, the valuation is done differently, by calculating the capital values of rent received and rent paid and then deducting the capital value of the rent paid from the capital value of the rent received (Butler & Richmond, 1990; Baum & Crosby, 1995; Gane, 1995; Ajayi, 1998; Udo, 2003; Wyatt, 2007; Udoekem, 2012 & Ogunba, 2013) to arrive at the market value and mortgage lending value of the leasehold interest, all taking into account income growth potential and proneness to inflation. The inputs of the real value/equated yield technique of property investment valuation are equated yield (e), rent review interval (t), initial capitalization rate (k), implied rental growth rate (g) and inflation risk free yield (i).

Equated yield for freehold property investments is equivalent to the yield on risk free investments plus risk premium. Although the interest under valuation is leasehold, equated yield for freehold property investments must be determined first before it is adjusted for leasehold valuation. Given a risk free yield (i.e. redemption yield on government bond) of 16.3%, the freehold equated yield is 18.3%. The implied rental growth rate required to achieve the equated yield, given the initial capitalization rate and rental growth being realizable at periodic intervals is obtained as follows:

$$(1 + g)^t = \frac{YP \text{ Perp}@k - YP \text{ t years}@e}{YP \text{ Perp}@k \times PV \text{ t years}@e}$$

Where:

- t: rent review interval
- g: implied rental growth per annum
- k: initial capitalization rate
- e: equated yield

The freehold equated yield is adjusted to obtain the equated

yield for leasehold interest. The essence of this adjustment is to account for the extra risks inherent in leasehold property investments (Crosby, 1987; Hargitay & Yu, 1993; Baum & Crosby, 1995; Gane, 1995; Wyatt, 2007). Thus, an extra 2% is added to the freehold equated yield to obtain the leasehold equated yield of 20.3%. Also, the growth potential in the current rental value of any property investment depends on factual conditions which are independent of the legal interest being valued. These conditions relate to the demand and supply, governed by the location, building quality, size, form of occupational lease, etc. which are unaffected by the legal interest being valued (Gane, 1995 ; Mackmin, 1995). Hence the annual rental growth rate of 7.02% is used in the leasehold valuation. Thus, the inflation risk free yield (i) for all items to be capitalized is computed as follows:

$$i = \frac{1+e}{1+g} - 1$$

The valuation of the term and reversionary incomes are done using the DCF Years' Purchase as follows:

$$\frac{YP_{t@e} \times YP_{n@i}}{YP_{t@i}}$$

### 3. Distinction between Market Value and Mortgage Lending Value in Secured Lending Valuations

Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion (IVSC, 2017). This definition is the same as that of NIESV (2006), TEGoVA (2016) and RICS (2017). On the other hand, Mortgage Lending Value is the value of immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property (TEGoVA, 2016).

The major distinction between market value and mortgage lending value is that market value is an estimate of the current value of the property in the market while mortgage lending value is an estimate of the value of the property in a long period of time. The purpose and nature of mortgage lending value in secured lending valuations are summarized in Sections 5.3 and 5.4 of European Valuation Guidance

Notes 2 (TEGoVA, 2016) as follows:

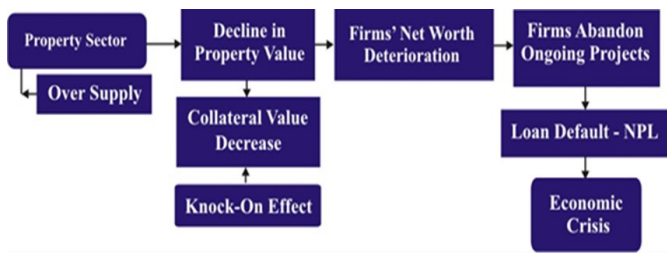
*“5.3 Mortgage Lending Value is distinguished from Market Value as it is intended to be an estimate of the value of the property for a long period of time. Market Value is an assessment only as at the valuation date.”*

*“5.4 There are thus important differences between Market Value and Mortgage Lending Value. Market Value is internationally recognized for the assessment of the value of a property at a given moment in time. It estimates the price that could be obtained for a property at the date of valuation, notwithstanding that this value could alter over time, sometimes very rapidly. In contrast, the intended purpose of Mortgage Lending Value is to provide a long-term, sustainable value as a stable basis for judging the suitability of a property as a security for a mortgage which will continue through potential market fluctuations. As a matter of prudence and recognizing the potential for short term market fluctuations, Mortgage Lending Value is likely, in most market conditions, to be below Market Value but offers a guide to expected underlying long-term trends in the market.”*

Mortgage Lending Value can serve the same purpose in the Nigerian investment market. Considering the volatile state of the Nigerian economy and its property and financial markets, mortgage lending value will be of great relevance to the banks and other lending institutions, particularly in the context of lending secured by interest in real property.

