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SCHOOL OF CIVIL AND ENVIRONMENTAL ENGINEERING

PRACTICE OF REAL PROPERTY VALUATION FOR COLLATERAL: CASE STUDY ON SELECTED BANKS

By: Ermiyas Teshome

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The undersigned have examined the thesis entitled **Practice of Real Property Valuation for Collateral: Case Study on Selected Banks** presented by **Ermiyas Teshome**, a candidate for the degree of **Master of Science** and hereby certify that it is worthy of acceptance.

Dr. Abraham Assefa		
Advisor	Signature	Date
Prof. Abebe Dinku		
Internal Examiner	Signature	Date
_Eng, Yilekale		
External Examiner	Signature	Date
-		
Chair person	Signature	Date

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I certify that research work titled Practice of Real Property Valuation for Collateral: Case Study on Banks in Ethiopia is my own work. The work has not been presented elsewhere for assessment. Where material has been used from other sources it has been properly acknowledged / referred.

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Ermiyas Teshome

ABSTRACT

The main aim of this research was to study the base for proper valuation method selection, study if the methods and procedures applied for valuation is consistent and assess the existence of real property valuation policy guidelines, manuals, and current practice. In order to achieve this objective, the practice of real property valuation for collateral was viewed as a phenomenon, taking place in real-life context; hence it qualified to be explored using case study method. Furthermore, the case study method was considered appropriate in collecting data for this study since it allowed interviews of the persons involved in the process. The study includes to find and study local or international literature related to real property valuation, banks and Ethiopian bank association valuation manual on real property and finally for benchmarking the practice of property valuation in Ethiopian banks guidelines, procedures, and criteria were chosen from the result of a structured interview. The study revealed that the base for valuation method selection is the type of property. Method of valuation is restricted to procedures on the valuation manual and in fear of problem in loan recovery due to lack of reliable market data almost 70% of banks use only the cost replacement method while the rest use a combination of cost replacement and income capitalization method with given weightage factor. Moreover, process map starting the minimum document requirements to the valuation process has been drawn. The study recommends in minimizing variation in valuation value, to align valuation method with the generally accepted methods and the property valuator to demonstrate commitment to ethical standards and further recommend the government to take the leading step by teaching property appraisal as a field of study at university level and produce qualified and competitive professionals.

Key word: Basis of Valuation, Collateral, Location Value, Method of valuation, Market value, Real property, Valuator maker/checker.

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LIST OF ACRONYMS

AI Appraisal Institute

BoQ Bill of Quantity

CBD Central Business District

CBZ Central Business Zone

CBE Commercial Bank of Ethiopia

CIS Corrugated Iron Sheet

CIC Construction Industry Council

DBE Development Bank of Ethiopia

EBA Ethiopian Bank Association

EELPA Ethiopian Electric Light and Power Authority

FDRE Federal Democratic Republic of Ethiopia

GS Guidance Statement/Note

GAVP General Accepted Valuation Principles

GEA Gross External Floor Area

GIA Gross Internal Floor Area

HCB Hollow Concrete Block

IVSC International Valuation Standard Committee

IVS International Valuation Standard

LHC Land Holding Certificate

MV Market Value

MR Market Rent

NIA Net Internal Floor Area

PS Practice Statement

RICS Royal Institute of Chartered Surveyors

TEGOVA European Group of Valuer's Associations

VAT Value Added Tax

LIST OF LAWS AND REGULATIONS, ETHIOPIAN LAWS AND REGULATIONS

Addis Ababa City Administration Directive No.3/2009

Constitution of 1931, chapter 8, Article 74-76

Constitution of 1955, Article 44

Constitution of 1995, Article 40(1.8)

Civil code of 1960 Article 1665 (1&2)

Proclamation No.31, 1975, Article 3, 4(5)

Proclamation No.47, 1975

Proclamation No.455/2005, Article 3(1)

Proclamation No.455/2005, Article 4(3)

Proclamation No.455/2005, Article 8

Proclamation No.455/2005, Article 9(1)

Proclamation No. 272/2002

Regulations No.135/2007

Proclamation No.721/2011

Regulations No.135/2007

CHAPTER 1: INTRODUCTION

1.1. Background

Banking is a rapidly growing industry in Ethiopia. There are currently two state-owned, one cooperative, and fifteen private commercial banks. State-owned Commercial Bank of Ethiopia is the market leader across various measures of market share. It is most dominant in providing credit, holding 66% of the nation's overall loan book and deposits at 62%. CBE also represents roughly half of the banking sector's capital and profits (AsokoInsight Web site, 2020). Despite strict government regulations through the lending quota, bond buying, windfall tax, and increased capital requirements, banks report healthy profit and pay high dividends (2Merkato Editor, 2012). Banking operation means lending and, by its design, entails a range of risks, which can be generally classified as financial risk, industrial risk, and risk management.

In addition to evaluating the applicant's collateral criteria, the lending divisions shall exercise a high degree of vigilance in the activity's economic and technological feasibility when reviewing, checking, and researching the title of the mortgagor (Gadkari, 2006). In general, the term property describes a legal concept; it refers to the rules that govern people's access to and control of physical things (tangible assets) like land, natural resources, and manufactured goods as well as of non-physical things (intangible assets) such as inventions or contractual rights and financial claims. Real Property refers to land ownership and its human-made improvements attached to the land, e.g., buildings (Appraisal Institute, 2001). In economic and other markets, valuations are commonly used and relied on whether for inclusion in financial statements, regulatory enforcement, or to promote protected lending and transactional activity (IVS Council, 2011). Collateral is a

property or other collateral provided as a means for a lender to secure the loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses (Kagen, 2018).

Property valuation is one part of all economic activity in any society. Everything we do as an individual or as groups of individuals in business or as members of society is influenced by the concept of value and valuation. A sound working knowledge of the principles and procedures of valuation is essential in all sorts of decisions.

1.2. Statement of the problem

The property industry is complex and involves various types of property, procedures, and laws, which require the market players to have a wide scope of knowledge and experience. (Amidu & Aluko, 2007) have elaborated at least three vulnerabilities in valuation practice: First was valuation inaccuracy and variance due to involvement with various variables require the valuers to use their skills and experience to value the property. Second, the probability of valuers to become bias on the valuation figures due to behavior attitudes. Third, the influent or pressure of the clients on valuers and the valuation processes, including threatening the future business or fees, pre-determined value, value negotiation, supplying information to influence the value, and a few others. The practice has to face a few adverse consequences due to these vulnerabilities, including liability for professional negligence, weakening investors' or public confidence in the valuation profession, and threatening the valuers' credibility and relevance (Amidu & Aluko, 2007) (Babawale & Ajayi, 2011).

This may also be true in Ethiopia; thus, this thesis is an attempt to study the practice of property valuation for collateral by Ethiopian banks and create awareness regarding the

general method employed for property valuation by the bank and also hence calling for better valuation approaches that can counter all the claims condemning the weaknesses of the valuation techniques.

1.3. Objective of study

1.3.1. General Objective

The research aims to study the current practice of real property valuation for collateral by banks in Ethiopia.

1.3.2. Specific Objective

First, assess the base for proper method selection to be employed in the determination of the value of a real property when properties are given for loan security;

Second, Assesses the methods and procedures applied for valuation is consistent regarding the determination of the market value of real property.

Third, assesses and discuss the existence of real property valuation policy guidelines, manuals, and current practice for the proper execution of the work. Finally, conclusions and recommendations are forwarded to the practice of property valuation for loan security.

1.4. Research questions

To achieve the objectives, the following research questions are formulated:

1. What are the bases of determination of the market value of specific property valuation?
2. Are the methods of real property valuation and procedures used /employed/ by different banks are consistent for a different property valuation?
3. Is there a policy guide or manual to valuate property and how is the valuation of property carried out practically?

1.5. SIGNIFICANCE OF THE STUDY

Assessing, evaluating, and solving most problems related to property valuation would help in the realization of sustainable and institutionalized valuation systems. Thus, this research is important for the study of the current real property valuation practices for collateral, hence calling for better valuation approaches that can counter all the claims condemning the weaknesses of the valuation techniques currently practiced and also the research findings will be another contribution to the existing stock of knowledge by filling the gap of information in the areas of bank real property valuation. Besides, it is hoped that the findings of this research may stimulate other researchers to conduct further research.

1.6. ETHICAL CONSIDERATIONS

This study has been conducted in a manner that consistent with ethical issues that need to be considered in conducting research. Hence, more than 50% individuals which the researcher visited for interviews has accepted and cooperated. Prior consent of the participants was requested before conducting the interview. Informants in the research are named as anonymous informants. The name of Banks and professionals participated are recorded confidentially. The result of this survey is intended to serve only for academic purposes.

CHAPTER 2: LITERATURE REVIEW

2.1. Introduction

Valuation is a combination of knowledge and skills accumulated from studies and job experience that blend together with the art of seeing, appreciating, and analyzing the subject property and value contributing factors. Czernkowski, (1990) has described it as:

"…*is a process of transformation. It combines a given set of facts, cues such as age, size, proximity to services, into a single output: the ratable value. As such, valuation is structured insofar as a set of rules (heuristics), which combine facts to deduce new facts (conclusions), can be brought to bear."*

In general, the term property describes a legal concept; it refers to the rules that govern people's access to and control of physical things (tangible assets) like land, natural resources, and manufactured goods as well as of non-physical things (intangible assets) such as inventions or contractual rights and financial claims. Real property refers to the ownership of land and its man-made improvements attached to land e.g., buildings (Appraisal Institute, 2001).

2.2. Importance of valuation

Property valuation is part of all economic activity in any society. The concept of value and valuation influences everything we do as individuals or as groups of individuals in business or as community members. A sound working knowledge of valuation principles and procedures is essential in all kinds of decisions relating to the acquisition, sale, funding, growth, management, holding, leasing, trading of real estate, and in ever more relevant matters involving income tax considerations (Pornchokchai, 2006).

Property valuation is carried out for many different purposes, their relative importance varying from one country to another and from time to time. Valuations are required for many purposes relating to the development and subsequent occupation and ownership of property. The purpose for which the valuation is required and the type of property that is to be valued will determine the nature of the valuation instruction, including the techniques employed and the basis on which value is to be estimated (Wyatt, 2007). Purposes for which a valuation may be required include sale or purchase, rent to be paid or demanded, the amount of mortgage which could be advanced on a security, calculation of compensation payable or receivable, assessment of taxation or rating, for insurance, to borrow money using the property as 'security' and the advisability of investment.

2.3. The property valuation profession

2.3.1. Skills required by and role of the property valuer

According to Appraisal Institute, (2001) the main task, by definition, is to find the value of a property. To do this, property valuers are recommended to possess and be competent in a diverse range of skills, such as:

- Calculation
- Measurement
- Report writing
- Negotiation
- Knowledge of building construction

Before valuers can value, they must know exactly what type of value they are seeking to find, for whom they are finding it and for what purpose this valuation is being sought. Without this knowledge, the resultant figure will have no relevance and has the potential

to be taken out of context and interpreted wrongly. When communicating with clients, valuers should endeavor to use clear, concise, and plain English.

2.3.2. Qualification of the valuator

In general, the valuer's task is to advise on what will be the best figure to obtain for a given property on the open market at a particular date. To do so, the valuer must know how its various and varied features of real property can influence valuation and how developments in social, economic, and political conditions are likely to affect it in the local, national and foreign contexts. The legislation will significantly impact the assessment of value. The valuer must have an excellent working knowledge of the relevant law to undertake the required valuations correctly.

According to RICS Red book 2012, Qualification of the valuer;

1. The test of whether an individual is appropriately qualified to accept responsibility for a valuation combines:

    - academic/professional qualifications, demonstrating technical competence;
    - membership of a professional body, demonstrating a commitment to ethical standards;
    - practical experience as a valuer;
    - compliance with any state legal regulations governing the right to practice valuation; and
    - where the valuer is a member of RICS

2. Members of RICS have to achieve and maintain defined standards of training and competence. However, as members are active across a wide range of specialisms and markets, membership of RICS or registration as a valuer does not imply that an individual has the necessary practical experience of valuation in a particular sector or market.

3. Valuers are expected to be accredited or authorized in some states to perform particular valuations

The reasons for which a valuation can be sought include but are not limited to the selling or purchase, the rent to be charged or requested, the amount of mortgage that may be advanced on the security, the estimation of the payable or receivable compensation, the determination of the taxes or rating and the advisability of the investment. The purpose of the valuation, together with the circumstances and requirements of the client requesting the assessment, can significantly affect the value. Consequently, depending on the meaning of the values being pursued, the valuer may provide any of the various clients dealing with one property with a separate valuation, or other valuations of the same client on the same property.

- Due to their professional skills, there are three key reasons why valuers are employed:
- The property market is an imperfect one – supply and demand are often changing and are different in each location and with each category of Property, and transaction knowledge is always limited;
- Each individual property and the interests therein tend to be unique, or at least never precisely the same as other goods;
- Legislation-the complicated and interrelated rules relating to the land are continuously changing. They can be adequately understood only by an expert with thorough knowledge of them who constantly need to be updated.

2.3.3. The Level of Accuracy Expected of the valuator

A significant principle that should be understood is that property valuation is more of an art than an exact, scientific subject (IVS Council, 2011). For all the use of mathematical formulae and calculations, valuers also exercise subjective opinions based on their knowledge of the market and their interpretation of facts. Two valuers, given the same property to value and the same facts to work from, will often arrive at different final values

as they have each formed somewhat diverse opinions on the current state of the market and how the information concerning the property should be interpreted.

2.3.4. Difference between a valuation and a building survey

The RICS describes a valuation as a member's opinion on the value of the listed interest or interest in a property, at the date of valuation, given in writing. Unless limitations are agreed in terms of engagement, this will be provided after inspection and any further investigations and inquiries (RICS 2007d: 9). It is necessary to note that valuation is not a building survey. Citing the concepts of building inspections and surveys by RICS describes the building survey as:

"an inspection and assessment of the construction and condition of a building and will not normally include advice on value … The survey will generally include the structure, fabric, finishes, and floorings."

The scope of the survey would be subject to a formal arrangement between the surveyor and the customer and to advise on this. Repair costs will be subject to such agreement. The report may contain appropriate, a guide to obvious deficiencies and recommendations on maintenance and remedial steps. Typically, the survey would not require detailed inspection of materials or structures or inaccessible or concealed places unless agreed with the building owner.

2.4. Types of property value

Generally, the intention of the valuation, together with the circumstances and requirements of the client requesting the assessment, can greatly influence the value. According to Motta & Endsley, (2003), property valuers are '*the independent axis around which property*

information flows.' The main task of property valuers is to find the value of a property. Valuers are also supposed to know precisely what sort of deal they are searching for, whom they are seeking it, and for what reason this valuation is being pursued before they value the property. Without this information, the resulting statistic may have little meaning and can be taken out of context and misinterpreted in an inaccurate way. (Blackledge M. , 2009).

According to Blackledge M. , (2009) there are many types of value, including:

- Freehold value
- Leasehold value
- Asset value
- Alternative use value
- Annual value
- Before and after value
- Break-up value
- Book value
- Compulsory purchase value
- Depreciated value
- Deprival value
- Development value
- Divorce value
- Exchange value
- Existing use value
- Fair value
- Forced sale value
- Going concern value

- Gross development value
- Market value
- Marriage value
- Mortgage value
- Permitted development value
- Ransom value
- Ratable value
- Rental value
- Residual value
- Site value
- Speculative value
- Surrender value
- Tax value
- Value in use
- Value to the owner
- Zone A value.

Many of these could apply to a specific property simultaneously and all result are likely to be different figures. So, to ask 'what is the value of this building?' is a meaningless question. A valuer must know which specific values or values he or she is required to find; and before proceeding must clearly define and firmly agree on this in writing with a client. The role of the valuer, in general, is to advise on what would be the best figure obtained on the open market for a given property at a particular date. To do so, the valuer must know how valuation will be influenced by the various and varied features of real Property and how shifts in social, economic, and political conditions are likely to impact value in local, national, and foreign contexts (Blackledge M. , 2009).

2.5. Developing and communicating the valuation

Valuations are established based on the Market Value of an asset or base other than Market Value. The principles of market, price, cost, and value are fundamental to all valuations. Both valuations based on market value and those based on non-market parameters apply to these principles.

Clear communication of the outcomes of the assessment and an understanding of how those results have been obtained is of similar significance to the work of Valuers. A well-prepared Valuation Report fulfills these functions (Blackledge M. , 2009).

2.5.1. Markets

A market is an environment in which goods, services, and commodities are exchanged between buyers and sellers through a price mechanism. The concept of a market implies buyers' and sellers' ability to carry on their activities without restriction. Each party may respond to supply-demand relationships and other price-setting variables, as well as to their view of the relative usefulness of the products or services and individual needs and desires (Blackledge M. , 2009).

