

Methods of Valuation Utilization for Secured Lending in Northcentral Nigeria

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Abstract

Methods of utilizing valuation reports for secured lending in Nigeria have not attracted sufficient research attention. This study, therefore, seeks to examine how deposit money banks (DMBs) apply the reports for loan underwriting in Northcentral Nigeria. Primary data collected from DMBs were analyzed using descriptive statistics and ANOVA. Although the methods adopted by the DMBs for utilizing valuation report did not conform to the international standards of Basel III and the International Valuation Standards Council (2017), they however supported the concept of a uniform sequence of valuation utilization. They also agreed with the application of both soft and hard copies of the reports during the process. Refusal of DMBs to adhere to international standards of valuation utilization could lead to mortgage valuation failure in the study area. The study, therefore, recommends that the Estate Surveyors and Valuers Registration Board of Nigeria (ESVARBON) should sensitize the Bankers Committee and their credit officers on the standardized and orderly procedure of valuation utilization as mandated by valuation regulators. While ESVARBON is enjoined to specify the appropriate methods of using valuation reports in the Nigeria Green Book, the Central Bank of Nigeria should equally include them in the Prudential Guidelines for Secured Lending (2010).

Keywords: *Methods, Valuation Utilization, Secured Loans, Northcentral Nigeria*

Introduction

Access to finance by business owners is very critical to the health and growth of every national economy, including that of Nigeria. Despite the availability of funds from various finance houses to commercial and industrial businesses in Nigeria, deposit money banks (DMBs) remained the most veritable source of their funding (Aruwa, 2004).

The management of loan underwriting by DMBs had however encountered the periodic crisis of insolvency and instability over the years (Ohwofasa & Mayuku, 2012). This and other reasons might have prompted the CBN (2010) to mandate DMBs to properly secure their loanable funds by suitable collaterals. The DMBs were also directed to utilize collateral valuation reports prepared by registered Estate Surveying and Valuation firms during loan underwriting processes.

The standard order and methods of applying collateral valuation reports for lending were well articulated by Basel III (2012), Financial Stability Board (2012) and International Valuation Standards Council, IVSC (2017). Studies on valuation reports for secured lending in Nigeria such as Oluwumi, Ajayi, Olaleye & Fagbenle (2011); Oluwunmi, Akinjare & Joshua

(2013); and Oyedokun, Adewusi, Oletubo & Thomas (2013) did not sufficiently examine the methods adopted by Nigerian DMBs when utilizing property valuation reports for loan underwriting.

Arising from the foregoing, a study on the methods of utilizing valuation reports for secured loans by DMBs in Nigeria and particularly in its Northcentral region to provide information that could reduce lending risks has become necessary. To achieve this goal, the following specific objectives are adopted:

- (I) To examine the order of applying valuation reports for secured lending transactions by DMBs in Abuja, Kwara and Niger States in Northcentral Nigeria;
- (ii). To evaluate the appropriateness of the methods they adopt when utilizing the reports; and
- (iii) To assess the variations in the methods by which the banks utilize the reports.

Literature Review

There is a dearth of literature on the methods of utilizing property valuation reports for secured loan underwriting in Nigeria. Few Nigerian studies that discussed the use of valuation reports for the lending purpose were Oluwunmi, Ajayi, Olaleye & Fagbenle (2011), Oluwumi, Omolade & Opeyemi

(2013) and Oyedokun, Adewusi, Oletubo & Thomas (2013). The studies which were mainly conducted in the South-western part of Nigeria indicated that DMBs expressed their satisfaction with the quality of the valuation reports prepared by ESV firms; that commercial banks' use of underwriting documents was faulty; and that DMBs did not show how they applied valuation reports during loan underwriting process (Oluwunmi, Ajayi, Olaleye & Fagbenle, 2011; Oyedokun, Adewusi, Oletubo & Thomas, 2013; Oluwumi, Omolade & Opeyemi, 2013).