### 4. The Linkage between Commercial Property Markets, National Economy and Secured Lending Valuations

The commercial property markets have forward and backward linkages to the economy of any nation. According to Ozyurt (2014), commercial property markets show significant interaction with macroeconomic activity and the stability of the financial markets. Most financial institutions globally depend on commercial property assets for their operations. Critical adjustments in the commercial property markets can exert noticeable impact on commercial property rental performance and pricing. As analyzed by Davies and Zhu (2009), sharp downward movements in commercial property prices can have a negative effect on the soundness of financial institutions and which if not properly managed can drive them into distress. In the same vein, Ozyurt (2014) recognized the impact of adjustments in commercial property markets on the economy and narrated that:



**Figure 1:** The Linkage between the Real Property Sector and the Overall Economy (Source: Doungmanee, n.d)

“The boom-burst nature of commercial property markets tend to magnify the upside and downside movements of economic activity. Adjustments in commercial property prices can have strong impact on the real economy and vice-versa, in particular in countries where construction and real estate activities significantly contribute to economic growth. During the boom phases, key macroeconomic aggregates, such as consumer demand or employment may drive demand for additional production facilities, storage space, retail shops and offices. This may stimulate the construction activity and drive up commercial property prices. Moreover, new construction activity may generate new demand for other industries as well as for bank credit. On the other hand, in times of economic downturns, weak macroeconomic conditions and slowed down business activity may decrease demand for commercial property. As a result, vacancy rates would rise and rental and sales prices of commercial properties would decline.”

As depicted in Figure 1, oversupply of commercial properties above the equilibrium demand level leads to decline in commercial property prices. This also results in decline in collateral values of commercial properties, resulting in reduction in firms’ net worth. As commercial property developers are unable to borrow more funds for development due to decline in value of their collaterals, they are forced to reduce their investments indirectly. This leads to reduction in revenue and by extension a fall in firms’ net worth. Consequently, as commercial property developers and investors abandon their property development projects and default in repaying their loans, this increases the amount of Non-Performing Loans (NPLs) and eventually triggers economic crises. However, this scenario is common to developed economies in Europe in which a greater proportion of the bank loans are secured by the commercial property sector (Zhu, 2003; Davies & Zhu, 2009; Ozyurt, 2014).

## 5. Methodology

Primary data utilized for the study were obtained from estate surveying and valuation firms in Abuja, Nigeria’s Federal Capital Territory. The data were obtained through structured questionnaires, administered using purposive sampling technique. A total of 107 questionnaires were administered to all the firms in the city, out of which only 36 were properly completed and returned. The 36 respondents are firms which have consistently carried out valuation of commercial properties in the city for secured lending purpose in the last decade. They were purposively sampled in order to obtain reliable data for the study. A

**Table 1:** Methods of Valuation adopted by Valuers in the Valuation of Investment Properties in Abuja

| Valuation Method                         | Frequency  |
|--|------------|
| Income Approach                          | 2 (5.6%)   |
| Direct Comparison Approach               | 6 (16.7%)  |
| Cost+Income+Direct Comparison Approaches | 28 (77.7%) |
| Total                                    | 36 (100%)  |

**Table 2:** Valuation Standards used in secured lending valuations by Valuers in Abuja

| Valuation Standards  | Valid Responses |        |         |        | Mean | RII  |
|--|-----------------|--------|---------|--------|------|------|
|  | Al-ways         | Of-ten | Rare-ly | Nev-er |      |      |
| International Valuation Standards (IVS)                      | 8               | 6      | 6       | 9      | 2.45 | 0.61 |
| European Valuation Standards (EVS)                           | 1               | -      | 9       | 17     | 1.44 | 0.36 |
| RICS Valuation Standards (The Red Book)                      | 2               | 7      | 10      | 9      | 2.07 | 0.52 |
| Uniform Standards of Professional Appraisal Practice (USPAP) | 1               | -      | 8       | 17     | 1.42 | 0.36 |
| ESVARBON Valuation Reporting Template                        | 16              | 5      | 9       | 2      | 3.09 | 0.77 |
| NIESV Valuation Standards and Guidance Notes                 | 34              | 1      | -       | -      | 3.97 | 0.99 |