It is important to consider the extent of the market on which that asset will trade in order to determine the most likely price that will be paid for an asset. This is since, on the valuation date, the price that can be achieved would depend on the buyers and sellers in the specific market. To have an effect on the price, buyers and sellers must have access to that market. A market can be defined by various criteria. These include:

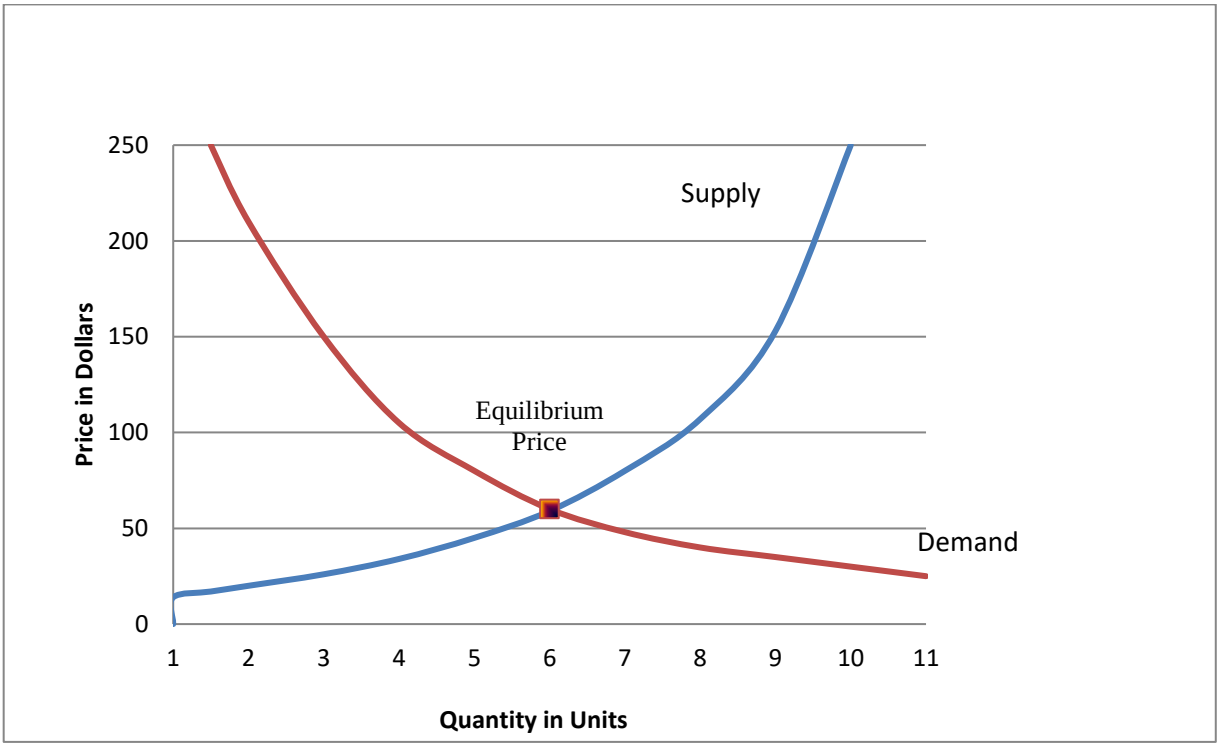
a) The goods or services that are traded, e.g., the market for motor vehicles is distinct from the market for gold,

b) The scale of distribution restraints, e.g., a manufacturer of goods may not have the distribution or marketing infrastructure to sell to end-users and the end-

users may not require the goods in the volume at which they are produced by the manufacturer,

c) Geography, e.g., the market for similar goods or services may be local, regional, national, or international.

However, although at any point in time a market may be self-contained and be little influenced by activity in other markets, over a period of time markets will influence each other. For example, the price of an asset in one state could be higher at any given date than could be obtained for an identical asset in another state. If any future distorting effects induced by government trade controls or monetary policy were ignored, producers would raise the supply of the commodity over time to the supply state where the price was lower, thus resulting in price convergence. On Figure 2-1, the supply and demand principle states that a good service or commodity price varies inversely with the product supply and directly with the item demand. In the property market, supply represent the number of property interest available for sale or lease at different prices in a given market over a given period, assuming that labor and production costs remain constant. Demand is the number of potential buyers or renters seeking specific types of property interest at different prices in a given market over a given period, assuming that other factors, such as population, revenue, price volatility, and consumer preferences, stay unchanged.



Source: (Blackledge M. , 2009)

Figure 2 - 1: Demand and Supply Curve

Discretion markets only work smoothly due to different imperfections, with a constant balance between supply and demand and an equal degree of operation. Common market imperfections include supply disruptions, sudden rises, and decreases in demand or knowledge asymmetry among market participants. Since market participants respond to these imperfections, a market is likely to adapt to any adjustment that has induced disequilibrium at a given period. A valuation intended to approximate the possible price on the market must, on the valuation date, reflect the conditions in the relevant market, not the adjusted or smoothed price dependent on a presumed restoration of equilibrium.

2.5.1.1. Market Activity and Market Participants

(Blackledge M. , 2009) The extent of activity in any market will fluctuate. While it may be possible to establish a typical operation level over a prolonged period of time, there may be times in most industries in which activity is considerably higher or lower than this benchmark. The degree of operation can be expressed in relative terms only, e.g., the market is more or less active than it was on the previous date. Prices are likely to rise when demand is high compared to supply Figure 2-1, which tends to attract more sellers to enter the market and therefore increased activity.

Market participants are to the entire group of individuals, businesses, or other organizations that are participating in actual transactions or who are contemplating entering into a transaction for a particular type of asset. The willingness to trade and any views attributed to market participants are typical of those of buyers and sellers, or prospective buyers and sellers, active in a market on the valuation date, not to those of any particular individual or entity. Issues and matters that are unique to the existing owner or to a specific prospective buyer are not important in performing a market-based assessment since both the willing seller and the willing buyer are imaginary persons or organizations with the characteristics of a traditional market consumer.

2.5.2. Price, Cost, and Value

According Blackledge M. ,(2009) these terminological are important to the operation of markets because of the distinct functional relationship each describes;

Price is a concept referring to the exchange of products, goods, or services. Price is the amount that has been asked, offered, or paid for the item. Owing to the financial capabilities, motivations, or special desire of the of a given buyer or seller, the price paid

may be different from the value which might be assigned to the asset by others (IVS Council, 2011). Once the exchange happens, the price, whether disclosed or undisclosed, becomes a historic fact. The price paid represents the intersection of supply and demand.

Cost is a production-related concept, distinct from an exchange, which is defined as the amount of money required to create or produce a commodity, good, or service. Once the good is completed or the service is rendered, its cost becomes a historic fact. Price is related to cost because the price paid for an asset becomes its cost to the buyer.

Value discusses the price most likely to be concluded by the buyers and sellers of a product or service available for purchase. Value establishes the hypothetical, or notional, a price that typically motivated buyers and sellers are most likely to conclude for the good or service and the hypothesis on which the value is estimated is determined by the purpose of the valuation. A Value to the owner is an estimate of the benefits that would gain to a particular party from ownership Thus; value is not a fact, but an estimate of the most likely price to be paid for the goods or services available for purchase at a given time.

According to Blackledge M. , (2009) it is assumed that there are three basic motives why people and organizations spend money on a property. These are:

- Investment – a return on fund from capital. The fundamental goal is to produce growth on the sum spent such that over time this number becomes greater.
- Occupation – for the owner own use and benefit for residential or business purposes.
- Speculation – is based on the hope that a significantly larger amount will be recovered in the long term in the hope of making a profit on expenditure by taking a calculated risk on the spent money. However, speculation involves risk and the size and likelihood of financial gain are far more uncertain than on investment.

A ridiculous example, to help prove this point, would be construction a high specification office block at a cost of millions in a completely inaccessible location, such as the middle

of the Sahara Desert. Its cost is colossal, and yet its value would be negligible. Indeed, it may have no value at all simply because there would be no demand for such property due to its total impracticability – and this is the whole basis of the difference between value and cost. The forces of supply and demand determine value. When there is little or no demand, then the property will have little value, however much it costs to construct or acquire. Conversely, if there is extremely good demand, and particularly if this is coupled with low or restricted supply, the property will have a very high value, which can far exceed its cost.

All items, whether they are goods and services or land and building, will have a market value or price at which they will be expected to sell. In economics, this is usually referred to as the equilibrium price (Figure 2-1), in that it is the point where demand is equal to supply and thus the system is in equilibrium. This will produce the open market value, which cannot be found from costs alone, since not all the factors that make up the effective demand and supply are then being taken into account (Blackledge M. , 2009).

2.5.3. Basis of Value

A statement of the fundamental measurement assumptions of valuation is a basis of value (IVS Council, 2011). It describes the basic assumptions, on which the reported value will be based, e.g., the nature of the hypothetical transaction, the parties' relationships and motivations, and the extent to which the asset is exposed to the market. For instance, A Basis of Value describes the nature of this hypothetical transaction, whether it takes place in a public market or not, and what accounts for the parties' motivation and behavior. It does not define the status of the goods or services involved in the transaction, such as whether they are operational or not and whether they are aggregated with other assets. Therefore, to adequately define the valuation hypothesis adopted usually need to be

accompanied by additional assumptions. For the same asset, different assumptions may result in different values, and therefore, these must be clearly understood and expressed. Depending on the purpose of the valuation appropriate selection of basis of value will vary. According to IVS Council, (2011) a basis of value should be clearly distinguished from:

- The technique or method used to provide an indication of value,
- The type of asset being valued,
- The actual or assumed state of an asset at the point of valuation,
- Any additional assumptions or special assumptions that changes the fundamental assumptions in specific conditions.

Valuation Basis can fall into one of three major categories:

- The first is to indicate the most likely price that would be achieved in a free and open market in a hypothetical transaction. Market value falls into this category.
- The second is to indicate the benefits that a person or an entity entitled from ownership of an asset. Investment value and the special value falls into this category.
- The third is to indicate the price that would be reasonably agreed between two specific parties for the exchange of an asset. Although the parties may be unconnected and bargain at arm's length, the asset may not actually be put on the market, and the negotiated price may be one that represents the unique benefits of ownership to the parties concerned rather than the general market. Fair value falls into this category.

Valuations may require the use of one or more bases of value that are defined by statute, regulation, private contract, or other documents.

2.5.3.1. Market Value

According to IVS Council, (2011) market value is the estimated amount for which an asset should exchange on the valuation dated between a willing buyer and a seller at an arm's length transaction, after proper marketing and where the parties had each acted

knowledgeably, prudently and without compulsion. The definition of market value shall be applied in accordance with the following conceptual framework:

a) "The estimated amount" refers to a price expressed in terms of money payable for the asset in an arm's length market transaction. In compliance with the market value definition, Market value is the most probable price reasonably obtainable in the market at the valuation date.

b) "an asset should be exchanged" refers to the price in a transaction that meets all the elements of the market value definition at the valuation date;

c) "on the valuation date" refers that the value is time-specific as of a given period. The estimated value may be unacceptable or inappropriate at another time since markets and market conditions may change.

d) "between a willing buyer" refers to one who is motivated, but not coerced to buy. This purchaser is neither over-eager nor determined to buy at any expense.

e) "and a willing seller" means not an over-eager nor a coerced seller who is repelled to sell at any price, nor a willing seller who is prepared to sell at a price which is not deemed fair in the current market.

f) 'In an arm's length contract means a transaction between parties who do not have a specific or special relationship, e.g., between parent and affiliate entities or between landlords and tenants. It is assumed that the market value exchange is between unrelated parties, each behaving separately;

g) "after proper marketing" means that the asset would be exposed to the market most suitably to affect its disposal at the best price reasonably obtainable following the market value definition. The exposure time is not a constant duration; it can vary based on the type of asset and the circumstances of the market. The only requirement is that there must have been ample time to allow an appropriate number of market investors to be brought to the asset's notice

h) "where the parties had each acted knowledgeably, prudently" presupposes that both the willing buyer and the willing seller are adequately aware of the nature and characteristics of the, its actual and potential uses, and the state of the market as of the valuation date. Each is further presumed to use that knowledge prudently to seek the price that is most favorable for their respective positions in the transaction.

i) "and without compulsion" provides that each party is encouraged to conduct the transaction but is not compelled or unduly forced to conclude the transaction." Page 05 of 19, IVS, (2005)

The market value concept presupposes a price negotiated in an open and competitive market where the parties behave freely. The market for an asset could be an international

market or a local market. The market may be made up of multiple buyers and sellers or could be characterized by a small number of market participants. Usually, the market value of an asset will reflect its highest and best use. Where, the highest and best use is the use of an asset that maximizes its productivity and that is possible, legally permissible, and financially feasible.

2.5.3.2. Investment Value

'Investment value is the value of an asset to the owner or a prospective owner for individual investment or operational objectives (IVS Council, 2011). Although the value of an asset to the owner may be the same as the amount that could be obtained from its sale to another party, this basis of value reflects the benefits received by an entity from holding the asset and, therefore, does not necessarily involve a hypothetical exchange. Investment value reflects the condition and financial goal of the entity for which the valuation is being produced. It is often used for to indicate/ measure investment performance.

2.5.3.3. Fair Value

"Fair Value is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties (IVS Council, 2011). Fair value requires the assessment of the price that is fair between two identified parties taking into account the respective advantages or disadvantages that each will gain from the transaction (IVS Council, 2011). Most of the time it is applied in judicial contexts. While in many situations, the price which is fair between the two parties is equal to that which can be achieved in the market, there may be cases where the calculation of fair value requires taking into consideration matters which need to be

disregarded in the assessment of market value, such as any element of exceptional value resulting from the combination of interests.

2.5.3.4. Special Value

"Special value is an amount that reflects particular attributes of an asset that are only of value to a special purchaser. A special purchaser is a particular buyer for whom a particular asset has special value because of advantages arising from its ownership that would not be available to other buyers in the market. Accorcing to IVS Council, (2011) special value exists where an asset has attributes that make it more appealing to an individual buyer than to any other buyers in a market. These characteristics can include the physical, geographic, economic, or legal features of an asset.

2.5.3.5. Synergistic Value

According to IVS Council, (2011) "Synergistic value is an additional element of value created by the combination of two or more assets or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer then it is an example of special value."

2.5.4. Valuation Reporting

According to IVS Council, International Valuation Standard, (2011) the content and presentation of the valuation Report are of critical importance to communicating the value conclusion to the client and user(s) of the valuation and confirmation of the valuation basis, the purpose of the valuation, and any assumptions or limiting conditions underlying the valuation. Valuation report, the final step in the valuation process, is vital in communicating the value conclusion and confirming the valuation basis, the purpose of

the valuation, and any conclusions or limiting factors that underlie the valuation. To guide the reader through the procedures and evidence undertaken in the valuation process and empirical data used to attain at the value conclusion may also be included in the valuation report.

The valuation report indicates procedure summary and the value conclusion and also contains the name of the Valuer and the date of the valuation is made. It identifies the property and property rights subject to the valuation, the basis of the valuation, and the intended use of the valuation. It reveals and clearly show all underlying assumptions and limiting conditions, specifies the dates of valuation made and reporting date, notify the extent of the inspection and includes the Valuer's signature. To perform valuations that comply with IVS and Generally Accepted Valuation Principles (GAVP), it is mandatory that Valuers stick to all sections of the IVSC Code of Conduct more specifically, relating to Ethics, Competence, Disclosure, and Reporting;

2.6. Method of measurement & valuation standard

According to the Royal Institution of Chartered Surveyors (RICS 2007c) which '*is the leading source of land, property, construction and related environmental knowledge*' and exist to '*promote best practice, represent consumers' interests and provide impartial advice to society, businesses, governments, and global organizations*'' It has set some standards and guidelines on property valuation to ensure consistency and the application of 'best practice' within the profession. These are contained in two publications

- The Red Book (RICS 2007d)
- Code of Measuring Practice (RICS 2007d)

In addition to RICS in the United Kingdom and similar bodies in other countries, there is an International Valuation Standards Committee (IVSC) to establish and encourage the conformity of professional practice around the world. The 8th edition of the International Valuation Principles (IVS) was issued in July 2007, and its contents are integrated into the text of the RICS Red Book so that compliance with one of them guarantees compliance with the other.

2.6.1. Code of Measuring Practice

Essentially, the purpose of the RICS code of measuring practice is to include concise, precise definitions for the correct measurement of buildings and property, the estimation of sizes (areas and volumes) and the classification or specification of land and buildings on a common and consistent basis. The code describes the methods of building estimation, along with when and how they can be used. The core approaches used in land assessment and management practice are (RICS 2007b: 2–3 and 8–21):

- Gross External Floor Area (GEA)
- Gross Internal Floor Area (GIA)
- Net Internal Floor Area (NIA)

Gross External Area (GEA)

This '*is the area of a building measured externally at each floor level'* (RICS 2007b: 8). It is mainly applied for the computation of plot ratio and other planning matters, and the estimation of building costs for residential buildings. Being an external measurement, it includes all external wall thicknesses and takes each floor into account. However, it must be recalled that if the building is not a single-story building, GEA is not the site area occupied by the building. Also, check whether each floor is the same shape and size of those above or below it.

Gross Internal Area (GIA)

This ‘‘*is the area of a building measured to the internal face of the perimeter walls at each floor level*’’ (RICS 2007b: 12). GIA is used for non-residential building costs estimation purposes and valuation of industrial and warehouse buildings (including ancillary offices), superstores, retail warehouses, and new homes for development purposes. It is broadly the GEA with all perimeter and party wall thicknesses and external projections and finishes thereto excluded.

Net Internal Area (NIA)

This ‘‘*is the usable area within a building measured to the internal face of the perimeter walls at each floor level’’* (RICS 2007b: 16). Mainly recommended for the valuation of offices or shops, it excludes ‘non-usable’ areas that would form part of the GIA. Examples of such exclusions are toilets, toilet lobbies, bathrooms, cleaners’ cupboards, lift rooms, plant rooms, stairwells, lift wells, those parts used for essential access, and internal structural walls, columns, and piers. This is just a brief indication of the meaning of NIA. Remember, it is essential to refer to and apply the exact wording of the Code of Measuring Practice for this and all other definitions.

2.6.2. The Red Book

The RICS valuation standards and guidance notes are known as the ‘Red Book’ because of the color of the cover used on the ‘hard copy’. The Red Book ‘was first published in 1980, and has been revised many times since then’ (RICS 2008d). The board of the RICS valuation expert association approves any improvements and changed to the criteria. The standards are divided into two main parts. The first provides guidelines and instructions applicable to members of the RICS everywhere in the world and is consistent with the

principles of the IVS. The second includes content that applies directly to a given region. The standard included a variety of guidelines on valuation definitions, methods, and processes, as well as some changes in organizational structure, much of which was integrated into the 4th Red Book (RICS 1997b). The key aim of the Red Book is to ensure that the valuations created by members meet high levels of integrity, clarity, and objectivity and are reported on a recognized basis that is appropriate for that purpose (RICS 2007d: para.1.1).