The need for a veritable sequence of utilizing valuation reports for secured lending by DMBs in Northcentral Nigeria was required to commence from the formal commissioning of a registered valuation firm and successively include communicating the DMB's observations in the report to the valuer for his acceptable response; tracking of the physical, market and legal information provided in the report on the subject collateral from the correct sources; verifying the accuracy of the report by more experienced valuers retained for such assignments; and monitoring of the market value of the collaterals during the tenure of the subject loan (Babatunde, 2017).

This order was however observed not to

have been clearly and adequately examined by the study. Regular order in the use of valuation reports for secured lending would ensure standardization during the loan underwriting process which would consequently promote transparency.

A transparent order would also enable the regulators to easily track errors in the process and prepare them to quickly nib in the bud any emerging challenge in the valuation application process. If this was done, it would reduce valuation risk and ensure efficiency and cost-effectiveness in the loan underwriting process

In managing valuation risk, market data, their analysis and financial modelling should be verified to avoid overvaluation (Gregoriou, 2009). Valuation risk management also entailed a formal articulated and computer-aided order of identification and verification of the collateral security, its location, title and marketability (Basel III, 2012 & Financial Stability Board, 2012). This formal and standardized order of screening valuation report for loan underwriting has not been adequately examined by Nigerian studies.

Appropriate utilization of valuation reports for loan underwriting also required a formal, veritable, orderly and standardized

process of report commissioning, verification and review. It similarly necessitated information tracking and property title search (Newell & Kishore, 1997; Parker, 1998; Fernandez, 2010; and Black & Eves, 20110).

Studies that examined the process of verifying valuation reports for secured lending purposes, which were mainly foreign included Newell and Kishore (1997), Crosby, Devaney & Matysiak (2003), Skitmore, Irons & Armitage (2007), Rossini & Kershaw (2008) and Mathole & Smith (2012). They considered digital models such as commercial property monitor (CPM), automated valuation model (AVM) to process valuation reports for lending use.

The use of the computer-aided models suggested by the aforementioned foreign studies to process valuation reports for a lending could only substantially apply in Nigeria if an investment property databank (IPD) was available (Babatunde, 2017). Does it, therefore, mean that there is no alternative method of doing so in Nigeria? Since the IVSC (2017) succinctly itemised the issues that were critical to lenders in processing valuation reports for use such as mode of commissioning and acknowledging valuation, type of report

(hard or soft), tracking of information on physical characteristics of collaterals, mode of confirmation of legal characteristics of collateral, the process of ascertaining the appropriate basis and method of value formulation, method of monitoring the market value of collaterals during loan tenure, they could therefore be adopted as the items to be progressively verified in the reports.

Despite the standards provided by Basel III (2012), Financial Stability Board (2012) on the need for physical identification and verification of the collateral security, its location, title and marketability by banks; IVSC (2017) provisions on how they could utilize valuation reports through proper verification of methods of valuation; and the validated suggestion made by Rossini & Kershaw (2008) and Mathole & Smith (2012) on the use of CPM and ATM to track rental and market values during tenures of loan, information on how the reports are utilized by Nigerian studies is still insufficient.

Methodology

Capital cities in Northcentral Nigeria were selected to represent their states since all the DMBs in the states were available there. Three cities of Abuja (Nigeria's capital), Ilorin (Kwara State Capital) and Minna (the

Niger State Capital) were subsequently and purposively selected to represent the Northcentral geopolitical zone (the study area). There were 19, 17 and 16 DMBs in Abuja, Ilorin and Minna respectively.

The list of the DMBs was obtained from the CBN website and confirmed at the CBN head office. Out of the DMBs surveyed, 15 (78.95%), 12 (70.59%) and 14(87.50%) of them responded in Abuja, Ilorin and Minna respectively. Descriptive and inferential statistics were the tools of analysis. Frequencies and percentages were the descriptive statistics adopted while analysis of variance (ANOVA) was the inferential statistics employed.

The sequential order of utilization of valuation reports was examined through aptitude questions that were drawn from the guidelines provided by Basel III (2012), FSB (2012) and IVSC (2017) on the use of valuation reports for lending. The questions required “agree” or “disagree” as responses (Nicolaas et al., 2015). The appropriate response for all the questions was “agree”.

