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Is Reviewing Valuations a Tool for Curtailment of Professional Opinions?: A Perspective of a Reviewer Based on Valuations for Secured Lending Purpose

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ABSTRACT

This paper delves into the pivotal role of valuation reviews in mortgage lending, dispelling misconceptions prevalent among private practice valuers. Drawing on the International Valuation Standards Framework, the study emphasizes the importance of qualified and ethical valuers in producing credible reports. Leveraging the author's extensive experience in the state sector and as a valuation reviewer for leading banks, the paper provides insights into fourfold review techniques—Administrative (Compliance) Review, Desk Review, Field Review, and Technical Review. These techniques ensure the accuracy, appropriateness, and adherence to Generally Accepted Valuation Principles, as per International Valuation Standards. In addition, the paper explores the technical background of mortgage valuations, highlighting nine key principles followed by valuers and examining Sri Lanka Valuation Standard-07. This paper also includes ten compelling case studies, covering diverse scenarios such as legal principles, wasting assets, building limits, accuracy of calculations, and valuation challenges associated with cattle farms and apartment buildings under construction. The paper reinforces the crucial role of valuation reviews in maintaining the integrity of mortgage valuations and the inclusion of ten case studies adds practical insights, covering a spectrum of scenarios and reinforcing the argument for adherence to regulatory standards and client requirements.

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1. INTRODUCTION

As defined in Sec. 30 of IVS Framework – International Valuation Standards, *Valuer* has been defined as “an individual, group of individuals, or individual within an entity, regardless of whether employed

(internal) or engaged (contracted/ external), possessing the necessary qualifications, ability and experience to undertake a *valuation* in an objective, unbiased, ethical and competent manner. In some *jurisdictions*, licensing is required

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before one can act as a *valuer*. Because a *valuation reviewer must* also be a *valuer*, to assist with the legibility of these standards, the term *valuer* includes *valuation reviewers* except where it is expressly stated otherwise, or is clear from the context that *valuation reviewers* are excluded”.

Generally, a property Valuer is a trained and qualified professional who does a thorough inspection of a property and provides an independent and customised valuation report on its market value. He has to convey his opinion of value in respect of a property, his comments and observations there on, in writing to the client. This process is known as Valuation Reporting and the written document is referred to as the Valuation Report. It is expected the content of the Valuation Report be arranged in logical and methodical manner so as to facilitate easy understanding of the Report by the client or any other authorized party or by a Court of Law. A Valuer is an independent third party with no financial interest in the property he values and may be selected locally by a client on his own, recommended by a mortgage provider or globally by a real estate agent.

In professional practice, there is a process of reviewing valuations. International Valuation Standards - Eighth Edition under International Valuation Guidance Note No. 11 states that “A Valuation review is a review of a Valuer’s work undertaken by another Valuer exercising impartial judgment. Because of the need to ensure the accuracy, appropriateness, and equality of Valuation Reports, valuation reviews have become an integral part of professional practice. In a valuation review, correctness, consistence, reasonableness, and completeness of the valuations are considered”.

On the directions given by the Central Bank of Sri Lanka, two of the leading state

Banks are using this tool of Reviewing Valuations for a long period of time, where one particular Bank is using it for over fifty years. Nevertheless, state valuations are always reviewed by the professional Valuers of State Valuation Department at different stages starting from the lowest managerial grade (District Valuer or now Valuer) up to the Govt. Chief Valuer, depending on the delegated approval limits.

However, there is a misnomer created among professional Valuers in private practice that reviewing of valuation is meant for reduction of values, may be, haphazardly, randomly, unsystematically or indiscriminately. With the experience gained in the State sector for more than thirty four years, as well as a Valuation Reviewer for two of the leading state Banks for last eleven years, the writer wishes to discuss the subject topic encompassing, what is reviewing, technical background of mortgage valuations, and necessity of reviewing of valuations for secured lending or mortgage with justifications supported by authentic examples.

2. REVIEWING OF VALUATION

This text is purely based on the International Valuation Guidance Note No. 11 in International Valuation Standards - Eighth Edition. Accordingly, a Valuation Review provides a credibility check on the valuation under review, and tests its strength by focusing upon,

- The adequacy and relevance of the data used and enquiries made,
- The appropriateness of the methods and techniques employed,
- Whether the analysis, opinions, and conclusions are appropriate and reasonable, and

- Whether the overall product presented meets or exceeds Generally accepted Valuation Principles (GAVP).
- Valuation reviews are performed for a variety of reasons among,
- Due diligence required of financial reporting and asset management,
- Expert testimony in legal proceedings,
- A basis for business decisions and specifically determination of whether a report complies with regulatory requirements, where,
- Valuations are used as part of the mortgage lending process and
- To test whether Valuers have met regulatory standards and requirements as detailed by professional institutions and by whom the service is requested.