**Table 3: Types of Value Reported by Valuers in Secured Lending Valuations in Abuja**

| Types of Value                   | Frequency  |
|----------------------------------|------------|
| Market Value                     | 6 (16.7%)  |
| Market Value + Forced-Sale Value | 16 (44.4%) |
| Forced-Sale Value                | 8 (22.2%)  |
| Investment Value                 | 3 (8.3%)   |
| No Response                      | 3 (8.3%)   |
| Total                            | 36 (100%)  |

commercial investment property in Wuse Commercial District of the city was used as a case study in the secured lending valuation to demonstrate the distinction between Mortgage Lending Value and Market Value.

## 6. Results and Discussion

Most of the estate surveying and valuation firms surveyed for the study (77.7%) use a combination of cost, income and market comparison methods in the valuation of investment properties for secured lending purposes as presented in Table 1.

The standardization of valuation bases, principles and methods has facilitated uniformity in property valuation process and reporting at the national, regional and international levels. To what extent do valuers in Nigeria apply valuation standards in secured lending valuations? A survey of estate surveying and valuation firms in Abuja revealed that most of the firms use the NIESV Valuation Standards and Guidance Notes (Relative Importance Index = 0.99) when compared with other relevant valuation standards as indicated in Table 2.

The survey also revealed that valuers do not estimate mortgage lending value in secured lending valuations. Most of the valuers (83.3%) only estimate market value and forced sale value as presented in Table 3.

The implication of this practice is that lending institutions in the country that rely absolutely on market value to grant mortgage loans in a highly volatile and inflationary economy instead of the mortgage lending value (i.e. value of the property on long-term basis) are taking very undue risk. Mortgage loans are long-term loans and as such the value of the security should be determined on long term basis. Even in developed and more stable economies in Europe, a stringent weighing criteria is adopted for

assessing whether a property to be mortgaged is qualified as sufficient collateral to secure a loan over a long time. To qualify, the loan to value ratio must be the lower of 50% of market value or 60% of mortgage lending value (Crosby, Hughes & Murdoch, 2004). In very stable property and financial markets, market value and mortgage lending value will be the same, but in very unstable and volatile markets, they are not the same.

Mortgage lending value provides the basis for assessing whether a property to be used as mortgage security provides sufficient collateral to secure a loan over a long period. It is not forced sale value. Whereas forced sale value is the amount that may reasonably be received from the sale of a property within a time frame too short to meet the marketing time frame required by the market value definition (NIESV, 2006), mortgage lending value is derived from the long term observations of markets and market data at the time of valuation, on the basis of durable characteristics of the property and its environment, and reflects a price which should be achieved in normal property transactions over a long period in the future (TEGoVA, 2016). In market valuation, the valuer provides an estimate of the value of the property based on current property market conditions while in mortgage lending valuation, the valuer provides an estimate of the long-term sustainable value of the security

### 6.1 Valuation Case Study

A three-story commercial property in Wuse Zone 2, Abuja comprises shops in the ground floor and offices in other floors. The certificate of occupancy indicates that the holder has an unexpired term of 62 years. He pays ground

**Table 4: Measurement and Rental Details of the Property in the Case Study**

| Components of the Property |       | Lettable Floor Space(m <sup>2</sup> ) | Actual Term Rent (N)                       | Actual Rack Rent (N)                   |
|----------------------------|-------|---------------------------------------|--|--|
| Ground (shops)             | Floor | 878                                   | (34,000/<br>m <sup>2</sup> )<br>29,852,000 | (40,800/m <sup>2</sup> )<br>35,822,400 |
| First (offices)            | Floor | 864                                   | (32,000/<br>m <sup>2</sup> )<br>27,648,000 | (35,600/m <sup>2</sup> )<br>30,758,400 |
| Second (offices)           | Floor | 864                                   | (30,000/<br>m <sup>2</sup> )<br>25,920,000 | (33,500/m <sup>2</sup> )<br>28,944,000 |
| Total                      |       | 2,606                                 | 83,420,000                                 | 95,524,800                             |

rent of N 45,000 per annum. The ground rent is subject to 7- yearly reviews and growth at 5% per annum. Current ground rent charged by the Federal Capital Territory Administration (FCTA) is N 75,000 per annum and next review of ground rent is due in 3 years' time. The tenancy agreement for the property contains rent review clause which states that the rent shall be reviewed every 3 years. The measurement and rental details of the property are presented in Table 4.