Method of utilization was also tested through multiple-choice questions (which were also aptitude) drawn from the recommendations of Rossini & Kershaw (2008) and Mathole & Smith (2012) on the

use of computer-aided models for valuation verification; and the provisions of Basel III (2012), FSB (2012) and IVSC (2017) on valuation report utilization. Each respondent was required to select a single appropriate answer for each question. Both sets of questions were analysed by the use of frequencies and percentages. Varied opinions of the DMBs in the three cities on the methods of valuation utilization were assessed by the use of ANOVA.

Results

Data analysis and the findings made in the study were presented and discussed as follows:

Veritable order of utilizing valuation reports for loan underwriting

Foreign studies in the literature affirmed the need for a veritable sequence of valuation report utilization to include its mode of commissioning, verification and review. DMBs were required to agree or disagree with statements that had been proffered by related studies as the proper order of valuation utilization. The result of the percentage response of DMBs that agreed (x_1) and disagreed (x_2) with each of the statements representing how valuation reports should utilize by DMBs in the cities was presented in Table 1.

Table 1: Percentage Response of DMBs on the Order of Utilizing Valuation Reports

Response in percentage	Abuja		Ilorin		Minna	
	X ₁	X ₂	X ₁	X ₂	X ₁	X ₂
Statements on order of utilization						
It is essential to follow an orderly pattern when utilizing valuation reports for loan	53.33	46.47	58.33	41.66	50.00	50.00
It is vital to formalize of valuation reports	33.33	66.67	50.00	50.00	35.71	64.29
It is crucial to standardize the verification & review of valuation reports	33.33	66.67	50.00	50.00	35.71	64.29
It is important to digitize the entire process of utilizing the report	46.67	53.33	41.67	58.33	35.71	64.29
Banks require both soft and hard copies of valuation reports for effective use	53.33	46.47	50.00	50.00	50.00	50.00
Screening of valuation report quality should be contracted to estate surveyors and valuers	46.67	53.33	50.00	50.00	50.00	50.00
A search of title should be outsourced to expert lawyers	46.67	53.33	50.00	50.00	50.00	50.00
It is necessary to monitor values of collaterals during loan tenure by expert valuers	53.33	46.47	50.00	50.00	35.71	64.29
It is obligatory for banks to crosscheck location graphics and Google map information by physical site inspection.	46.67	53.33	41.67	58.33	42.86	57.14
It is apt to review draft reports for final approval before use	33.33	66.67	50.00	50.00	28.57	71.43
Response in percentage	Abuja		Ilorin		Minna	
Statements on order of utilization	X ₁	X ₂	X ₁	X ₂	X ₁	X ₂
It is essential to follow an orderly pattern when utilizing valuation reports for loan	53.33	46.47	58.33	41.66	50.00	50.00
It is vital to formalize of valuation reports	33.33	66.67	50.00	50.00	35.71	64.29
It is crucial to standardize the verification & review of valuation reports	33.33	66.67	50.00	50.00	35.71	64.29
It is important to digitize the entire process of utilizing the report	46.67	53.33	41.67	58.33	35.71	64.29
Banks require both soft and hard copies of valuation reports for effective use	53.33	46.47	50.00	50.00	50.00	50.00
Screening of valuation report quality should be contracted to estate surveyors and valuers	46.67	53.33	50.00	50.00	50.00	50.00
A search of title should be outsourced to expert lawyers	46.67	53.33	50.00	50.00	50.00	50.00

Data on Table 1 were further analyzed to obtain the percentage response of DMBs that agreed with the stipulated standards prescribed by international valuation and credit regulators and their ranks were presented in Table 2.

Table 2: Percentage and Ranks of DMBs that Agreed with the Veritable Order of Utilizing Valuation Reports