For any valuation, the 'basis of value that is appropriate to be reported' must be determined. It is appropriate to use one of the bases of valuation recognized in the IVS for most valuation purposes (RICS 2007d: PS 3.1, 41). The bases of value that are recognized in the standards are (RICS 2007d: PS 3.1, 41):

- Market Value
- Market Rent
- Worth (Investment Value)
- Fair Value

Market Value (MV)

''The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arms-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion'' (IVSC 2007b, cited in RICS 2007d: PS 3.2, 42).

Market Rent (MR)

''The estimated amount for which property, or space within a property, should lease (let) on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms in an arms-length transaction after proper marketing wherein the parties had acted

knowledgeably, prudently and without compulsion." (IVSC 2007b: GN 2, para.3.1.9.1, cited in RICS 2007d: PS 3.3, 46).

Worth (or Investment Value)

''The value of property to a particular owner, investor, or class of investors for identified investment or operational objectives'' (IVSC 2007b, cited in RICS 2007d: PS 3.4, 47).

Fair Value

''The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties, in an arm's length transaction'' (IVSC 2007b: IVA 2, para.3.2, cited in RICS 2007d: PS 3.5, 48). 'Fair value' is now recognized and defined as 'a price that is fair between two parties acting at arm's length for the exchange of an asset' (Thorne 2007).

2.7. Land valuation

2.6.1. Introduction

According to IVS Council, (2011) implicit within the definition of market value is the concept of highest and best use. This is the most probable use of a property which are physically possible, appropriately justified, legally permissible, financially feasible, and which results in the highest value of the property being valued. The existing use of the land may or may not represent the highest and best use. Therefore, it is the valuer's responsibility to consider different benefits and corresponding land values in estimating the highest and best use and market value. Where there is no evidence of market land values for the existing use of the land, alternative highest and best land uses need to be considered.

For land, reliable market-based evidence is considered to be market evidence of land in a similar or alternative use, which is located adjacent (or in close proximity) to the landed property being valued. In addition to third party transactions, arm's-length purchases or sales by the reporting entity will provide relevant market evidence. Adjustments for physical characteristics such as size, shape, contour, etc. will typically need to be addressed by the valuer.

2.6.2. Land Use Principles

According to Lean & Goodall, (1966) every metropolitan area's land-use trend illustrates competition for sites between various uses that operating through the force of supply and demand powers. An activity will tend to locate at the place where it has the greatest relative advantage in the long run. This would be the profit-maximization location for businesses and the utility or facility maximization location for customers.

The person or company who can pay the highest price for a given location is the person who is most likely to occupy and use it. Suppose government action or regulation does not change the market. In that case, urban sites may appear to be used to generate the more significant benefit that is primarily dictated by accessibility, complementarity, and strength of use:

- Accessibility – to transportation systems, markets, other similar users, labor supply, etc.
- Complementarity – which leads to group like and some unlike users together on specific area. Although different uses, offices, and shops are usually found together in a city center as they complement each other.
- The intensity of Use – the more intense the permitted use of the site, then mostly the highest will be its value. Those sites which enjoy the greatest accessibility and

complementarity will have the highest demand and will, therefore, need to be used intensively to try and satisfy as much of this demand as possible.

According to Lean & Goodall, (1966) most modern metropolitan areas share a broadly similar land uses pattern, with variations and differences in each town or city and modern urban areas pattern of land uses can be stated into five zones or regions; the central business district or zone, the zone of transition, suburban area, rural-urban fringe, and rural area.

2.6.2.1. Central Business District (CBD) or Zone (CBZ)

This is the heart of the city and the area that has the highest levels of accessibility and complementarity. It is common which the transportation routes radiate. In most cases, the CBD is in the geographical center of the town, but this does not necessarily have to be so. The central zone is relatively small-sized and, coupled with intense demand from users due to the advantages of its location; it will enjoy peak land values. Along with these high prices, the scarcity of land would generate the greatest intensity of use of land in the urban area, which results in high-rise buildings.

Commercial uses that benefit more from high accessibility and complementarity, such as offices, retail, and some recreational activities, such as theaters, are gathered in this area. The other uses that benefit from and need to be in this area are major public buildings such as museums, main libraries, town halls, and central administrative offices. This heavy competition for space and high land prices would significantly limit residential property in the area. Those that remain are of high value, particularly in good condition.

2.6.2.2. The Zone of Transition

This zone immediately surrounds the CBD and can be termed the inner-city area. It has relatively high land prices and was developed by expansion of the CBD. It typically consists of new buildings or existing buildings that have been adapted, rehabilitated, or restored. It is the oldest suburban neighborhood, mostly made up of affluent houses or low-income multi-family homes, which are comparatively high in terms of land value. For several other users' Radial transport routes out of the center offer reasonable accessibility.

2.6.2.3. Suburban Area

Land values and land use intensity are much smaller than in the two previous regions. The majority of users are suburban with modest densities and related complementary applications, including open and recreational areas. Development tends to be low-rise with the possible exception of regional centers within the area. There is less pressure for high-rise development with lower land values.

2.6.2.4. Rural-Urban Fringe

This is the countryside near which single-family homes are combined with farming. Besides those working in local agriculture, people here are in classes with higher revenues. They prefer to live here because the land that allows for building big houses is relatively limitless. The high prices of commuting travel back to town deter low-income communities.

2.6.2.5. Rural Area

This is the open countryside beyond the city's outer boundary limits. It is widely committed to farming, woodland, heathland, and other open spaces with few houses. Most of the time many of these areas are designated as national parks, outstanding natural beauty areas, or special scientific interest sites, and are strictly supervised for any development.

The size and exact shape of the five zones varies from city to area, city to city, and country to region. In many instances, a region or regions that radiate from one center overlap with those from a neighboring village so that there are no all five regions exist in that particular district. Besides, small regional centers, which often create their land areas that overlap those of the city itself, may be located within a major city's limits. Thus, a region of territory may be situated in the city's suburban area but form part of the regional city's central business district. Establishing the economic area of land use within which a property is located in an important factor in understanding the economic, social, political and geographical factors that exist and help to determine the levels of supply and demand for a particular property type and thus influence its value (Blackledge M. , 2009).

2.6.3. Valuation of Land Approach

According to Lean & Goodall, (1966), Lands are broadly classified into;

1) Open Land
2) Land with Structures,

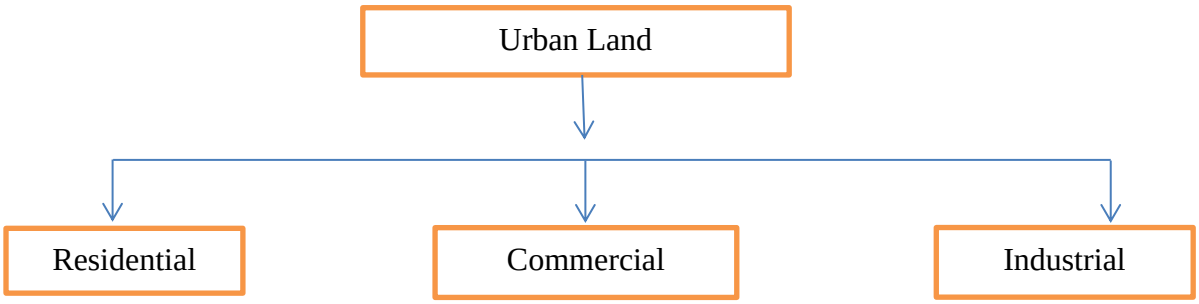
Further the open land as:

1) Urban Land
2) Agricultural (or) farmland

Further the urban land as;

1) Residential
2) Commercial
3) Industrial

The urban land again classified into three categories shown on the figure below:



Source: Principle of Valuation by Lean & Goodall, (1966)

Figure 2 - 2: Urban Land Classification

The market value of the land should be arrived by multiplication of Total Extent of Land or Plot and the unit Rate of the land.

$$Land\ Value = Total\ Exttent\ x\ Unit\ Rate\ of\ Land \quad \text{... Equation (2.1)}$$

CALCULATION OF EXTENT:

The extent is calculated based upon the documents (or) actuals. The following documents are to be utilized to found the extent;

(1) Peruse of title Deeds & Settlements / will deeds

(2) Encumbrance Certificates

(3) Site plan which is given by the local administration Authority

(4) Survey Book

(5) Previously approved plans etc.

(6) Legal opinions

Even though over the above documents a valuer may be the case, physical measurements to be executed in the site while doing the valuation.

UNIT RATE

The unit rate application in the valuation of land will not be the same for all types of plots. It varies with the shape, size, nature, etc. According to Lean & Goodall, (1966), there are generally two types of unit rates systems applied in the assessment of land valuation. This is;

1) Guideline Rate

The guideline rate is the unit rate fixed by the local registration department authorities to decide the stamp duty for any sale transaction between the buyer and seller. This rate is fixed based on the recent transactions and sale instants.

2) Prevailing Market Rate

This is the rate to be adopted while assessing the present market value. This rate is to be arrived from comparable/ recent sale instances, transacted in the surrounding or nearby areas.

2.8. Property valuation approach

Generally, most of the world follows more or less similar methods for property valuation. In some jurisdiction, those rules are written in formal law and codes in other professional organization were organizing the formal patterns of valuation like the Royal Institution of Chartered Surveyors (RICS), London, the Appraisal Institute (AI), Chicago or the International Valuation Standards Committee (IVSC), London, or the European Group of Valuers' Association (TEGoVA), Brussels. But in general, the essence of valuation is the similar: It should be "[...] estimation of the most likely selling price on the open market […]" (Sayce et al, 2006). The target for the valuation professionals is in most

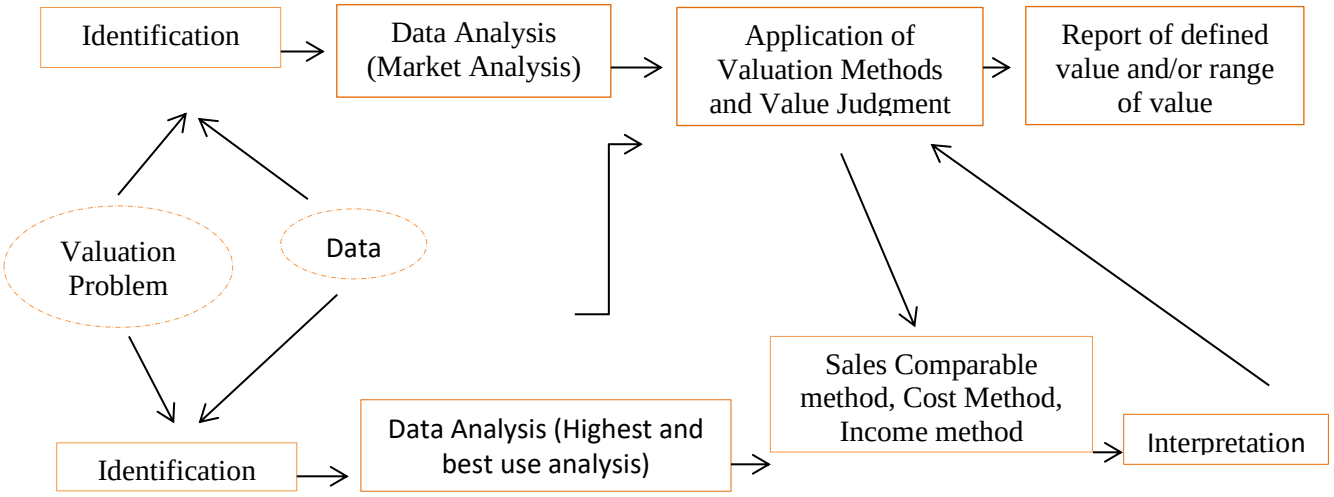
circumstances the "Market Value". RICS; IVC and TEGoVA are using the same definition of "Market Value", which is:

> *"The estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value shall be documented in a transparent and clear manner." ass coated on (IVSC, 2007; TEGOVA, 2009; RICS, 2007; cited in Bienert, et. al.__)*

According to Appraisal Institute, (2001) There are three internationally recognized methods of property valuation and they are all based on the principle of market comparison which is an anticipation of benefits or substitution, which are the economic principles of price equilibrium. They are:

1) sales comparison;
2) income capitalization; and
3) replacement cost.

Using the sales comparison method, the valuer examines the recent sales of comparable properties and uses this market intelligence to help estimate a value. Income capitalization considers the net income that a property might generate, typically in the form of rent, and this income is capitalized using an appropriate yield or by discounting the projected cash-flow at a suitable target rate of return. Both the rent and yield will be estimated using comparable evidence. The steps in the process of defining the valuation problem-identification of the real estate to report of defined value are shown here below on figure 2-3.



Source: Appraisal Institute (2001)

Figure 2 - 3: The Valuation Process

The replacement cost method considers the possibility that, as a substitute for the purchase of a given property, one could construct another property that is either a replica of the original or could offer comparable utility. In practice, the approach also involves an estimate of depreciation for older or less functional properties where the estimated cost of a new replacement is likely to exceed the price that would (hypothetically) be paid for the subject property (IVS Council, 2011). Building costs, depreciation rates and land values are all estimated by referring to comparable evidence.

A brief description of the three internationally recognized methods of property valuation will be provided as follow;

2.6.4. The Sales Comparison Method

According to Wyatt, (2007) a property may be valued by comparing it to similar properties for which recent price information is available. In the sales comparison approach transaction prices of highly comparable and recently sold properties are used to estimate

the market value of the subject property being valued. The economic rationale of the sales comparison method is that a knowledgeable and prudent person would not pay more for a property than other persons have recently paid for comparable properties given that the general market conditions are the same. If meanwhile, the general market conditions have changed, then persons are only willing to pay comparable prices adjusted by the general price level for properties (Millington, 2000).

The degree of similarity or difference between the subject property and the comparable sales is usually established on the following elements of comparison: property rights conveyed, financing terms, conditions of sale, expenditures made immediately after purchase, market conditions (time), location, physical characteristics, economic characteristics, use (zoning), and non-reality components of value (Betts & Ely, 2005: Appraisal Institute, 2001). Value-significant differences between each comparable and the subject property must be reconciled before price information from the former provides reliable evidence of the value of the latter. This reconciliation can be undertaken qualitatively by the valuer, who would have experience and knowledge of the local market, or a quantitative technique can be used to weight comparable properties, isolate differences in the elements, quantify these differences and adjust the values accordingly. Typically, a combination of qualitative and quantitative approaches would be employed (ibid).

According to Appraisal Institute, (2001) and Wyatt, (2007), procedurally which is shown on figure 2-4, the comparison method involves the following steps:

- Collect evidence of transactions and eliminate those not conducted at arm's length (between parent and subsidiary companies, for example).
- Determine which transactions are suitable for adjustment having regard to their comparability with the subject property. The geographic extent from which a comparable can be selected depends on the type of property and the state of the

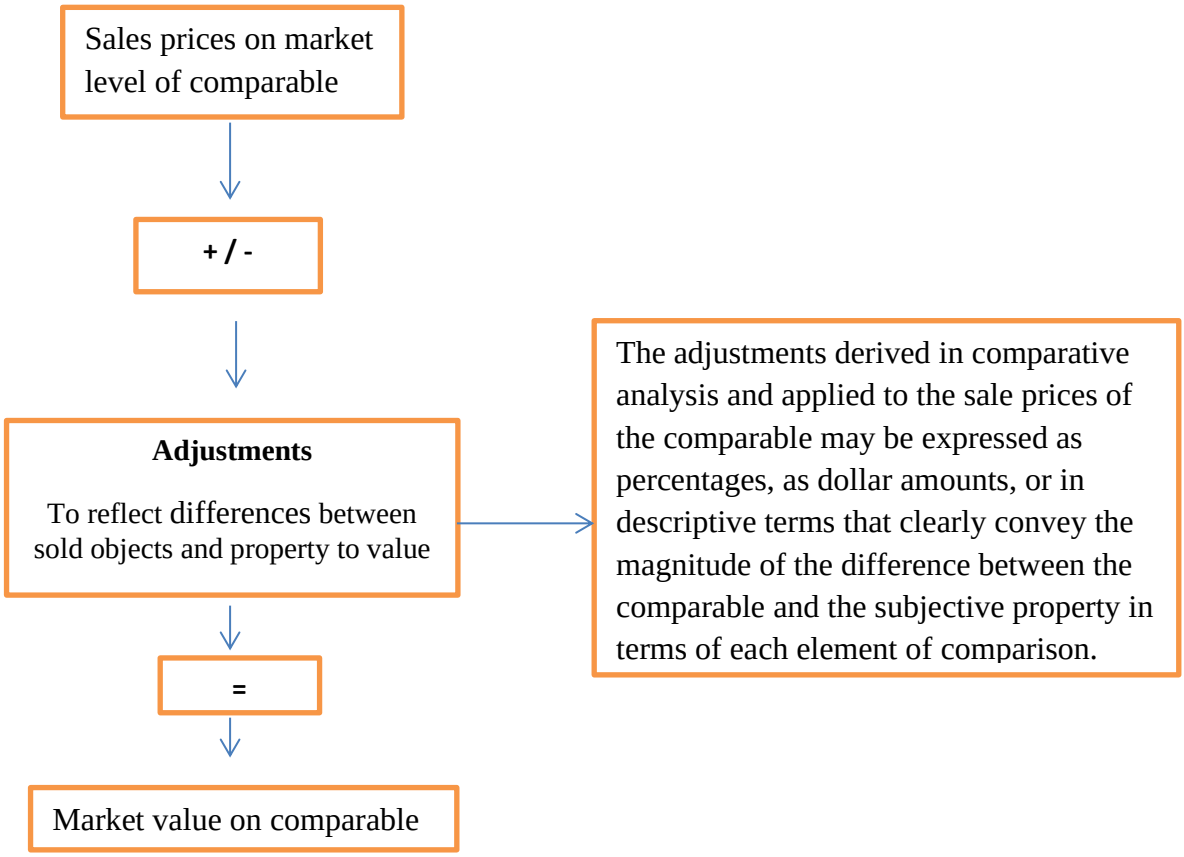
market. Comparable yet to transact or beyond a suitable time-frame should be used with caution (Appraisal Institute, 2001).