The current rent on the property is due for review in 2 years' time. Total outgoings on the property, exclusive of ground rent is N 825,000 per annum and increases at 10% per annum. Current income yield for comparable commercial properties in the zone is 12% and redemption yield on government bond is 16.3%. The average vacancy rate in commercial properties in Wuse Zone 2 for the past 10 years is 24.5% while the average all risks yield for comparable commercial properties and redemption yield on government bond during the same period are 9.5% and 15.6% respectively. The mortgage lending rate is 26% and the repayment period is 15 years. Value the property for the purpose of secured lending. The inputs for all items to be capitalized in the market valuation of the property in the

**Table 5: Inputs for all items to be capitalised in the market valuation of the property in the Case Study**

| Items to be capitalized        | Equated Yield (e) | Review Interval (t) | Growth Rate (g) | Inflation Risk Free Yield (i) |
|--------------------------------|-------------------|---------------------|-----------------|-------------------------------|
| Income from leasehold interest | 20.3%             | 3 years             | 7.02%           | 12.41%                        |
| Ground rent                    | 20.3%             | 7 years             | 5%              | 14.57%                        |
| Other outgoings                | 20.3%             | 1 year              | 10%             | 9.36%                         |

**Table 6: Inputs for all items to be capitalised in the mortgage lending valuation of the property in the Case Study**

| Items to be capitalized        | Equated Yield (e) | Review Interval (t) | Growth Rate (g) | Inflation Risk Free Yield (i) |
|--------------------------------|-------------------|---------------------|-----------------|-------------------------------|
| Income from leasehold interest | 19.6%             | 3 years             | 8.81%           | 9.92%                         |
| Ground rent                    | 19.6%             | 7 years             | 5%              | 13.9%                         |
| Other outgoings                | 19.6%             | 1 year              | 10%             | 8.73%                         |

**Table 7: Sustainable Term and Rack Rents of the Property in the Case Study based on long term vacancy rate in the commercial property market**

| Components of the Property | Total Occupied Space (m <sup>2</sup> ) | Expected Vacant Space (m <sup>2</sup> ) | Expected Occupied Space (m <sup>2</sup> ) | Sustainable Rent Payable for the Term (N) | Sustainable Rack Rent Payable at Reversion (N) |
|----------------------------|--|---|---|---|--|
| Ground Floor (shops)       | 878                                    | 215.11                                  | 662.89                                    | 22,538,260                                | 27,045,912                                     |
| First Floor (offices)      | 864                                    | 638.47                                  | 652.32                                    | 20,874,240                                | 23,222,592                                     |
| Second Floor (offices)     | 864                                    | 638.47                                  | 652.32                                    | 19,659,600                                | 21,852,720                                     |
| Total                      | 2,606                                  | 638.47                                  | 1,967.53                                  | 62,982,100                                | 72,121,224                                     |
|                            |  |   | Say                                       | 62,982,000                                | 72,120,000                                     |

NOTE: USD 1 = N 365

Case Study are presented in Table 5.

In order to determine the sustainable income of the property, the stable occupancy level must be determined, based on long term vacancy rate for comparable properties in the property market. This is computed as follows:

$$\text{Expected Occupied Space} = \text{Total Occupied Space} - \text{Expected Vacant Space}$$

The expected occupied space and sustainable income of the property based on a 10-year vacancy rate of 24.4% is presented in Table 7. The stable occupancy level is the

**Table 8: Summary of Market Valuation (MV) and Mortgage Lending Valuation (MLV) of the property in the Case Study**

| Market Valuation             |                   | Mortgage Lending Valuation   |                   |
|------------------------------|-------------------|------------------------------|-------------------|
| Valuation Items              | Capital Value (N) | Valuation Items              | Capital Value (N) |
| Term                         | 126,985,260.8     | Term                         | 96,691,100.08     |
| Reversion                    | 535,027,700.5     | Reversion                    | 510,411,273.4     |
| Less Ground Rent (Term)      | 94,348.13         | Less Ground Rent (Term)      | 95,388.62         |
| Less Ground Rent (Reversion) | 290,254.15        | Less Ground Rent (Reversion) | 309,240.63        |
| Less Other Outgoings         | 7,981,326.38      | Less Other Outgoings         | 8,543,373.30      |
| Market Value                 | 653,647,000       | Mortgage Lending Value       | 598,150,000       |