Response in percentage	Abuja x ₁	Ilorin x ₁	Minna x ₁		Rank $\sum x_i/n$
Statements on order of utilization					
It is essential to follow an orderly pattern when utilizing valuation reports for loan	53.33	58.33	50.00	53.89	1
It is vital to formalize commissioning of valuation reports	33.33	50.00	35.71	39.68	8
It is crucial to standardize the verification & review of valuation reports	33.33	50.00	35.71	39.68	8
It is important to digitize the entire process of utilizing the report	46.67	41.67	35.71	41.35	7
Banks require both soft and hard copies of valuation reports for effective use	53.33	50.00	50.00	51.11	2
Screening of valuation report quality should be contracted to estate surveyors and valuers	46.67	50.00	50.00	48.89	3
Search of title should be outsourced to expert lawyers	46.67	50.00	50.00	48.89	3
It is necessary to monitor values of collaterals during loan tenure by expert valuers	53.33	50.00	35.71	46.35	5
It is obligatory for banks to crosscheck location graphics and Google map information by physical site inspection.	46.67	41.67	42.86	43.73	6
It is apt to review draft reports for final approval before use	33.33	50.00	28.57	37.30	10
$\sum x/n$	44.67	49.17	41.43	45.09	

Table 2 showed that although 53.89% and 51.11% of the DMBs in the region agreed that an orderly pattern of report utilization was necessary and also that it was necessary to make use of soft and hard copies of reports, they did not believe in adopting an orderly system of commissioning, verification and review of valuation reports during loan underwriting.

Appropriate Methods of utilization of valuation reports for secured lending Basel III (2012), FSB (2012) and IVSC (2017) guidelines specified the items which should be considered in utilizing valuation reports for lending. The percentage of DMBs that selected the appropriate method on each item of valuation utilization was presented in Table 3.

Table 3: Percentage of DMBs' Appropriate Methods of Utilizing of Valuation Reports

Activities	Appropriate Response	Percentage			Mean
		Abuja	Ilorin	Minna	
Mode of commissioning and acknowledging valuation report	Letter in hard and soft copies	13.33	25.00	14.29	17.07
Categories of requested report	Both draft and final reports in soft and hard copies	6.67	8.33	7.14	7.32
Mode of communicating your observations and receiving response thereon on valuation contents	Letter in hard and soft copies	20	33.33	14.29	21.95
How do you track information on physical characteristics of collateral in the report?	Google map and location graphics in the report; visit site to crosscheck the \ information supplied by all media	26.67	66.67	57.14	48.78
How do you confirm information on legal characteristics of collateral in the report?	Engage a solicitor to search for title, and development approvals plus visit to the land registry and the development control office to verify the solicitor's report	26.67	33.33	50	36.59
How do you track information on rental and market values of collateral in the report?	Confirm rental and market values in the report with recent rents and sales prices of similar properties in the neighbourhood from approved estate agents and make comparison through an analysis	66.67	50	35.71	51.22
How do ascertain the appropriate basis and method of value formulation?	Cross checking the provisions in the report with both IVSC and NIESV standards as approved by the Bank's Management plus engagement of an experienced registered independent valuer verify the bank's opinions thereon	46.67	50	42.86	46.34
Method of monitoring market value of collaterals during loan tenure	AVM installed with home value explorer and ot her estimation accuracy software operated by both the staff and the consultants of the bank AVM installed with home value explorer and other estimation accuracy software operated by both the staff and the consultants of the bank	53.33	75	28.57	51.22
		32.50	42.71	31.25	35.06
	$\frac{\sum x}{n}$				

The result in Table 3 showed that the DMBs in Abuja, Ilorin and Minna scored 32.50%, 42.71% and 31.25% respectively. The mean percentage of the appropriate use of valuation of 35.06 was assessed poor by every standard. The DMBs in Ilorin came first; they were followed by those at Abuja while those at Minna came last.

The result consequently suggested that the reports were not used in accordance with the guidelines provided by Basel III Accord (2012), FSB (2012) and IVSC (2017) standards. This implied that DMBs in the

study area could also constitute one of the factors of mortgage valuation failure. However appropriate and adequate a valuation report might be, if the report was not appropriately utilized, there was every tendency that mortgage valuation failure might arise which could consequently lead to a breakdown or failure of the entire loan transaction.

Variation in the methods of utilization of valuation reports in the three cities was explored and the result was presented in Tables 4 and 5.