- Select the elements of comparison.
- Compare the transactions based on these elements, and make adjustments where necessary.
- Reconcile comparison elements to provide an indication of value for the subject property (taking care to ensure that any adjustments made to the comparable evidence reflect the likely reactions of market participants).

The sales comparison method applies to all types of real property interests when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market (Betts & Ely, 2005; Ling, & Archer, 2005). The sales comparison method is predicated on comprehensive and up-to-date records of transactions and is therefore a reliable method in an active market where recent evidence is available.

For property types that are bought and sold regularly, the sales comparison method often provides a supportable indication of market value. When the market is weak and few market transactions are available, the applicability of the sales comparison approach may be limited. For example, the sales comparison method is usually not applied to special–purpose properties because few similar properties may be sold in a given market, even one that is geographically broad. The more specialized the type of property, the less likely is it that the valuer will be able to find well" comparable", and it is not unusual for there to be a complete lack of evidence of sales of comparable properties (Appraisal Institute,2001; Millington,2000; Scarrett, 2008). Hence, in the sales comparison method, reconciliation involves consideration of the strengths and weaknesses of each element. A valuer uses judgment to determine the direction and magnitude of the effect that each element has on value and assesses its relative importance. When this has been done for each factor and

every comparable, the net adjustment for each is resolved. Here below on the figure 2-4 is the general procedure employed on sale comparison method (Schulz, 2003; Wyatt, 2007).



Source: (Appraisal Institute, 2001)

Figure 2 - 4: General Sales Comparison Method or Comparative Method

According to Millington (2000), perhaps the biggest weakness in the use of the sales comparison Method is the underlying and simple assumption that because in the past one person was prepared to pay a certain figure for a particular property, another person will also be prepared to pay similar figure for a similar property. It may be that the purchaser of the comparable property had special reasons and specific personal circumstances which both prompted and enabled the purchase to be made, such reasons and circumstances being completely irrelevant to others in the market place. However, despite the need for great care in the use of the Sales Comparative Method and the frequent shortages of suitable

comparable evidence, it is a method which the valuer will use regularly and which will give reliable results if used properly and in the correct circumstances.

According to (Wyatt, 2007, Betts & Ely,2005), one of the weaknesses of the sales comparison approach is to find significant information about the property of comparison when it comes to location-, technical-, legal- and economical characteristics, and qualities. In the sales comparison method, it is not that easy to compare the subject property's income variables (rent, rental area, what is included and excluded in terms of taxes, etc) to comparable' variables. The same problem is applied to operating and maintenance costs. It can be necessary to find out and give information on both real circumstances and circumstances adjusted to market conditions regarding rents, vacancies, operating and maintenance costs, and their estimated values must be openly showed in one's calculations.

2.6.5. The Income (Capitalization) Method

According to Millington (2000), "Income method is usually applied for a property that is capable of generating rental income and for which an investor is the most likely purchaser". The income approach to value consists of methods, techniques, and mathematical procedures that a valuer uses to analyze a property's capacity to generate benefits (i.e., usually the monetary benefits of income and reversion) and convert these benefits into an indication of present value (Appraisal Institute, 2001). The problem with the sales comparison approach lies in the fact that income properties are not frequently traded, so the available sample becomes so small that it is very difficult to apply that method. The economic rationale of the income approach for existing properties is that no investor will pay more for a property than he/she will retrieve by holding the property.

In applying the income method, a property valuer assumes that the investor ultimately seeks a total return greater than or equal to the amount invested (Hungria-Garcia, 2004). Therefore, the investor's expected return consists of two components: full recovery of the amount invested, i.e., the return of capital and a reward for the assumption of risk, i.e., a return on invested capital. Because the returns from real estate may take a variety of forms, many rates, or measures of return, are used in capitalization. All measures of return can be categorized as either income rates, such as an overall capitalization rate or equity capitalization rate, or discount rates, such as an effective interest rate (the rate of return on debt capital), yield rate (the rate used to convert future payments into present value), or internal rate of return (The-Appraisal-Institute, 2001).

According to (Mott, 1997), there are two recognized approaches to valuing a property using the income method: yield method and discounted cash-flow method. Both calculate the present value of future economic benefits (Mott, 1997).

2.6.6. The Cost Method

According to Millington, (2000) the cost method is used to value specialist properties that are seldom sold because there is no clear market demand. Consequently, there is little or no comparable evidence. A property might be specialist because its use requires it to be constructed in a particular way, including highly production-specific manufacturing plants such as chemical works and oil refineries; public administration facilities such as prisons, schools and colleges, hospitals, town halls, art galleries, and court facilities; and transport infrastructure such as airports and railway buildings, etc. (Vos, 1996). Its economic rationale is that no rational person will pay more for an existing property than it would cost to buy the land and to build a new building on it. However, given that construction of buildings needs time and that land for building purposes might not be immediately

available, prices and costs will diverge in the short-run. The method is employed when the existing uses of these sorts of properties need to be valued for different purposes, for example, compulsory purchase and compensation. However, when these sorts of properties are offered for sale, perhaps because they are no longer required for their current use, the primary market is likely to be for alternative uses (Wyatt, 2007).

According to ADB (2007), the method does not calculate market value. Instead, it calculates a replacement cost for the improvements that have been made to the land, typically in the form of buildings and ancillary man-made land uses such as car parks and the like. It is therefore fundamentally different from the valuation methods described so far. Because of an almost complete lack of comparable market transaction information, the method seeks to estimate replacement cost rather than exchange price. It does not produce a market valuation (value-in-exchange) as such because cost relates to production rather than an exchange, and it is often regarded as the method of last resort for this reason.

2.9. Real property valuation in Ethiopia

2.6.7. Introduction

According to (Belachew, 2014) the 1995 Ethiopian Constitution draws a broad framework for land policy in the country and enshrines the concept of public land ownership and there are no private property rights for land. However, the present government has formulated articles in the constitution and proclamations that can address property holders' rights, especially land use rights. According to Article 40 of the Constitution which provides the right to property in general; First, it provides the right to ownership of private property relating to tangible and intangible goods, which subject to the limitations to be imposed by law in the interest of the public, includes the right to acquire, use and transfer (Article

40(1 & 2)), Secondly, and more importantly, Article 40 (3-8) of the Constitution enunciates on land rights. The 1995 Constitution declared the land to be the property of the state and the people of Ethiopia, over which individuals have only usufruct rights(is a legal right given by an owner to someone who is not the owner to use the owner's property for a certain period). Article 40(7) of the Constitution also specifies the rights to the compensation payments for investment on land in case the "right to use expires," Every Ethiopian shall have the full right to the immovable property he builds and to the permanent improvements he brings about on the land by his labor or capital. This right shall include the right to alienate, to bequeath, and, where the right of use expires, to remove his property, transfer his title, or claim compensation for it (Constitution of 1995, Article 40 (7)).

Since the country is structured along the line of a federal setup with nine autonomous regional states and two city administrations the use and administration of land are left to each regional government within the framework of the federal parliament's legislation (Belachew, 2014). According to proclamation No.455/ 2005, Art 3(1), a Woreda or an urban administration as an agent of the government, can expropriate rural or urban land holdings for a public purpose where it believes that it can be used for a better development project to be carried out by public entities, private investors or other organs with payment of compensation. As this same proclamation, a landholder whose holding has been expropriated shall be entitled to payment of compensation for his property situated on the land, and for permanent improvements, he made to such land shall be equal to the value of capital and labor expended to the land.

Resettlement and rehabilitation are recognized as civic rights in the Ethiopian legislation. Article 44 No.2 of the 1995 Constitution of the Federal Democratic Republic of Ethiopia (FDRE) has a clause stating that;

> *"All persons who have been displaced or whose livelihoods have been adversely affected as a result of state programs have the right to commensurate monetary or alternative means of compensation, including relocation with adequate State assistance."*

This is the basis for the compensation procedures and the legal framework for the resettlement and rehabilitation policy framework of Ethiopia. All project affected peoples and organizations (whether public or private) that loose, houses, crops, or sources of income will be compensated or rehabilitated according to the type and amount of their losses. The cut-off date for compensation eligibility will be set once all detailed measurements have been completed. Compensation will not also be paid for any structure erected or crops and trees planted purely to gain additional compensation.

According to Proclamation No.455/2005, compensation can be made in cash, in-kind, or both to a person for his/ her property situated on the expropriated holdings. The Ethiopian Constitution of 1995, Article 40(8) puts an obligation on the government to pay, in advance, compensation "commensurate" to the value of the property expropriated. This principle is also found in other regions' constitutions (Belachew, 2014). However, no further definition is given in the Constitution as to what "commensurate" means. According to Belachew, (2014) the Ethiopian Civil Code has adopted the indemnity theory in determinations of compensation. Stated on Article 1474 (1) of the Code says that ''the amount of compensation or the value of the land that may be given to replace the

expropriated land shall be equal to the amount of the actual damage caused by expropriation.'' That is, if the amount of compensation is equal to the actual damage, there is no possibility for the owner to be harmed or benefited as a result of the taking.

Two broad types of situations for which compensation will be due in case of expropriation are envisaged under the Federal laws. The first category of compensable is what may be considered as immovable private property as defined under Article 40 of the 1995 Constitution. The second category of compensable is payment for displacement and appears to be based on Article 42 of the same constitution, which requires payment for persons displaced by government development programs.

In the first instance Article 7 of Proclamation No. 455/2005, compensation is payable for each property situated on the land and for permanent improvements made to such land. While compensation for "property" is to be fixed based on the replacement cost of the property, compensation for permanent improvement is to be fixed based on, and equal to, the capital and labor expended on the land. The amount of compensation payable to an urban dweller, may not, in any way, be less than the current cost of constructing a single room low-cost house under the standard set by the concerned region (Article 2). As article 5 of the same proclamation, the cost of removal, transportation, and erection shall be paid as compensation for a property that could be relocated and continue its service as before.

In the second instance based on Article 8 of Proclamation No. 455/2005, compensation is payable for displacement in addition to what is paid for each property situated on the land and for permanent improvements made to such land. Accordingly, compensation for permanent displacement of the rural landholder should be "equivalent to ten times the average annual income ... secured during the five years preceding the expropriation of the

land. Article (8) however, in the case of temporary displacement Article 8(2), while the approach is still the same as in permanent displacement, it is time-bound and only payable as long as the displacement continues, and should not exceed the amount that a person would have received had he/she been permanently displaced. In the case of displacement resulting from expropriation under the Proclamation, the Woreda Administration may decide to compensate the displaced person by providing substitute land "which can be easily plowed and generate a comparable income" Article 8 (3). 'In such cases, compensation payment due to the landholder in cash cannot exceed a one-time payment of the average annual income secured during the five years preceding the expropriation of the land.'

An urban landholder whose landholding has been expropriated, in addition to the compensation paid for the property situated on the land and for permanent improvements made to such land, it shall also be paid the following additional compensation, according to Article 8(4):

- "the expropriate should be provided with a plot of urban land for the construction of a dwelling (business) house of which the size can be determined by the urban administration; and"
- "the expropriate should be paid a displacement compensation equivalent to the estimated annual rent of the demolished dwelling (business) house or be allowed to reside (trade), free of charge, for one year in a comparable dwelling (business) house owned by the urban administration."

Also, when the land is possessed in lease system, the land use right can be terminated where it is decided to use the land for other purposes due to the public interest (Proc. No. 721/2011, Article 25 (1b)) i.e. when an urban land lease holding is expropriated before its expiry date. In this case, the leaseholder has a right, in addition to the compensation paid for the property situated on the land and for permanent improvements made to such land, to be provided with a similar plot of land which he/she can use for the remaining lease

period or longer if the new land is less than the former land or if its rent is less than the former land (Belachew, 2014). However, if the leaseholder does not want a replacement land, he/she still has the right to request for, and take, the balance of the lease payment (Proc. No. 455/2005 Article 8(6)).

2.6.8. Mandate to value

The Federal Expropriation Proclamation assumes the existence of certified appraisal professionals and a nationally adopted uniform formula for valuation based on (Article. 9(1) of Proc. 455/2005). roc. 455/2005). Based on this situation, regions and the federal government have adopted or are adopting their valuation formulas. However, the Ministry of Federal Affairs has not yet given a clear direction in this regard. In most regions, the urban and rural land administrations have already adopted implementing regulations that contain mainly compensable interest and valuation formulas. Similarly, and lately, the federal government has also come up with Regulations No. 135/2007, which contains basic valuation methods and assessment systems.

In rural land regulations, property valuation is to be carried out by a committee of people. The Federal Expropriation Proclamation gives a direction where the land to be expropriated is located in rural areas; the woreda administrative head shall head the committee. Hence, regional rural land administration authorities have been given the mandate to constitute the committee members and appraise the property. Likewise, in the urban administration, the municipality is given the same power to designate committee members to value the property.

2.6.9. Valuation Method by Government

Modern valuation systems give market value for expropriated land and, during the calculation of compensation; location value has always been given a place (https://chilot.com, 2011). In Ethiopia, valuation guidelines are reflections of the prevailing tenure system. This is especially clearly shown in urban valuation and compensation regulations. According to Belachew, (2014) the existing land legislation, however, ignores location value for the land which the general reason given is that land is public property and, hence, no compensation should be paid by the government for its property. The problem is that it denies the holder of the land fair compensation. To mitigate its effect the holder may be given another land. About other fixtures on the land, especially buildings, the accepted valuation method is the cost replacement method. This is clearly shown under Article 7(1) of the Expropriation Proclamation:

Based on Regulation No.135/2007 the amount of compensation for property situated on the expropriated land shall be determined based on the replacement cost of the property. Also, Articles 3 and 4 of Regulations No. 135/2007 incorporate similar principles in replacing a demolished building and fences.

2.10. Real property valuation by banks in Ethiopia

2.6.10. Ethiopian Banks Practices of Property valuation

Property valuation practice in Ethiopian banks, most of the banks developed their manuals and some of the banks use nationally developed EBA's manual (Elizabeth, 2017). The manual deals with the valuation of buildings and other associated civil works. According to EBA Manual, (2015). EBA's Manual aims to endeavor of minimizing variations

observed on valuation procedures employed by member banks and thereby avoid and/or curtail differences in estimated values of properties pledged as collateral. It will also be a step forward towards aligning the Banks' valuation methods in line with generally accepted valuation techniques.

In case of Development Bank of Ethiopia (DBE) most of the projects that they finance are specialized in nature, which produce a specific product and cannot easily be exchanged in the market in case they fail, hence, it entails (requires) both overestimation and underestimation issue which needs careful and proper estimation. Particularly Development Bank has its own valuation manual.

According to (Elizabeth, 2017) in the valuation methods used by most of the Banks, the depreciated (or un-depreciated) replacement cost of development on the premises to be held as collateral are calculated and multiplied with some kind of appreciation factor/s or some sort of location value is added to determine the estimated value of the property. For developments under construction requesting project finance, most of the Banks employ an engineering cost estimation using the specification and bill of quantities method. Valuation methodologies employed by almost all Banks are similar except the figurative elements and some minor differences inherent in each method (Elizabeth, 2017). Generally, the proper method to be employed in the determination of the value of a property will depend mainly on the purpose of the assignment, the type of value sought, the type of property under consideration, and the type and reliability of available comparable market data.

As per EBA's real property valuation standard and the IVS (2011), valuations for loan security shall be based on market value. Due to the constraint on availability of reliable transactional market data in the city, infancy of property market in the country, and

difficulty of consistency in EBA's appraisal applications, only the cost approach and income approach are employed in the valuation of a major class of properties. An income approach is based on the income which the property is generating at the time of valuation, while a cost approach is based on the total cost of the construction of a property. According to EBA valuation manual the appropriate models developed for valuation of properties, as dictated by the purpose of the assignment and the types of property to be valued are discussed hereunder

2.6.11. Property Class and method for Valuation Purpose

For the valuation purpose, Properties are generally classified into three major classes, namely: Commercial /Investment Property, Residential Property, and Specialized Property.

Commercial /Investment Properties

These classes of properties are developed and owned to lease to a third party, for possible future occupation by the owner, or for future development to earn rental income or profit upon resale. A prospective Investor on commercial property will mainly be interested in the income-producing capacity of the property. The assignment of weight in the final reconciliation of market value indicative resulting from, the application of the Cost & Income Approaches will be as follows:

Table 2 - 1: Valuation Approach for Commercial/Investment Property

No.	CORRELATION FACTOR	Factor weight (100%)	ASSIGNED WEIGHT	
			Cost approach	Income approach
1	Strength of approach to value	40	35	65
2	The relevance of approaches to the subject	30	40	60
3	Amount and reliability of data for each approach	30	45	55
	Total	100	40%	60%
	Value indicative using Cost approach		X	
	Value indicative using the Income approach			Y
	Final Reconciled Market Value of the property		0.4(X) + 0.6(Y)	

Source: EBA manual as referred by Elizabeth, (2017)

Residential Properties

Are those which are mainly developed for residential purposes, whether they are owner-occupied or rented out. A prospective buyer will mainly consider the suitability of the premises for satisfying the required needs rather than contemplating the expected yield from investing on the property. Accordingly, one has to assign more weight on the cost approach value indicative than the income approach indicative, the detail specifics of which are depicted in the table below:

Table 2 - 2: Valuation Approach for Residential Property

No.	CORRELATION FACTOR	Factor weight (100%)	ASSIGNED WEIGHT	
			Cost Approach	Income Approach
1	Strength of approach to value	40	85	15
2	The relevance of approaches to the subject	30	80	20
3	Amount and reliability of data for each approach	30	74	26
	Total	100	80%	20%
	Value indicative using Cost approach		X	
	Value indicative using the Income approach			Y
	Final Reconciled property Market Value of the property		0.8*(X) + 0.2*(Y)	

Source: EBA manual as referred by Elizabeth, (2017)

Specialized Properties

These classes of property are those that are rarely if ever sold on the open market, except by way of a sale of the business of which they are part of, due to their uniqueness, which may arise from the specialized nature and design of the buildings, their configuration, size or location or other factors. Key characteristics of the specialized property are that they:

- Are useful to a limited number of uses or users;
- Are rarely, if ever, sold on the open market, except as part of the business entity;
- Have generally specialized structures; and
- Earn revenue that has not been derived from an open market and for which market-based evidence does not exist.