NOTE: USD 1 = N 365

**Table 9:** The lending ratios and other indicators for the property in the case study

|   |                 |
|---|-----------------|
| Market Value (MV)   | N 653,647,000   |
| Mortgage Lending Value (MLV)                                    | N 598,150,000   |
| Ratio of MLV to MV  | 91.5%           |
| Loan-to-Value (LTV) Ratio                                       | 51%             |
| Maximum amount of loan to be granted                            | N 305,056,500   |
| Annual cost of loan @ 26% based on repayment period of 15 years | N 81,870,758.41 |
| Interest Cover Ratio (ICR)                                      | 104.1%          |
| Rent Cover Ratio (RCR)  | 100.8%          |
| Forced-Sale Value   | N 435,765,000   |

NOTE: USD 1 = N 365

expected occupancy level on long-term basis. It is computed as the difference between the total occupied space and the expected vacant space. The expected vacant space is based on the average vacancy rate in the property market over a reasonable period of time. Vacancy rate is a major determinant of commercial property rent in urban areas (Chin, 2003; Hui & Yu, 2006; Boon & Higgins, 2007; McCartney, 2012 & Udoekanem, 2015).

The Market Valuation (MV) and Mortgage Lending Valuation (MLV) of the property in the Case Study is summarized in Table 8.

## 6.2 Lending Ratios

The lending ratios and other indicators for the property in the case study are presented in Table 9.

Secured lending is an investment which involves the lender and the borrower. While the lender aims to avoid undue risk by ensuring that the loan is adequately secured by a collateral (in most cases interest in real property), the borrower aims to borrow as much as possible to meet his financial needs. Valuation is inevitably required to guide the lender on the maximum amount of loan to be granted to the borrower. In Nigeria, most valuers do not estimate the mortgage lending value of properties to be used as collateral for mortgage loan. A survey of some valuers in Abuja has shown that the types of value reported by them in mortgage valuation reports are market value and forced-sale value. In a highly volatile economy like the Nigerian economy, market value of investment properties are unstable and absolute reliance on such value for long-term

mortgage lending may spell doom for the prudent lender. This situation makes the use of MLV very necessary in perfecting secured credit transactions. MLV is determined from data on long-term trends in the property and financial markets. In a stable property market, MLV is equal to MV (TEGoVA, 2016). But in the case of the property in the case study, the ratio of MLV to MV is 91.5%, an indication that the market for the subject property is volatile.

Also, the LTV ratio is dependent on other lending ratios such as ICR and RCR. In the valuation of the property in the case study, the LTV is 51% and is derived from the maximum amount of loan to be granted by the lender if the property is used as collateral to secure such loan, based on the MLV. Similarly, the annual equivalent of the amount of loan to be granted must be lower than the current annual net rent of the property otherwise the loan is unviable to the lender, *ab initio*. Besides, granting a loan more than the recommended maximum amount means that in case of default, the annual net rent of the property cannot cover the annual cost of the loan. This is not only unviable but very risky to the prudent lender. It is important to note that the lending ratios vary across financial markets. In the UK for example, lenders aim to maximize LTV while staying inside ICR and RCR. ICR and RCR in the UK varies between 115-150% and 110-125% respectively, depending on tenant covenant, length of lease and tenant quality (Wyatt, 2013). The ICR and RCR of the subject property is 104.1% and 100.8% respectively. It is an undue risk for the lender to grant a loan secured by the property below the ICR and RCR, but may grant any amount above.

## 7. Conclusion

There is need for valuers in Nigeria to report mortgage lending value in secured lending valuations in the country. This is very necessary particularly in the valuation of urban commercial properties for secured lending purposes. The reason for this is that the value of commercial properties is significantly influenced by demand and supply factors in the commercial property market, which in turn are influenced by the dynamics of macroeconomic factors in the national economy. The extent of this influence is indicated by vacancy rate. This should be considered in determining the MLV of commercial properties in urban areas in the country. Since the inputs for determining the MLV of a commercial property must be derived from long-term trends in the property and financial markets, it is more stable than MV when used to determine the maximum amount of mortgage loan to be granted by a lender. Thus, the stability of the MLV makes it more reliable than the MV



in achieving commercial prudence in mortgage lending as it fits into the long-term nature of mortgage loan repayment.

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## Appendix

The implied rental growth rate required to achieve the equated yield, given the initial capitalization rate and rental growth being realizable at periodic intervals is obtained as follows:

$$(1 + g)^t = \frac{YP \text{ Perp}@k - YP \text{ t years}@e}{YP \text{ Perp}@k \times PV \text{ t years}@e}$$

Where:

g annual rental growth rate