Table 4: Variations in DMBs' Methods of Utilization of Valuation Reports in the Cities

x	x ²	Y	y ²	z	z ²
13.33	177.69	25.00	625.00	14.29	204.20
6.67	44.49	8.33	69.39	7.14	50.98
20	400	33.33	1110.89	14.29	204.20
26.67	711.29	66.67	4444.89	57.14	3264.98
26.67	711.29	33.33	1110.89	50	2500.00
66.67	4444.89	50	2500.00	35.71	1275.20
46.67	2178.09	50	2500.00	42.86	1836.98
53.33	2844.09	75	5625.00	28.57	816.25
$\Sigma=260.01$	11,511.83	341.66	17,986.06	250	10,152.79

Table 5: ANOVA Contingency Table for DMBs' Methods of Valuation Utilization

	Sum of Squares	df	Mean Square	F
Between Groups	888.739	2	444.369	1.073
Within Groups	8700.127	21	414.292	
Total	9588.865	23		

At $\alpha = 0.05$; it implied that there was confidence at 95% about the validity of the test.

At $df = 2$ and $df = 21$; the t-calculated value is 1.073. At $\alpha = 0.05$; and $df = 2$ and 21, the t-table value was 3.47.

Decision Rule: Reject Null hypotheses (H_0) if the t-calculated value was greater than the t-table value otherwise it should be accepted.

Result: Since the t-calculated value (1.073) was less than t-table value (3.47) at the confident level of 95%; df of $(K-1) = 2$; and df of $(N-K) = 21$, there was no enough evidence to reject H_0 . Therefore, there was no significant difference in the methods of utilization of valuation reports for secured lending by deposit money banks in Abuja, Ilorin and Minna.

Findings in this study had been much different from those of earlier related ones on valuation report application for secured lending in Nigeria. The majority of previous related studies concentrated their investigations on the satisfaction or otherwise of bankers with secured lending valuation reports. This might have necessitated the following fresh results

discovered in the study:

- (I) Guidelines provided by international credit regulators such as Basel III Accord (2012) and FSB (2012) that were targeted on minimizing lending risks such as formalized commissioning of valuers; verification of title and the valuers' reports by third party-experts; monitoring of collateral values during loan tenure; and e-tracking of the physical attributes were often ignored by DMBs.
- (ii) Models for monitoring rental and market values of collaterals such as multiple listing system, MLS (of estate agents) and computer-aided system (such as AVM) which were considered desirable and applicable were not adequately utilized when applying the reports for lending.
- (iii) Prescribed instruments and expertise for commissioning valuation briefs, making observations in the reports, tracking legal and physical attributes of collaterals and ascertaining the accuracy of the reports were substantially ignored by the DMBs.

Conclusion

The results obtained from this study have necessitated the affirmation of the following conclusions:

That since a substantial percentage of DMBs did not subscribe to adopting formal order of use of the reports, it, therefore, suggested that the utilization pattern was not standardized. Also, this unstandardized practice does not allow for transparency. An opaque system of this nature could also breed corruption. It could similarly make tracking of points of error in the use of the reports to be complicated.

That non-formalization of the order and process of utilizing valuation reports was grossly inappropriate. Non –digitization of the process also easily lent it to abuse. The combination of these acts of negligence implied that DMBs in the study area could constitute themselves as a factor of secured lending valuation failure. However appropriate and adequate a valuation report might be, if the report was not appropriately utilized, there was every tendency that secured lending valuation failure would ensue which could lead to a breakdown or failure of the entire loan transaction.

Lack of adequate use of digital map and computer-aided models to track property location and monitor rental and market values of properties could affect the security of collaterals and value preservation respectively. Also, the attitude of the DMBs

in not adequately engaging practising professionals for valuation screening was against global best practices of peer-review and this action could consequently promote valuation inaccuracy. Also, the non-appointment of practising lawyers to properly search property title could affect the security of collaterals.

To mitigate the impact of the awkward use of valuation reports by DMBs, NIESV and ESVARBON are enjoined to adequately enshrine in the Nigeria Green Book the order and methods of utilizing valuation reports prepared by ESVs for secured lending. They are subsequently advised to interact with the Bankers Committee, their members at their Credit Departments by thoroughly educating them on the appropriate use of valuation reports. It is also important that the Prudential Guidelines for Lending by CBN (2010) should also be amended to prescribe how valuation reports should be used by DMBs during the loan underwriting process.

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