In general, specialized properties are those that, due to some specialized physical or geographical factor, offers very little utility for any purpose other than that for which they were originally designed. These classes of properties are so specialized by nature that no comparable market data could be employed to apply the Income approach, as tabulated below. Hence, the final market value conclusion will fully rely on the results of the Cost approach.

Table 2 - 3: Valuation Approach for Specialized Property

No.	CORRELATION FACTOR	Factor weight 100%	ASSIGNED WEIGHT	
			Cost Approach	Income Approach
1	Strength of approach to value	40	100	0
2	The relevance of approaches to the subject	30	100	0
3	Amount and reliability of data for each	30	100	0
	Total	100	100%	0%
	Value indicative using Cost approach		X	
	Value indicative using the Income approach			Y
	Final Reconciled Market Value of the property			X

Source: EBA manual as referred by Elizabeth, (2017)

Specialized property: the type of property that would be referred to as a specialized are those properties where there is insufficient market data to value them by some form of comparison.

Non-specialized property: the type of property that would be referred to as non-specialized are the dominant property types of residential, offices, shops, industrial units, and warehousing.

2.11. Practice of property valuation in other countries

As it has been reviewed the general practice form IVS and RICS here practice of Ghana & Nigeria from Africa and Romani from Europe has been selected for review as it has been difficult to view other country practices from different source.

Ghana

According to Mantebea, (2006) Property valuation is carried out in Ghana for various purpose such as for insurance, payment of compensation for state acquired lands, taxation, rent/lease, sale and mortgages. In all these though different methods of valuation are applied, until now real estate appraisers have assessed real estate based on their intuition or experiences. The basis of valuation that is widely adopted is the open market value basis using comparative sale method. Property valuations are therefore usually distorted and not a true reflection of what would be an open market value. These constraints include high inflation and interest rates, difficulty in determining interest in the property being valued due to the land tenure systems, social behaviors, dearth of knowledge of the property market, an informal property market and lack of adequate data.

Nigeria

In Nigeria, the real estate valuation profession is regulated by two complementary bodies, the Estate Surveyors and Valuers Registration Board of Nigeria and the Nigerian Institution of Estate Surveyors and Valuers. Babawale (2005) observed that the evolution of the Nigeria property market has been held back by a number of structural problems, among which are the risks associated with unsecured titles, high interest rates resulting from high inflation, lack of reliable transaction information, discriminatory government intervention and lack of transparency in the market. Others include obsolete training curriculum, weak regulatory framework, lack of national valuation standards, predominance of small size firms, and lack of specialization. Valuators' are mostly aware of the traditional methods and the wide spread method of valuation in use is that "sales comparison method" in practice. Due to lack of national valuation standard each valuator uses their own method (Babawale,, 2012).

Romania

According to EMF-ECBC, (2017) the Romanian National Association of Chartered Valuers, is the professional competent authority that organizes and coordinates valuation activity in Romania. Valuation activities can only be undertaken by authorized valuers which are members of the Romanian National Association of Chartered Valuers. There is no specific legal framework for the valuation of property. the value used for mortgage lending purposes is generally the market value. Three main valuation methods are used: comparison, income approach and cost approach.

For Residential properties:

- Comparison method
- Income method
- Depreciated replacement cost: for new properties or special properties (some banks do not accept this method any more)

For Commercial Properties:

- Income method or discount cash flow approach
- Comparison method
- Depreciated replacement cost method (some banks do not accept this method any more)

According to Veronica Deaca (2014) in Romania, the main challenge concerning valuation is the lack of access to information about traded properties and missing of a general data base concerning the information about the similar and recent real properties transactions. This information is not for public access, and it is impossible to find out who, what and how has been valuated another property, so that you can compare a valuation made in the past with one made in the present (Fechita, 2009). Because of this impediment, each valuer is forced to apply another method.

2.12. Literature summary

Valuation is a combination of knowledge and skills accumulated from studies and job experience that blend together with the art of seeing, appreciating, and analyzing the subject property and value contributing factors. (Czernkowski, 1990) has described it as:

"*…is a process of transformation. It combines a given set of facts, cues such as age, size, proximity to services, into a single output: the ratable value. As such, valuation is*

structured insofar as a set of rules (heuristics), which combine facts to deduce new facts (conclusions), can be brought to bear."

In general, the term property describes a legal concept; it refers to the rules that govern people's access to and control of physical things (tangible assets) like land, natural resources, and manufactured goods as well as of non-physical things (intangible assets) such as inventions or contractual rights and financial claims. Real Property refers to the ownership of land and its man-made improvements attached to land e.g., buildings (Appraisal Institute, 2001). Property valuation is carried out for many different purposes, their relative importance varying from one country to another and from time to time (Wyatt, 2007). Valuations are required for many purposes relating to the development and subsequent occupation and ownership of Property. The reasons for which a valuation could be sought include but are not limited to the selling or purchase, the rent to be charged or requested, the amount of mortgage that may be advanced on the security, the measurement of the compensation payable or receivable, the tax assessment or the ranking, for insurance, to borrow money using the Property as 'security' and the advisability of investment.

The role of the valuer, in general, is to advise on what would be the best figure obtained on the open market for a given property at a particular date. To do so, the valuer must know how valuation will be influenced by the various and varied features of real Property and how shifts in social, economic, and political conditions are likely to impact value in local, national, and foreign contexts (Blackledge M. , 2009). A statement of the fundamental measurement assumptions of valuation is a *basis of value* (IVS Council, 2011). Market value is the estimated amount for which an asset should exchange on the valuation dated between a willing buyer and a seller at an arm's length transaction, after

proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion (IVS Council, 2011).

According to Lean & Goodall, (1966) every metropolitan area's land-use trend illustrates competition for sites between various uses that operating through the force of supply and demand powers. An activity will tend to locate at the place where it has the greatest relative advantage in the long run. This would be the profit-maximization location for businesses and the utility or facility maximization location for customers. According to IVS Council, (2011) for land, reliable market-based evidence is considered to be market evidence of land in a similar or alternative use, which is located adjacent (or in close proximity) to the landed property being valued. In addition to third party transactions, arm's-length purchases or sales by the reporting entity will provide relevant market evidence. Adjustments for physical characteristics such as size, shape, contour, etc. will typically need to be addressed by the valuer. According to Lean & Goodall, (1966) modern urban areas pattern of land uses can be stated into five zones or regions; the central business district or zone, the zone of transition, suburban area, rural-urban fringe, and rural area.

According to Appraisal Institute, (2001) there are three internationally recognized methods of property valuation and they are all based on the principle of market comparison which is an anticipation of benefits or substitution, which are the economic principles of price equilibrium. They are (1) sales comparison; (2) income capitalization; and (3) replacement cost. Using the sales comparison method, the valuer examines the recent sales of comparable properties and uses this market intelligence to help estimate a value. Income capitalization considers the net income that a property might generate, typically in the form of rent, and this income is capitalized using an appropriate yield or by discounting the projected cash-flow at a suitable target rate of return. The replacement cost method

considers the possibility that, as a substitute for the purchase of a given property, one could construct another property that is either a replica of the original or could offer comparable utility.

In line with the above literature reviews intensive desk study on legal documents, academic literature, and documents reflecting international practices and also key informant interviews intended to produce primary data responses through direct questioning the practice of real property valuation for collateral on selected banks have been examined through systematically answering the research questions.

CHAPTER 3: MATERIAL AND METHODS

3.1. Introduction

This section discusses the methodology used in this research. It explores the way the research was designed, the instruments that were applied in the data collection and methods of analysis used in the study. Different sources of information and data are investigated. Also, data and information sources, research instruments, selection of cases, and methods of analysis are presented.

3.2. Research design

Huff (2009) defines research design as "A plan that guides the investigator in the process of collecting, analyzing, and interpreting observations. It is a logical model that allows the researcher to draw inferences concerning causal relations among the variables under investigation".

According to Denscombe (2007), a case study method allows using a variety of data sources, data types, and data collection tools. Whatever the subject matter, the case study normally depends on a conscious and deliberate choice about which case to select from among many possibilities. From these, the following two points have to bear in mind. First, cases are not selected randomly; instead, they are selected deliberately based on known attributes to be found in the case or cases. These attributes are particularly significant in terms of the practical problem that the researcher wants to investigate. Second, the criteria used for the selection of cases need to be made explicit and justified as an essential part of the methodology Denscombe, (2007) as quoted by Belachew, (2014). Consistent with the case study definition and explanation, the practice of real property valuation for collateral

was viewed as a phenomenon, taking place in real-life context; hence it qualified to be explored using case study method. Furthermore, the case study method was considered appropriate for this study since it allowed direct observation of activities under research and interviews of the persons involved in the events.

3.3. Selection of cases

There are sixteen private and two government-owned banks practicing real property valuation (http://www.nbe.gov.et, 2012). Most of them are frequently engaged by real property valuation (land and building). However, those banks are mainly located in the capital; some of them have national coverage of real property valuation practice applicable to the same basis for all areas. Moreover, most of the banks developed their manuals, and some of the banks used nationally developed EBA's Manual. Such organizational divergence has helped the study to have a touch with the national wide practice. Based on this, selected case study Banks are Bank Z, Bank X & Bank Y. I have compared and contrast the methods of valuation of real property for bank Z & Bank X, for completeness I used Bank Y for triangulation of the results and also compared the overall approach with the International Valuation standard (IVS) and Ethiopian Banks Associations Valuation manual (EBA manual).

3.4. Data sampling, collection, and analysis

3.4.1. The approach of the Study

According to Yin, (2003) the Case Study approach in research is not restricted to any specific data collection method. It allows for the use of a variety of methods depending on the circumstances and the specific needs of the situation. It is for this reason that several

sources of data and methods of data collection were used in this research. The following main methods of data collection were used, through structured Key Informant Interviews and Desk study.

The starting action of the study was to search for and study local or international literature related to real property valuation in general. The study included a bank valuation manual for the valuation of real property by banks and Ethiopian bank associations' and internationally accepted standards, reference books, previously conducted research, and the internet. The study also included EBA real property valuation techniques for the literature review and gathering of the necessary information. as much as possible for benchmarking the practice of property valuation in Ethiopian banks guidelines, procedures, and criteria were chosen from the result of a structured interview as best practices.

3.4.2. Target Participants

This case study is intended to get in-depth information and assess the current practice of the method used for property valuation for collateral by a bank; valuers and responsible key personnel working in valuation-related matters working on organization level or privately working as loss accessors was the target participants.

3.4.3. Data Gathering Instruments

3.4.3.1. Structure in-depth interviews

Interviews are intended to produce primary data responses through direct questioning. Since an interview is a purposeful discussion between two or more people, a structured in-depth interview enabled me to examine the level of understanding a respondent has about

the topic. One reason is that people are usually more willing to talk than to write and also, I can explain more explicitly the investigation's purpose and justify what information I want. If the subject misinterprets the question, I may follow it with a clarifying question.

All respondents are asked the same questions and it helped me to replicate the discussion and standardize the result.

3.4.3.2. Literature Review

Relevant documents and papers, legal concepts and provisions, valuation methods, and matters related to financial sources and their influence on the determination of rate/amount was gathered and used in the study. Documents has been gathered from various published journals, reports, books, project reports, and related materials. In general, documentary sources are classified into three major categories: legal documents, academic literature, and documents reflecting international practices. Legal documents including the Federal and Regional Constitutions, proclamations, regulations, bank manuals, etc. dealing with valuation. Academic literature, which reflects various research work and studies on issues/problems related to valuation and related matters.

CHAPTER 4: RESULTS AND DISCUSSIONS

4.1. Result and discussions from interview

Knowledge and Skills required and role of the property valuer

The valuer's role, in general, is to advise as to what would be the best figure obtainable for a given property, in the open market, at a specific date. To do this, the valuer must know how the many and varied characteristics of real property can affect value and how changes in social, economic, and political factors, in the local, national, and international contexts, are likely to influence it. To do this, property valuers are expected to possess and be competent in a diverse range of knowledge and skills.

Based on the structured interview conducted, most of the bank valuators who are willing to conduct the interview believe that academic background primarily Civil Engineers and Construction Technology and management professionals, and some also suggested that urban planners and even architects can conduct the valuation.

Table 4 - 1 Academic Background Required

SN.No	Academic Background Required for property Valuator	Choice of Respondents' (%)				
1	Civil Engineering	100				
2	Construction Technology & management		>50			
3	Accounting				1	
4	Urban planning			<20		
5	Mechanical Engineering				1	
6	Architect				1	
7	Any person with some training related to valuation				1	
8	Any person					None

One also suggested that type of property & method of valuation is prim factor in selecting valuator's academic background. He said if there is reliable market data and information, any professional who take property valuation training can conduct the valuation by using sales comparison approach. Skill and knowledge which valuator should possess as mentioned by most respondents are listed on Tale 4-2.

Table 4 - 2 Skill & Knowledge Required

Required Skills	Required knowledge
Easily identifying the type of construction material and construction methodology	Regulation & legal guidelines and procedures related to valuation
Communication	Construction technology
Understanding location	Construction Material type
Observation	Current market Condition & factors
Visualization	Computer & engineering software
Guessing	Understanding drawing & Plot reading
Report writing	Measurement & Calculation
Documentation	Data recording & encoding,
	Methods of valuation

Internationally, property valuators are required to be certified/licensed to undertake certain valuations. Interview respondents has been asked which the result is reported on Table 4-3, if there is a certification/licensing for property valuator; as it can be said most of the interviewees when they are asked if they know/ familiar with certification/licensing for property valuator in Ethiopia, they said not familiar or here about certification or licensing for property valuator. Still, most of them suspect there might be at international level and believe in the necessity at a local level.

Table 4 - 3 Is their certification or licensing

Respondent frequency	Is there certification or licensing for property valuator in Ethiopia?
>80%	No
<20%	Yes
One	There is short term training

Type of property, Purpose, and Method of Valuation

So as to study the practice of Banks, researcher has asked the interviewees the purpose of valuation of real property in their bank/organization. The response of the respondents has been summarized on Tale 4 – 4 the purpose of valuation of real property by banks.

Table 4 - 4 Purpose of valuation by banks

Purpose of valuation	BANK X	BANK Y	Bank Z
For collateral	√	√	√
For project financing	√	√	√
Foreclosure	√	√	√
Loan security	√	√	√
Financial reporting	√	X	X

Similarly, to understand the types of property pledged for collateral the researcher has asked the interviewees that the types of properties that they valuate in the past five years. They have mentioned different types of properties which includes;

- Residential Buildings
- Commercial Buildings from G+0 up to high rising buildings in the city
- Industrial/ factory Buildings
- Condominium Buildings
- Agricultural farms/ coffee farms/ flower farms
- Special Use facilities like gas stations, resorts

Moreover, to study the method of valuation the researcher has asked the interviewees that, which internationally accepted methods/approaches of property valuation, does their bank/organization use in the valuation of real property and why they choose the method? Most Respondents have indicated the method used in their bank as Cost replacement method due to lack of reliable market data source or provider and market is very fluctuating in short period of time no representative market data will be found so that using cost replacement method reduce the risk of the Bank but there has been some banks that use

cost replacement and income capitalization method jointly with given weightage/factor so as to make the valuation representative of the market though it has never been.

Minimum document & construction requirement for properties pledged as collateral

All respondent said, based on the client request for valuation, documents regarding the property will be submitted to the loan/ credit committee of the Bank and this division order the client to submit required documents which may include;

- Landholding certificate (LHC) (attested copy)
- Approved architectural plans with site plan on it (Original)
- Lease agreement, if land holding is on lease basis
- Bill of quantity (not mandatory)
- Purchase/Performa invoices (whenever necessary)
- Construction permit (Attested Copy)

After this, the loan committee checks the submitted documents according to the company credit policy and procedures of the Bank and directives of municipalities or sub-cities pertinent to property valuation and decide on the sufficiency of the given property for valuation. If it is decided to be valuated then it will order the valuation department to conduct the valuation. Based on the request and order given by the committee, assigned valuator will survey the property to acquire relevant data for the valuation. The survey may include;

- Land and title/ownership information
    - Confirm that the ownership information, plot orientation and dimension indicated on the title corresponds with the physical property
    - Carryout measurement of actual plot, to determine dimensions and plot area
    - Take note of location of the property with respect to prominent land marks

- Identify any easements or restrictions

- Information on improvements on the site
    - Measurement of buildings, compound works, fences and ancillary facilities
    - Construction details and improvement category
    - age of property
    - condition and depreciation information
- Neighborhood information
    - Take representative picture
    - General use of property
    - Location
    - Type and width of access road
    - Distance from main road
    - Availability of basic utilities

The researcher has understood from the interview with bank property valuator maker and checker that most banks follow common procedures regarding collecting the relevant document and carrying out property survey.

Basic steps in the process of collateral estimation for unfinished/finished property

Based on the response of the interview and desk study once relevant documents are collected, and a physical survey of properties are carried out to capture the pertinent characteristics and parameters of neighborhood and specific property, the valuator maker interprets the data, estimates the value of collateral based on the Bank valuation method and produces collateral estimation result reports then the collateral valuator checker, checks and ensures the appropriateness of all collateral property documents and the valuation process undertaken by the valuator maker. If necessary, the valuator checker

may conduct a site visit to countercheck the physical conditions of collateral properties, then he confirms the genuineness of collateral estimation results reports.

Respondents identify the difference in the process of collateral estimation for unfinished and finished property residue on the procedure and method used in the estimation of the value. The method used varies from Bank to Bank which can either be empirical formula or bill of quantity method.

Location value in valuation process, challenges & difficulties in land valuation

So as to determine the practice of banks on land valuation interviewee was asked that for property pledged for collateral do your Bank consider land value? If so, how is land value is assessed? All respondents said that land valuation is not done in their bank & mentioned the existing land legislation in Ethiopia ignore land value as land is public property. Hence, no compensation should be considered (paid) for the property of the Government but respondents' said they consider the land use right of the given property and develop location value based on land grade indicated on Land Holding Certificate (LHC) to properties held on a permit basis and use the corresponding unit rate list applicable for year of estimation prepared by the Bank itself or based on prepared Empirical Equation, which is the function of Zone, Plot Grad & Plot Area Range which then using the corresponding empirical equation value of land use right which is the market value indicative is estimated in Birr/m^2. If the property is held on lease base from the Government, the value of LHR will be calculated by deducting liabilities on the title to the Lease office from the indicative value calculated using the above approach, in proportion to the remaining lease period.

Example given for elaboration by interviewees'

- $200m^2$ land found in Ambo city and $200m^2$ land located in Addis Ababa cannot have the same just because they have same plot area. Location value of plot in Addis Ababa has much higher value than the Plot in Ambo.

- G+1 Residential building with the same construction material and plot area, one in Bole & other in Kality, will not have similar value. The location value will make a difference.

Here below are challenges and difficulties in land valuation mentioned by interviewee;

- Unrealistic increase in market price of land in short period which is identified by its instability

- The proportion of land and the improvements (building and other) on the land

- Banks only valuate land use right in the valuation process, which most of the time not representative of the actual market value to the land.

- The location value will approach zero for property held on lease based as the remaining lease period reduces.

Practice of Property Valuation

Interviewees were asked if they have noticed improvements in the practice of property valuation and to kindly mentioned the factors. They try to answer the question in two broad ways: one in the valuation method applied by Banks and the second on customers' valuation trend;

- **Regarding valuation method:** almost all respondents said that there is no significant change in the valuation method and procedures employed in the valuation process. The reason could be Banks want to avoid risks and use valuation method like cost replacement method which don't give representative value of the market, due to unavailability of realistic market data & information Bank tend to relies on more general valuation method and also the instability of the market unable Banks not to foresee the future to take reasonable risks.

- **Regarding valuation trend and competition between Banks:** all respondents confirmed that there has been an increase in customer requesting for valuation, and there is high competition between Banks.

Interviewees was also asked if they got the chance to see property valuated by two or more different banks in the same year and noticed significant variation in result 90% of the

interviewees confirmed that they have seen and noticed difference in the valuation result and less than 10% of them has not yet encountered.

Recommendation by interviewees

The recommendation was requested on the valuation process of real property to minimize variation results for property pledge as collateral.

- To digitalize and make information exchange between Banks easy
- Government should arrange a way to find genuine and up to date data of the market
- Banks should use common standard manual and method of valuation
- Banks should update rates at least per year
- Bank should arrange periodic training program for their valuators
- It is better to involve external third party as maker or checker to avoid discrepancy and partiality.

4.2. Result and discussions from the desk study

Here I have selected Bank X and Bank Z, in Ethiopia, to study their practice and procedure on the valuation of real property held as collateral. Based on the structured interview conducted and their respective valuation manual, I have discussed their minimum requirement for property held as collateral, property class, method of measurement used, method of valuation applied, approach on market value determination, and method on estimating land use-value. There is also a section that compares and contrasts the two bank methods and procedures. For completeness, I have included a third bank, Bank Y in Ethiopia, to triangulate the results. Then I have compared their approaches and steps with the international valuation standard.

4.2.1. Bank Z practice for real property valuation for collateral

According to Bank Z Real Property Valuation manual, which is adopted from EBA VALUATION MANUAL OF JUNE 2015, the proper method to be employed in the determination of the value of a property will depend mainly on the purpose of the assignment, the type of value sought, the type of property under consideration, and the type and reliability of available comparable market data. The appropriate models developed for valuation of properties, as dictated by the purpose of the assignment and the types of property to be valued, are discussed hereunder:

4.2.1.1. Property class

For the valuation purpose, properties are generally classified into three major classes, namely:

- **Commercial /Investment Property:** A prospective Investor on commercial property will mainly be interested in the income-producing capacity of the property.

- **Residential Property;** Are those which are mainly developed for residential purposes, whether they are owner-occupied or rented out.
- **Specialized Property;** are those that, due to some specialized physical or geographical factor, offers very little utility for any purpose other than that for which they were originally designed.

4.2.1.2. Minimum requirement of building to be held as collateral

Foundation: It is mandatory that the building to be valued need to have a masonry foundation with a reinforced beam on top.

Floors: The building to be valued needs to have a screed concrete floor with a hardcore base.

Infrastructure: Connected private water mains, EELPA power connections are among basic requirements.

Fence: Only a stone fence made of cement mortar or HCB combination can qualify for collateral, no wooden and corrugated iron sheet/CIS/ fences will be considered.

Facilities: For toilet facilities, pit latrines of an internal water-based system with proper septic tank facilities are required.

Drainage: Rainwater gutter and downpipe are mandatory requirements.

Doors & Windows: Should be made of durable metal or seasoned wood, no corrugated iron sheet doors or windows will be considered.

Walls: External walls need to be plastered with cement sand mortal as a protective cover. Mud wall construction needs to have concrete grade beam and cement plastered external walls. Corrugated iron sheet walling will not be allowed for estimation.

Others: thatched roofs and constructions with traditional material need to be treated in consultation with the management.

4.2.1.3. Methods of measurement

The manual adopts the Code of Measuring Practice, 5th Edition of The Royal Institute of Chartered Surveyors. For all practical purposes and reporting needs of the cost approach, GEA (Gross External Area) as defined in the code shall be used. Moreover, for the income approach, Net Internal Area (NIA) as defined in the code shall be used.

4.2.1.4. Basis and method of valuation for collateral

Similar to EBA's Real Property Valuation Standard and The International Valuation Standards, valuations for loan security (Collateral) are based on market value. The valuation manual states that due to the constraint on availability of reliable transactional market data in the City, infancy of property market in the country, and difficulty of consistency in EBA's appraisal applications, only the Cost Approach and Income Approach are employed in the valuation of most of the class of properties.

Determination of the market value of a specific property, as similar to the EBA Manual, will require the full application of the two approaches to determine an indication of the value and a final reconciliation through a weighted average method to reach to the final market value estimate. Weights assigned for indicative values resulting from each approach require analysis of the following factors: the inherent strength of each approach to the specific property class, the relevance of each approach to the subject property, and the amount and reliability of data to be employed in the application of each approach. Valuation so produced is consolidated, summarized, and reported with the reporting format stipulated in the EBA's Real Property Valuation Standard. The appropriate models

developed for valuation of properties, as dictated by the purpose of the assignment and the types of property to be valued are discussed hereunder:

Commercial /Investment Property: The assignment of weight in the final reconciliation of market value indicative resulting from the application of the Cost & Income Approaches will be as follows:

Table 4 - 5 Bank Z Assigned Weigh for Valuation of Commercial Property

No.	CORRELATION FACTOR	Factor weight (100%)	ASSIGNED WEIGHT	
			Cost Approach	Income Approach
1	Strength of approach to value	40	35	65
2	The relevance of approaches to the subject property	30	40	60
3	Amount and reliability of data for each approach	30	45	55
	Total	100	40%	60%
	Value indicative using Cost approach		X	
	Value indicative using the Income			Y
	Final Reconciled Market Value of the property		0.4(X) + 0.6(Y)	

Residential Property: here, one has to assign more weight on the cost approach value indicative than the income approach indicative, the detail specifics of which are depicted in the table below:

Table 4 - 6 Assigned Weigh for Valuation of Residential Property

No.	CORRELATION FACTOR	Factor weight (100%)	ASSIGNED WEIGHT	
			Cost Approach	Income Approach
1	Strength of approach to value	40	85	15
2	The relevance of approaches to the subject property	30	80	20
3	Amount and reliability of data for each approach	30	74	26
	Total	100	80%	20%
	Value indicative using Cost approach		X	

	Value indicative using the Income approach		Y
	Final Reconciled property Market Value of the Property	0.8*(X) + 0.2*(Y)	

Specialized Property; these classes of properties are so specialized by nature that no comparable market data could be employed to apply the Income Approach. Hence, the final market value conclusion will fully rely on the results of the Cost Approach.

Table 4 - 7 Assigned Weigh for Valuation of Specialized Property

No.	CORRELATION FACTOR	Factor weight (100%)	ASSIGNED WEIGHT	
			Cost Approach	Income approach
1	Strength of approach to value	40	100	0
2	The relevance of approaches to the subject property	30	100	0
3	Amount and reliability of data for each approach	30	100	0
	Total	100	100%	0%
	Value indicative using Cost approach		X	
	Value indicative using the Income approach			Y
	Final Reconciled Market Value of the property			X

4.2.1.5. Approach for market value determination

Determination of the market value of a specific property, as similar to EBA Manual, will require the full application of the Cost and Income approaches to determine an indication of market value and a final reconciliation through a weighted average method to reach to the final market value estimate.

4.2.1.5.1. Cost Approach

The cost approach is based on a determination of the minimum cost of replacing or replicating the service potential embodied in the property with a modern equivalent, in the most efficient way practicable, given the service requirements, the age, and condition of the existing property and replacement in the normal course of the business. The approach

mainly involves the determination of replacement cost of developments and corresponding depreciation. Replacement cost is the cost of replacing an existing property with a substantially identical new modern equivalent property.

According to the Bank valuation manual, the process of completing the cost approach analysis involves carrying out tasks at various steps. There first step in the cost approach, as in any valuation exercise, will require the collection of relevant documents and carrying out a property survey. This basic pre-analysis step will mainly involve the following activities:

Step 1: Document Collection

The valuer shall at first collect the following relevant documents

- Title certificate/s
- Construction permit/s for improvements
- Approved plan/s
- Specification and Bill of Quantities prepared by qualified professional /for improvements under construction/
- Other relevant documents deemed necessary for the specific task

Step 2: Carry out a survey of the property/s to acquire relevant data:

- Land and title/ownership information
    - Confirm that the ownership information, plot orientation and dimensions indicated on the title correspond with the physical property, and take the owner's address.
    - Measure the actual plot, to determine dimensions and plot area.
    - Take note of any encroachments or reductions of vis-à-vis the title deed.
    - Take note of the location of the property with respect to prominent landmarks.
    - Determine holding type and remaining holding period

  - Identify any easements or restrictions.

- Information on Improvements on the site
  - Measurement of buildings, compound works, fences, and ancillary facilities and comparison with permitted constructions.
  - Construction details and improvement category
  - Age/remaining lives for buildings, land, and improvements
  - Quantities, area, volume, size or capacity
  - Condition and depreciation information
  - Costing information (original cost and major refurbishment details and costing, where available)
  - Component information (where applicable).
  - Notes on special structures.
- Neighborhood information
  - General use of property
  - Location
  - Type and width of access roads
  - Distance from the main road
  - Information on local development plans in the near future
  - Encumbrances on the site
  - Availability of basic utilities

Once relevant documents are collected, and a physical survey of properties is carried out to capture pertinent characteristics and parameters of the neighborhood and the specific property, there are five steps to completing the Cost Approach to Valuation.

Step-1: **Estimate** the replacement cost new (RCN) of all improvements to the land

Step-2: **Estimates** the accrued (accumulated) depreciation for each improvement.

Step-3: **Calculate** replacement cost new less depreciation (RCNLD) by deducting all accrued depreciation from replacement cost new for each improvement. (Subtract step 2 from step1).

Step-4: Estimates the value of land rights, using the highest and best use.

Step-5: Add all replacement cost new less accrued depreciation to the calculated land value. This step will derive a value that is indicative of the Cost Approach to market value.

4.2.1.5.2. Income Approach

The income approach to value is based on the assumption that potential buyers will pay no more for the subject property; hence they set the subject's value than it would cost them to purchase an equally desirable substitute investment that offers the same return and risk as to the subject property. It considers the subject property as an investment and bases its value on the rent it will produce for the owner.

One basic principle in estimating the value of a property is the anticipation of future benefits. The income approach, also called income capitalization, converts future benefits of property ownership into an indication of present worth (market value). Present worth, which results from capitalizing net income, is the amount a prudent investor would be willing to pay now for the right to receive the future income stream. The prospective commercial property buyer is primarily interested in the potential net return the property will provide. The price the buyer is justified in paying for the property is a measure of his prospects for a net return from his investment. Thus, the income property valuer must explore the rental market and compare the income-producing capabilities of one property to another.

The net, Normalized income of the property is determined based on the assumption that the property is fully let at market rentals and incurs market-related operating costs. The net normalized income is then capitalized into perpetuity using a market-related capitalization rate to give the market value indicative. Below an overview of the steps used by the Bank Z to develop and apply the income approach to value.

STEP I: Estimate Gross Annual Income

A. Determine the type of rental unit (i.e. per m^3, per m^2, etc.)
B. Calculate other income (i.e. parking fees, etc.)
C. Identify vacancy and collection loss

STEP II: Identify Operating Expenses

A. Fixed Expenses (Taxes and Insurance)
B. Variable Expenses
C. Repairs and Replacements

STEP III: Determine Net Operating Income

STEP IV: Determine Income Projection Period

A. Remaining Economic Life
B. Investment Holding Period

STEP V: Identify Method of Capitalization house

A. Direct Capitalization

4.2.1.6. Estimating the value of the land rights

It is this right to use and transfer land, which is the land use right the Bank attempts to value when estimating the value of the land. The estimation of land use rights is carried out in two major steps, which are described as follows:

4.2.1.6.1. Determination of plot grade

At time of the physical inspection of properties to be valued, the Valuer/s shall make note of such parameters as; type and width of the access road, distance from main roads, quality of access roads, plot frontage, location within the city as described by its Sub City, Woreda and previous Kebele designation and proximity to business and residential centers. Once, the Sub City and Woreda of the plot are determined, its grade is selected from the list of plot grading table depicted. The plot grading index is mainly prepared for Addis Ababa with some modifications to alignment with current situations.

The following guidelines are set by the Bank to aid in the selection of alternative plot grading within a Woreda;

- The 1st-grade limit shall be 50m from main roads within a Woreda
- The distance limit for 2nd-grade plots shall be 150m from the end limit of first-grade plots
- The distance limit for 3rd-grade plots shall be 350 m from the end limit of 2nd-grade plots
- Those plots located beyond the end limits of the third-grade plots shall be categorized as fourth-grade plots

Asphalt paved roads in a Woreda with a total width greater than or equal to 20 m can be taken as main roads. Accordingly, the best plot within the Woreda shall be assigned the corresponding first grade listed within the Woreda and other grades assigned according to the rates on the location parameters. Moreover, the valuer shall consider the frontage, shape, and natural terrain of the plot in determining plot grades.

4.2.1.6.2. Determination of rates of land use rights

The indicative estimates of values of Land Holding Rights (LHR) to properties held on a permit basis in Addis Ababa are estimated based on prepared Empirical Equation by the Bank. Which is the function of Zone, Plot Grad & Plot Area Range which then using the corresponding empirical equation value of land use right which is the market value indicative is estimated in Birr/m^2.

For plots of land held on lease basis from the Government, the value of LHR will be calculated by deducting liabilities on the title to the Lease office from the indicative value calculated using the above approach, in proportion to the remaining lease period.

Hence for land held by way of lease, the value of LHR is calculated using the simplified formula depicted below:

$$Value\ of\ LH = [Market\ value\ indicative\ using\ above\ approch * \left(\frac{Remainging\ lease\ period}{Total\ lease\ period}\right) - unpaid\ sum\ owed\ to\ lease\ office] \quad \ldots \quad \text{Equation 4 - 1}$$

4.2.2. Bank X practice for real property valuation for collateral

According to Bank X Real Property Valuation manual, the cost approach is adopted for the valuation of properties mortgaged as collaterals due to their suitability for the property market, in terms of availability of relevant comparative database in Ethiopia. However, location value is determined based on an assessment of the local market value of the land.

4.2.2.1. Building categories

4.2.2.1.1. Lower Villa

Definition: Single story low-quality residential, utility, or small commercial houses made of a wooden fillet and chiqa plastered walls with partition walls and alternative construction materials as described in the checklist of the manual.

Method of cost estimation: the relevant equations based on the plinth area.

4.2.2.1.2. Higher Villa

Definition: Single story modern standard residential, utility, or commercial houses made of chiqa, stone, brick or concrete block walls, with partition walls and alternative construction materials as described in the checklist of the manual.

Method of cost estimation: the relevant equations based on the plinth area.

4.2.2.1.3. Multi-Story Buildings

Definition: Multi-story residential, utility or commercial buildings made of R.C structures, Masonry or concrete block walls, and alternative construction materials as described in the checklist of the manual.

Method of cost estimation: the relevant equations based on the plinth area.

4.2.2.1.4. Multi-Purpose Halls/Warehouses

Definition: It shall include stores, factory buildings, showrooms, halls, studio type rooms, etc., made of *chiqa*, masonry or concrete block walls, and alternative construction materials as described in the checklist of the manual.

Method of cost estimation: The relevant equations based on the plinth area or volumetric method, i.e., for clear heights (measured from floor finish level to top face of tie beam or to bottom face of lower truss chord) less than or equal to 4m, the plinth area method shall be used. However, for those exceeding the 4m height limit, the volumetric method of valuation shall be adopted.

4.2.2.1.5. Factory Building

Definition: this shall include all buildings that function as factories.

Method of cost estimation: Same as for multi-purpose halls. However, supplementary structures, such as machine foundations, corbels, etc., shall be measured separately using the bill of quantity method. Structural Steel Quantity Estimation

For buildings under construction, the structural steel quantities per m^3 of concrete could be estimated in the following rule of thumb:

- R.C. Footing 50Kg/m^3 of concrete;
- Medium reinforced structure such as beams etc., 80-90kg/m^3 of concrete;
- Heavily reinforced structure such as columns, T-beams, etc., 110-120kg/m^3 of concrete;
- Light reinforced structure such as slab etc., 7kg/m^2 of concrete;
- Approved plans are not mandatory for car shades of area less than 30m^2;
- For all types of buildings, the total ceiling area equals the ceiling area of the rooms plus the eave ceiling.

4.2.2.2. Minimum requirement of building to be held as collateral

The building offered for collateral should at least have:

a) A wall made of eucalyptus fillets with three coats of mud plastering, and/or G-30 CIS over wooden frames.

b) Masonry foundation below ground level and above ground level.

c) Mass concrete flooring.

d) A Door and windows made of solid wood panels.

e) CIS roof cover.

f) One coat of cement sand plastering for external wall surfaces.

g) Smooth painted internal wall surface.

Fuel stations offered for collateral should at least incorporate office or shop building. The buildings should be structurally stable as per the national standard codes of practice.

4.2.2.3. Methods of measurement

Bank X manual has adapted the RICS Code of Measuring Practice, 5th Edition of the Royal Institute of Chartered Surveyors. For all practical purposes and reporting needs, GEA (Gross External Area) as defined in the code are used as a method of measurement.

4.2.2.4. Replacement cost computation

4.2.2.4.1. Bill of quantity method

Having all the necessary documents, the project cost of a building under construction is estimated using the BOQ method. In this case, the valuator shall undertake the following tasks during estimation.

a) Check the quantity against the presented documents;

b) Revise the unit prices as per the estimation manual;

c) Establish the finished project cost using plinth area/volume method (using the relevant factors and equations); and

d) Estimate the expected cost of the intended developments.

The main purpose of establishing the project cost using the plinth area/volumetric method is to avoid discrepancies on project costs during and at the end of construction. Hence, during the first assessment of the building under construction, the valuer shall fix the

project cost assuming the construction of the building is completed using the materials stated on the specification and bill of quantity, and revising the unit price and quantities accordingly.

Under different conditions, the value of a building under construction shall be determined by considering the following points:

i. For a building under construction offered for project financing/collateral/ foreclosure purpose, the valuator shall:

   a) Estimated the amount and percentage of the executed and remaining works;

   b) Determine the expected market value of the property when the project is finalized by using empirical formulas of the manual and other relevant procedures laid out in this manual, assuming the prevalent market parameters;

   c) Determine the current market value of the property vis-à-vis the works executed.

ii. For projects whose works have not yet commenced, the valuer shall:

   a) Assess the site and make a provisional estimate using empirical procedures of the manual, with all the required information noted as remark on the estimation report by stating that the construction is not started and the submitted specification and BOQ is not thoroughly reviewed;

   b) A final and detailed estimate of the projects shall be carried out using the bill of quantities method once the commencement of the projects' work is inspected and ascertained.

iii. Furthermore, consultation fee, labor, and material increments should be calculated for the total project, assuming the construction is completed, and then proportioned according to the percentage of executed and remaining works

iv. Electromechanical equipment fixed to a building and used to increase its functionality is parts of the real property and considered in this estimation. Such items include:

v. Besides increase by multiplying the percentage, as shown on the table 4 - 8, only for superstructure cost assuming the current building are in average G+11 and exceptional buildings greater than G+11 is treated similar with the G+11.

Table 4 - 8 Percentage Increase for superstructure cost

Description	Percent increase
G+5-6	1.03
G+7-8	1.06
G+9-10	1.09
G+11 & above	1.12

The BOQ presented by the customer for estimation project cost and the executed amount shall not exceed by more than 10% from the estimation made by the Bank's valuator. If so, the valuator can reduce both the project cost and executed amount by a factor of the exceeding percentage. Where the cost presented in the BOQ is less by 10% from the estimation made by the Bank's valuator, the valuator shall request to adjust the deviation or present take off sheets to verify the amount.

However, to mitigate the problem of front-loading; the BOQ on the substructure of multi-story buildings, villas, and multipurpose hall shall not exceed 20%, 30%, and 40% of the total project cost respectively. In case the substructure exceeds this limit, the customer is required to submit structural detail drawings and take off sheets to verify the amount.

4.2.2.4.2. Empirical equation method

1) The cost of completed buildings with the relevant documents shall be estimated using the equations specified on manual.
2) The analytical equations derived for the purpose shall be applied for all possible current construction materials combinations as well as for external sanitary and electrical works that occur in the course of the valuation.
3) For valuation of compound and fence works, unit prices are computed based on current construction materials, labor wages, and equipment rental rates.
4) For building located in Addis Ababa, the construction cost of a building should be calculated by assuming that;
    a) The building is located in Addis Ababa and adding an additional sum in proportion to increment in transportation cost of construction materials per

kilometer as indicated in the manual. In this case, the assigned evaluator has to identify the types of materials available on the site;

b) Labor wage cost increments shall be computed based on the total project cost indicated in the manual.

c) Cost increments due to transportation and labor wage cost increment shall be considered in computing the cost of a completed and under construction building.

4.2.2.5. Estimating location values

The estimation of land use rights in the bank valuation manual is carried out in two major steps and described as location value for Addis Ababa and outlying area, which are described as follows:

4.2.2.5.1. Location value for Addis Ababa

In addition to the description of road conditions and distance limitations, a comprehensive list of the main roads in Addis Ababa has been incorporated in the valuation manual to facilitate the plot-grade choosing process and to reduce subjectivity.

4.2.2.5.2. Plot Grading

At time of the physical inspection of properties to be valued, the Valuer/s shall make note of such parameters as; type and width of the access road, distance from main roads, quality of access roads, plot frontage, location within the city as described by its Sub City, Woreda and previous Kebele designation and proximity to business and residential centers.

Once, the Sub City and Woreda of the plot are determined, its grade is selected from the list of plot grading table depicted on the prepared manual. The plot grading index is mainly prepared for Addis Ababa with some modifications to alignment with current situations.

The following guidelines are set to aid in the selection of alternative plot grading within a Woreda; First grade shall be the best grade from the available plot grades in the category in the specified kebele. Second, third, fourth grades shall be chosen based on the property distance from the nearest main road. Distance is measured from the listed main road via the nearest accessible and functional route to the property.

I. The first grad limit shall be 50mts from the listed main roads.
II. The distance limit for second-grade plots shall be 150mts from the end limit of first-grade plots.
III. The distance limit for third-grade plots shall be 350mts from the end limit of second-grade plots.
IV. Those plots located beyond the end limits of the third-grade plots shall be categorized as fourth-grade plots.

Road width Criterion; A five percent location value deduction factor shall be considered for functional feeder roots of width less than 6m or internal roads of width less than 4m.

Road Quality Factors; Unworn and stable asphalt feeder and internal roads shall be considered as functional roads; the appropriate percentage factors listed on the manual shall be applied as the site accessibility condition dictates.

However, besides using the plot selection procedure, the valuator should use his/her professional judgment in the selection of grades from the listed ones, considering relevant parameters.

4.2.2.5.3. Determination of Rates of Land Use Rights

The indicative estimates of values of landholding rights (LHR) to properties held on a permit basis in Addis Ababa are estimated based on the prepared location value table, which is the function of Plot Grad & Plot Area Range, which then, by selecting the corresponding value of land use right the market value indicative is estimated in Birr/m^2.

After analyzing the relationship between location value and civil works cost, the following limits are proposed for implementation.

Table 4 - 9 Location value Limit

Cases	Plot area (M^2)	Location value Limit
1	Up to 2000	3* CWC
2	2001 to 10,000	3.5*CWC-CWC*PA 4000
3	Above 10,000	CWC

Where:

CWC: Cost of all civil works (before depreciation)

PA: Plot area (from the LHC)

When the location value of plots acquired through lease, for the rights corresponding to the full lease period, shall be determined by:

Option 1. Deducting the unpaid lease amount from the location value calculated by parameters stated in the manual

Option 2. In case the agreed lease value exceeds the location, value calculated by parameters stated in the manual, take the plot grade on the LHC and deduct the unpaid lease amount.

Option 3. In case the agreed lease value exceeds the location, value calculated in option 2, take the lease amount paid up.

Note: In all the above options, the amount shall be proportionally factored for the remaining lease period, and 90% of this amount is taken to arrive at the net current location value.

4.2.2.5.4. Location Value for Outlying Areas

The same procedure and methodology laid out for Addis Ababa shall be applied for outlying towns in the calculation of location value of lease land and location value limit and also for road width criterion a five percent (5%) location value deduction factor shall be considered for functional feeder roads of width less than 6m or internal roads of width less than 4m. For road quality factor unworn and stable asphalt feeder and internal roads shall be considered as functional roads, otherwise, the percentage factors shall be applied as site accessibility condition dictates.

Accessibility Rating

Based on the accessibility of the properties from the main road the following deduction factor shall be used to determine the location value:

- No deduction shall be made for properties located within 25 meters from the nearby main road;
- A 30% deduction shall be made for properties located within 75 meters from the no-deduction boundary;
- A 60% deduction shall be made for properties located within 100 meters from the 30% deduction boundary; and
- An 80% deduction shall be made for properties located beyond the 60% deduction boundary.

Note:

1) Distance is measured from the available shortest, stable, and functional roads to the property.
2) Since the location values are not exhaustive for every town, the valuer should make his professional judgment and compare it with the current market value of the area whenever the calculated values exceed the market. Hence, he/she should adjust the value to suitable lower plot grades.
3) Accessibility rating will not be applied for locations specified only with kebeles, and with no specific roads and marked locations.

4.2.3. Bank Y practice for Real Property Valuation for Collateral

According to Bank Y Real Property Valuation manual for real property pledged as collateral a combined result of ratio combination of Net income capitalization method with Depreciated Replacement Cost (DRC) Method is recommended. Moreover, it specifies real properties are often considered by the bank as back-up related to any risk associated with the loan they grant for a business. So, such property is expected to endure providing utility within the collateral period thereby easily marketable. Dilapidated buildings made of mud which doesn't last the collateral period and corrugated iron sheet shelters are by no means eligible to be considered as collateral.

4.2.3.1. Building class determination

Four Major Building classification groups are considered against finishing material as indicators depicting their respective class they belong. These are:

- Multi-story commercial Buildings
- Three stories or less (G+1 – G+3) Residential and commercial buildings.
- Lower villa (G+0) Residential and Commercial Buildings
- Multipurpose Halls/warehouse

According to the manual to simplify building class determination, work categories are classified weighted as under listed;

a) The general condition of building considers the under listed work items.
   - Excavation & Earth Work
   - Concrete Skeleton from (super + sub)
   - Block works and masonry
   - Fence and Site work
   - Soundness of the building of current status

b) Block works (Internal + External walls)

- Brick construction
- Hollow Block construction
- Stone
- combined

c) Window, Door and Glazing

- Aluminum door and window + tinted glass/or normal
- Metal profile imitation type door/ windows
- Normal LTZ door/ windows
- Wooden Door/ window

d) Finishing (General Quality)

- Internal wall finish
- External wall finish
- Floor wall finish
- Stair and skirting finishing works
- Toilet wall & floor finish
- Ceiling decoration with gypsum

e) Roof and ceiling work

- Roof – Harvey/Decra/Clay
- Ceiling – Parquet, PVC Décor
- Guard Rails
- Floor tiles and coping works

f) Electrical & Sanitary and Mechanical works

Table 4 - 10 Work categories under Electrical, Sanitary & Mechanical Works

Electrical	Sanitary	Mechanical
· Light Point · Socket outlets · Transformer · Fire detection & security installation · Site electrical works · Electrical board installation · Lightning arrestor · Manhole & cover marks · Tele electrical installation · Data, Telecom, IP camera · EEPCO connection	· Sanitary fixture · Domestic water supply system · Septic tank · Sewerage line system · Water supply pipes for fire fighting · Domestic water pump · Water reservoir	· Elevator · AC split system · AC full System · Fire pump installation · Generator

- Multi-Purpose commercial buildings

General condition	- 35%
Window door + glazing	- 7%
Roof & ceiling	- 10%
Wall & floor finish	- 28%
Sanitary & Electrical	- 20%
	100%

- G+1 – G+3 (Three Stories or less) (Commercial & Residential Building)

General condition	- 35%
Window door + glazing	- 10%
Roof & ceiling	- 10%
Wall & floor finish	- 27%
Sanitary & Electrical	- 18%
	100%

- Lower G+0 Villa (Residential + Commercial Building)

General condition	- 30%
Window door + glazing	- 10%
Roof & ceiling	- 12%
Wall & floor finish	- 30%
Sanitary & Electrical	- 18%
	100%

- Multipurpose halls/ warehouse

General condition	- 40%
Window door + glazing	- 14%
Roof & ceiling	- 25%
Wall & floor finish	- 13%
Sanitary & Electrical	- 8%
	100%

To ensure proper use of the index rate of finance or collateral for the different typology of the house, it is mandatory to know the basic building grading principle to facilitate selection for the application. This is an objective measure for the construction quality, materials used in completing the built structure. It is important to properly determine building grade because costs are directly related to the quality of materials and workmanship associated. To reflect cost as related to the grade, five grade levels have been developed for Residential, Commercial, and Storage facility building.

These grade levels are: -

- Extra special
- Special
- Class 1 Excellent
- Class 2 Very Good
- Class 3 Average
- Class 4 Economy Building
- Class 5 Minimum Standard buildings

The first two are included to facilitate estimation in case of their appearance in practice; where buildings under this category mostly founded in Addis Ababa and few outlying towns. For easy and logical determination of class, weight is assigned to each classification based on Quality for material used on the building construction.

4.2.3.2. Minimum qualification of building to be held as collateral

The valuation manual clearly states as buildings need to last the collateral period, maintaining solid physical status and market demand, the following need due consideration.

- The building considered for loan collateral must be constructed according to the approved plan by local government permit giving authorities.
- Residential building door, windows should be made of durable material.
- Foundations need to be masonry strip foundation or framed reinforced concrete structure.
- The floor finish needs to be at a minimum of concrete.
- The minimum standard roof cover has to be corrugated iron sheet (CIS) or equivalent.
- The building needs to last the collateral period (loan period)
- Adequate infrastructure has to be in place

- The service quarter will be considered alone as collateral if it is habitable fulfilling all necessities (such as toilet & kitchen).
- Walls made of mud have to be externally plastered with cement mortar.
- No wall made of a corrugated iron sheet (CIS) shall be accepted or considered as a Residential building nor considered as a collateral exception to coffee sites whereby the purpose function demands.

4.2.3.3. Method of measurement

The bank has a general guide as a method of measurement

- All internal floor area measurements shall be taken as a built-up area taken from outside walls excluding external verandahs, balconies, and lobby.
- Take half of the area of External verandahs, balconies, and lobby to be used in conjunction with the internal floor area.
- When roof terraces have approved plans and further improvements like waterproofing, floor tiling, and others are conducted, use full floor area of the roof terrace but apply 30% of the unit rate prepared for the floor located underneath.

4.2.3.4. Method of Valuation for Collateral Estimation

According to Bank Y Real Property Valuation manual for real property pledged as collateral a combined result of ratio combination of Net income capitalization method with Depreciated Replacement Cost (DRC) Method is recommended. It states that in order to strike a balance the effect of market influence one over the other collateral value rate is adjusted. The Collateral value indexes are combined results of net income capitalized values and investment expenditures. The combination ratio is 90% (Market income capital value) to 10% (Replacement Cost or Investment expenditure) in Addis Ababa as it has relative market strength and in outlying Branches of the Bank, the combination modality; is 50%/50% to avert un-required overcapitalization which negatively hampers the quick exist during foreclosure.

4.2.3.5. Location Value

The estimation of land use rights in the manual is carried out, in such a way that the location value fixing of the land shall be taken from the unit rate list applicable for year of estimation and the grade shall be based on land grade indicated on LAND HOLDING CERTIFICATE (LHC). In circumstances where the grade of the land is not clearly stated on the LHC or the grading is outdated which doesn't reflect the current development, the Engineer may fix the land grade based on the existing development status of the neighborhood, proximity to the main road and other factors. The property owner or loaner's personal identification should be taken from the name identification on the transfer log stamp on the back of LHC.

However, when plot holding is acquired through lease competition, the computation of location value shall consider reaming lease period and unpaid liabilities to the Lease office. The computation will be made using the following formula:

$$\boldsymbol{Location\ value} = (\boldsymbol{Total\ Area} * \boldsymbol{Unit\ rate}) \left[\frac{\boldsymbol{Remaining\ lease\ period}}{\boldsymbol{Totla\ lease\ period}}\right] - \boldsymbol{unpaid\ lease}$$

Equation 4 - 2

During circumstances where the unpaid sum owed to the Lease office exceeds the total location value set by the unit price index, no (zero) location value will be fixed for the plot.

4.3. General discussion on similarity and difference in bank practice

Real property valuation procedures employed by Bank X, Bank Z, and Bank Y, member banks of EBA, similarities, and variations are observed on major futures of the qualification and procedure employed for the valuation of property pledged as collateral which may cause differences in estimated values of properties. Here I have discussed the observed similarities and differences in the valuation procedure of the three-member banks of EBA.

4.3.1. Regarding Minimum Qualification of Building to be held as Collateral

Generally, real properties are often considered by financial and commercial banks in particular as a back-up to any risk associated with the loan they grant for a business. More or less, all the three Banks (Bank Z, Bank X, and Bank Y) do not consider property as collateral if it is dilapidated buildings made of mud which does not last the collateral period and corrugated iron sheet shelters. The minimum qualification for the elements of the building such as foundation, floors, internal and external wall, roof, door, and windows are similar and bases it justification on such property is expected to endure providing utility within the collateral period thereby easily marketable as buildings need to last the collateral period, maintaining solid physical status and market demand.

4.3.2. Regarding Method of Measurement

Basically, the purpose of the RICS Code of Measuring Practice is to provide succinct, precise definitions to permit the accurate measurement of buildings and land, the calculation of the sizes (areas and volumes), and the description or specification of land and buildings on a common and consistent basis.

Bank X and Bank Y manual has adapted the RICS Code of Measuring Practice, 5th Edition of the Royal Institute of Chartered Surveyors, GEA (Gross External Area) for all practical purposes and reporting needs as defined in the code are used. Similarly Bank Z manual adopts the Code of Measuring Practice, 5th Edition of The Royal Institute of Chartered Surveyors, for all practical purposes and reporting needs of the cost approach, GEA (Gross External Area) as defined in the code are used. Moreover, for the purpose of the income approach, Net Internal Area (NIA) as defined in the code is used.

Generally, the RICS Code of Measuring Practice suggested GEA for the computation of plot ratio and other planning matters, and the estimation of building costs for residential buildings, GIA for non-residential building costs estimation purposes and valuation of industrial and warehouse buildings (including ancillary offices), department and variety stores, food superstores, retail warehouses, and new homes for development purposes and NIA for valuation of offices or shops.

4.3.3. Regarding an appropriate basis for the valuation of real property

A *basis of value* is a statement of the fundamental measurement assumptions of valuation. It describes the fundamental assumptions, on which the reported value will be based. Property valuers, before they value the property, are expected to know exactly what type of value they are seeking to find, for whom they are finding it and for what purpose this valuation is being sought without this knowledge, the resultant figure will have no relevance and has the potential to be taken out of context and interpreted in an incorrect manner (Blackledge M. , 2009).

Per EBA's real property valuation standard and the IVS 2011, valuations of real property interests for secured lending, provides that the basis of value will normally be market

value. Similarly, Bank Z, Bank X, and Bank Y are based on the market value for valuations of property held as loan security (collateral). They directly adopted the international experience on the selection of an appropriate basis for the valuation of real property.

4.3.4. Regarding method of valuation

According to IVS, Six Edition market-based valuation approaches include Cost approach, Sale Comparison approach, and Income Capitalization approach. Each valuation approach has alternative methods of application. The valuer's expertise and training, local standards, market requirements, and available data combine to determine which method or methods are applied. Valuers should also have regard to recognized best practices within the valuation discipline or specialist area in which they practice, although this should not constrain the proper exercise of their judgment in individual valuation assignments to arrive at an opinion of value that is professionally adequate for its purpose. Unless expressly required by statute or by other mandatory requirements, no one valuation approach or single valuation method necessarily takes precedence over another. In some jurisdictions and/or for certain purposes more than one approach may be expected or required to arrive at a balanced judgment. In this regard, the valuer must always be prepared to explain the approach (es) and method(s) adopted.

According to Bank Z proper method to be employed in the determination of the value of a property will depend mainly on the purpose of the assignment, the type of value sought, the type of property under consideration, and the type and reliability of available comparable market data, the valuation manual states that due to the constraint on availability of reliable transactional market data in the city, infancy of property market in the country and difficulty of consistency in EBA's appraisal applications, only the cost

Approach and Income Approach are employed in the valuation of a major class of properties.

Whereas in the case of Bank X due to their suitability for the property market in terms of availability of relevant comparative database in Ethiopia the valuation manual states the Cost Approach is adopted for all valuation of properties mortgaged as collateral. Nevertheless, the reason provided for the selection of cost approach as a sole method for valuation of property mortgaged as collateral which is the availability of relevant comparative database is not persuasive based on literature, the basics and/or definition of cost approach method which considers the possibility that, as a substitute for the purchase of a given property, one could construct another property that is either a replica of the original or could offer comparable utility. It does not produce a market valuation (value-in-exchange) as such because cost relates to production rather than exchange and it is often regarded as the method of last resort for this reason. Being said this it is difficult to use the cost method as a sole valuation approach for all types of property.

According to Bank Y real property valuation manual for real property pledged as collateral a combined result of ratio combination of net income capitalization method with Depreciated Replacement Cost (DRC) Method is recommended. An adjustment has been considered to strike a balance the effect of market influence one over the other. In Addis Ababa, collateral value rate is adjusted giving a higher percentage for income approach as it has relative market strength and in outlying branches of the Bank, both income and cost approach has the same adjustment percentage in order to avert un-required overcapitalization which negatively hampers the quick exist during foreclosure.

4.3.5. Regarding land valuation

Land in Ethiopian is property of the Government and the people hence is not physically transferrable. However, various forms of land use rights exist in the country, which is legally transferrable. It is this right to use and transfer land, which one attempts to value when estimating the value of property and land.

In the case of Bank Z, the indicative estimates of values of landholding rights (LHR) to properties held on a permit basis in Addis Ababa are estimated based on prepared Empirical Equation. Which is the function of Zone, Plot Grad & Plot Area Range which then using the corresponding empirical equation value of land use right, which is the market value indicative, is estimated in Birr/m^2. For plots of land held on lease basis from the Government, the value of landholding right will be calculated by deducting liabilities on the title to the Lease Office from the indicative value calculated using the empirical equation, in proportion to the remaining lease period.

In the case of Bank X, the indicative estimates of values of landholding rights (LHR) to properties held on permit basis in Addis Ababa are estimated based on prepared location value table, which is a function of plot grade & plot area range which then by selecting the corresponding value of land use right which is the market value indicative is estimated in Birr/m^2.

For Bank Y, land use rights in the manual are carried out, in such a way that the location value fixing of the land shall be taken from the unit rate list applicable for the year of estimation and the grade shall be based on land grade indicated on LAND HOLDING CERTIFICATE (LHC) or the grading is outdated which doesn't reflect the current development, the Engineer may fix the land grade based on the existing development status

of the neighborhood, proximity to the main road and other factors. There is a similarity between Bank C and Bank D that location value is estimated using the prepared location value table which is a function of plot grade and plot area range.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1. General

This chapter presents conclusion of the study by combining results of both the interview and desk study based on the objectives stated in section 1.3 under the introduction chapter. Similarly, recommendations are forwarded in improving the practice of real property valuation for collateral by Banks.

In general, the term property describes a legal concept; it refers to the rules that govern people's access to and control of physical things (tangible assets) like land, natural resources, and manufactured goods as well as of non-physical things (intangible assets) such as inventions or contractual rights and financial claims. Real Property refers to the ownership of land and its man-made improvements attached to land e.g. buildings (Appraisal Institute, 2001). Valuation is a combination of knowledge and skills that accumulated from studies and job experience that blend together with the art of seeing, appreciating, and analyzing the subject property and value contributing factors.

Property valuation is the heart of all economic activity in any society. Everything we do as an individual or as groups of individuals in business or as members of society is influenced by the concept of value and valuation. A sound working knowledge of the principles and procedures of valuation is essential in all sorts of decisions. Studying the overall practice of real property valuation by banks moreover regarding the base for proper method selection in the determination of the value of a real property, regarding the method and procedure employed in the valuation process and regarding the existence of real property valuation policy guideline and prepared valuation manuals was the objective of this study. Targeting valuers and responsible key personnel working in banks using key

informant interview and desk study on valuation manual & procedures for the valuation of real property by selected banks and Ethiopian bank associations' and internationally accepted standards, reference books and previously conducted research.

5.2. Conclusions

Accordingly, in studying the base for proper valuation method selection, literatures indicates the purpose of valuation required and the type of property that is to be valued will determine the nature of the valuation instruction, including the techniques employed and the basis on which value is to be estimated but based on my study, currently the purpose of valuation by banks are to estimate the value of property held as collateral either for loan security, project financing or foreclosure. In most of the case the base for the selection of the method of valuation is the type of property held as collateral. Currently each bank has its own valuation manual and procedure in performing valuation. In fear of problem in loan recovery almost 70% of banks use only the cost replacement method while the rest use a combination of cost replacement and income capitalization method with given weightage factor for each method so as to produce representative value of the market.

As this study indicates value obtained from the valuation process not only depends on the method of valuation & the purpose of valuation but also on the person conducting the valuation which is the valuator. As valuation is a combination of knowledge and skills that accumulated from studies and job experience which blend together the art of seeing, appreciating and analyzing the subject property and value contributing factors, the valuer role will be to advise as what would be the best figure obtainable for a given market, at specific date so the qualification of the valuator is a prim factor in the process.

Internationally qualification like the academic/professional qualifications, demonstrated technical competence, member of a professional body, demonstrated commitment to ethical standards, compliance with state legal regulations is considered but in our country banks valuators academic qualification is the primary factor taken under consideration. In this study the researcher has found Civil Engineering profession is the primary qualification for banks to hire as valuator. They believe the person at least possess and be competent in calculation, measurement, and knowledge of building construction materials relative to other professions. And also, the researcher has found the property valuation/appraisal field of study is not given in most of the government and private university despite there is a high demand in the banking sector only Ethiopian Civil Service Institute in Bachelor level and Addis Ababa University in its Lideta Campus in masters level that the field of study is given. Moreover, during interview respondents identified skills like; communication, understanding location, observation, guessing, report writing and having knowledge of construction material, current market condition, measurement & calculation, regulation and legal guidelines and procedures related to valuation. Based on this study the researcher has found that there is not certification or licensing for property valuator but it very important for the growth of the profession.

Literatures indicate the method of valuation will be different based on the type of property. for example: commercial buildings will not be evaluated by the same valuation method as residential building similarly choose of valuation method for warehouses will not be the same as apartments. In most of our banks similar method of valuation is employed despite the type of properties and the cost replacement method is the preferred method of valuation. The researcher has found that most of our banks has get the chance to valuate almost all type of properties including: residential buildings, commercial buildings from

G+0 to high rising buildings, factory, condominium, agricultural farms and special use facilities like gas stations.

The researcher has found and able to understand from this study that all banks in our country follows more or less common procedures regarding collecting the relevant document and carrying out property valuation for collateral which the researcher has tried to conclude and draw the process map starting the minimum document requirements to the valuation process:

First documents regarding the property will be submitted to the loan/ credit committee of the bank and this division order the client to submit required documents which may include;

- Landholding certificate (LHC) (attested copy)
- Approved architectural plans with site plan on it (Original)
- Lease agreement, if land holding is on lease basis
- Bill of quantity (not mandatory)
- Purchase/Performa invoices (whenever necessary)
- Construction permit (Attested Copy)

After this, the loan committee checks the submitted documents according to the company credit policy and procedures of the bank and also directives of municipalities or sub-cities pertinent to property valuation and decide on the sufficiency of the given property for valuation. If it is decided to be evaluated then it will order the valuation department to conduct the valuation. Based on the request and order given by the committee assigned valuator will carry out a survey on the property to acquire relevant data for the valuation. The survey may include;

- Land and title/ownership information

  - Confirm that the ownership information, plot orientation and dimension indicated on the title corresponds with the physical property
  - Carryout measurement of actual plot, to determine dimensions and plot area
  - Take note of location of the property with respect to prominent land marks
  - Identify any easements or restrictions
- Information on improvements on the site
  - Measurement of buildings, compound works, fences and ancillary facilities
  - Construction details and improvement category
  - Age of property
  - Condition and depreciation information
- Neighborhood information
  - Take representative picture
  - General use of property
  - Location
  - Type and width of access road
  - Distance from main road
  - Availability of basic utilities

Once relevant documents are collected and physical survey of properties are carried out to capture the pertinent characteristics and parameters of neighborhood and specific property the valuator maker interprets the data, estimates the value of collateral based on the bank valuation method and produces collateral estimation result reports then the collateral valuator checker, checks and ensures the appropriateness of all collateral property documents and the valuation process undertaken by the valuator maker. The valuator checker may conduct site visit to countercheck the physical conditions of collateral properties, if necessary then he confirms the genuineness of collateral estimation results reports.

About the practice of land valuation, it can be concluded that there is no valuation for land in any of the banks in Ethiopia but they consider the land use right of the given property in the valuation process. The existing land legislation in our country ignore land value as land is public property and hence no compensation should be considered for the property of the government. Here are the main challenges and difficulties in land valuation:

- Unrealistic increase in market price of land in short period of time which is identified by its instability
- The proportion of land and the improvements (building and other) on the land
- Banks only valuate land use right in the valuation process which most of the time not representative of the actual market value to the land.
- For property held on lease based as the remaining lease period reduces the location value will approach to zero

Finally, about practice of the property valuation it can be said that:

- **Regarding valuation method:** there is no significant change in the valuation method and procedures employed in the valuation process. The reason could be banks want to avoid risks and stick to use valuation method like cost replacement method which don't give representative value of the market, due to unavailability of realistic market data & information, banks tend to relies on more general valuation method and also the instability of the market unable banks not to foresee the future to take reasonable risks.

- **Regarding valuation trend and competition between banks**: there is high variation of valuation result between banks. One bank property valuation result highly varies from other bank valuation result of the same property valued at the same year which make customers to search and find the best offer at different banks before accepting the result. Nevertheless, it has been noticed that there is an increase in customer requesting for valuation and there is high competition between banks.

5.3. Recommendations

This research was intended to study the practice of real property valuation for collateral which was a case study on Banks in Ethiopia and hence on the basis of the research finding recommendation are given here below;

Regarding valuator:

- Valuator should demonstrate commitment to ethical standards which can be achieved either by periodical examination or licensing being member a professional body
- Understanding its significant for the growth of the country, government shall take the leading step by teaching property appraisal as a field of study at university level and produce qualified and competitive professionals
- Unless additional trainings and courses are given valuation is not only measuring and calculating but it is also an accounting and also economics so banks should understand the difference between hiring appraisal professional and hiring a civil engineer/other as value maker/checker

Regarding Valuation method

- It is better to align valuation method with the generally accepted methods and address the problem of non-conformity to international standard and best practices.
- Banks should not stick to one or two valuation method in fear of the problem of loan recovery. Valuation method selection at least shall be based on type of property.
- At least elements of the EBA's standard valuation manual be enforced by each member bank.
- Selection of valuation method shall not only base in protecting the bank interest by not taking any risk but customer satisfaction shall also be considered by providing market representative value.

Regarding minimization of variation of valuation results:

- It is better to prepare database on sale, rent, construction materials cost, lease values and all other relevant information and made available to all by digitalizing and make market related information exchange between banks easy,

- Banks should use common standard manual and method of valuation and at the same time updates rates used in the valuation process at least twice a year and because the current economic condition of our country is not stable it is better to find a way to update rates at least twice in a year.
- It is better to prepare platform for experience sharing among banks
- Bank should arrange periodic training program for their valuators.
- It is better to involve external third party as valuator maker or checker to avoid discrepancy and partiality.

Moreover, currently there is an increase for customer requesting for valuation which create a great competition between banks. This competition has made significant variation of offer value among banks which make customer to go to different banks before settling for good offer. So, banks should take a serious correction step in minimizing variation in offer value and making the offer value to be as much as possible representative of the market offer price.

5.4. Further research area

Here are areas for further research regarding property valuation;

- Findings of this research regarding valuator, method of valuation and variation of value could be an area of research.
- As this research is only a case study a broad understanding could be achieved regarding the practice if research could be done on other banks also.

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APPENDIX - A

STURCTURED INTERVIEW

on

"Practice of Real Property Valuation for Collateral:

Case Study on Banks in Ethiopia"

RESEARCH OBJECTIVE

"Assess the base for proper method selection to be employed in the determination of the value of a real property when properties are given for loan security"

"Assesses the methods and procedures applied for valuation is consistent regarding determination of the market value of real property"

"Assesses and discus the existence of real property valuation policy guideline, manuals and current practice for the proper execution of the work**"**

Researcher: Ermiyas Teshome

Email Address: **ermiyasteshome@gmail.com**

Mobile Address: +251913151555

Advisor: Dr. Abraham Assefa

Advisor Email Address:

Profile of Interviewee

Profession ----------

Company ----------

Year of Experience in the Company----------

Position ----------

1. By whom shall you believe, in their academic background, that property valuation should be conducted? Accountant, Urban Planner, Civil Engineer or Kindly mention if it is other academic area?

2. What do you believe that property valuator should possess as a skill and knowledge in order to perform valuation?

3. Is there certification for property valuator in Ethiopia?

4. What are the purposes of property valuation in your Bank/ Organization?

5. What type of real property did you valuate in the past five years?

6. Which internationally accepted methods/approaches of property valuation do your organization use in the valuation of real property? Is it Income Capitalization, Cost Replacement, Comparative Sale Approach or/and combination of this approach? Kindly mention if it is other method?

7. Kindly mention why your Bank/ Organization choose to use the approach which currently using?

8. What do you think property valuers, before they value the property, are expected to know?

9. Is it International Standard or Nationally prepared manual/Guideline (Ethiopia Bankers Association (EBA) Manual or Consultant prepared) or particularly prepared by your organization itself does your organization use in valuation of property for collateral?

10. What are the basic steps that your Bank/ Organization follow in the process of collateral estimation for unfinished property pledged as collateral?

11. What is the minimum construction requirement/standard of properties pledged as collateral in your Bank/ Organization?

12. What is the document requirement for finished or/and unfinished properties pledged as collateral in your Bank/ Organization?

13. What are the basic steps/ process map/ that your Bank/ Organization follow in the process of collateral estimation for finished property pledged as collateral?

14. It is known that the existing land legislations in Ethiopia ignore location value for land that land is public property and, hence, no compensation should be paid by the government for its own property. So, for property pledged for collateral do your Bank/ Organization consider the location value in valuation process? If so, how is location value of a property is assessed?

15. What do you think is the challenge and difficulties in land valuation?

16. Have you noticed improvements in the practice of property valuation in Ethiopia as general and particularly in your organization now days? Kindly mention if there are factors for the improvement in the practice of property valuation?

17. Have you ever got the chance to see a property valuated by two or more different banks in the same year and noticed any significant variation in the valuation results?

18. What do you recommend on valuation process of real property to minimize variation results for property pledge as collateral?