Reviews are fourfold, Administrative (Compliance) Review, Desk Review, Field Review and Technical Review.

2.1 Administrative (Compliance) Review:

A valuation review performed by a client or user of valuation services as an exercise,

1. In due diligence, when the valuation is to be used for purpose of decision-making such as underwriting, purchasing or selling of the property.
2. To assist a client with above functions.
3. To ensure that a valuation meets or exceeds the compliance requirements or guidelines of the specific market and
4. At a minimum, conform to Generally Accepted Valuation Principles (GAVP)

2.2 Desk Review:

A valuation review that is limited to the data presented in the report, generally

performed with a checklist of items. The reviewer checks with the,

1. Accuracy of calculations,
2. The reasonableness of the data,
3. The appropriateness of the methodology,
4. 4.Compliance with client guidelines,
5. 5.Regulatory requirements and
6. Professional standards.

2.3 Field Review

A valuation review that includes,

1. Inspection of the exterior and sometimes the interior of the subject property
2. Possibly inspection of the comparable properties to confirm the data provided in the report.
3. Generally covers the items examined in a Desk Review and
4. Also include confirmation of market data,
5. Research to gather additional data and verification of the software used in preparing the report.

2.4 Technical Review

A valuation review performed by a Valuer to form an opinion as to whether the analysis, opinions, and conclusions in the report under review are appropriate, reasonable, and supportable.

All 'fourfold Review Techniques' are applied in their day to day performances by the State Valuation Department and Reviews by the Banks generally are limited to 'threefold reviews' except the Field Review.

There are different types of valuations prepared for different purposes. The principal characteristic of all valuation

reviews in common are that one Valuer exercises impartial judgment in considering the work of another Valuer. A valuation review may support the same valuation conclusion in the valuation under review or it may result in disagreement with that value conclusion. Valuation reviews provide a credibility check on the valuation as well as check on the strength of the work of the valuer who developed it, as regards the Valuer's knowledge, experience, and independence.

A salient feature in reviewing is that the Review Valuer shall consider only information that was readily available in the market at the time of valuation and but not the events affecting the property or market that occurred subsequent to a valuation.

3. TECHNICAL BACKGROUND OF MORTGAGE VALUATIONS

A mortgage is "a pledge of an interest in a property as security or collateral for repayment of a loan with provision for redemption and payment. In the event the borrower (Mortgagor) defaults, the lender (Mortgagee) has the power to recover the property pledged".

When a Bank takes property as a security, it is taking three risks.

1. Interest on the loan will not be paid,
2. Borrower cannot or will not repay the loan when required and
3. Price obtainable for the property will not cover the loan.

So, in taking its lending decision, the Lender wants to minimise those risks by making careful assessment of the applicant. In taking this decision on careful assessment of the applicant, the Lender relies heavily on a Professional Valuation Report and there are three salient features between the Valuer and the Mortgagee as below.

1. The Valuer must have regard to the mortgagee's position in relation to the property - value of property and amount of loan,
2. Remedies available to mortgagee in the event of default by the mortgagor.
3. It is necessary to realise the security in the future to cover the mortgage debt, arrears of interest and costs.

Generally, following nine principles are adhered to when a mortgage valuation is done.

1. Mortgage valuations are generally called "Bricks and mortar valuations".
2. While Market Value is the basis, valuer must consider not only the present market value, but particularly whether that value is likely to be maintained in the future and would be readily realisable on the Forced Sale of the property.
3. Valuation should be on the basis of existing use value unless planning permission have been already granted for development.
4. Any likely capital expenditure on the property, such as accrued repairs/dilapidation or the estimated cost of future development or reconstruction, must be allowed for as a deduction.
5. Any future element of value which is reasonably certain, such as reversion to full rental value, should be taken into account.
6. In case of business premises, goodwill should be excluded.
7. Anything which can be easily removed or sold by the mortgagor, such as timber, should be excluded.
8. Information is sometimes tendered as to the price paid for the property by the mortgagor. This is sometimes misleading. An excessive price may

have been paid for a special reason or market value since have changed.

9. The cost of erection of buildings is usually disregarded for mortgage purpose. Because, large sums may have spent on individual tastes or considerable changes in building costs may have occurred.

Further, Sub Section : 3.5 of Sri Lanka Valuation Standard- 07, Valuation for Mortgage Purpose, states as below. “The Valuer shall exclude the values of the following in ascertaining the Market Value:

Values based on factors that are of speculative nature, Buildings under construction or incomplete buildings, semi-permanent buildings/ structures, Temporary buildings/ structures, Unauthorised buildings/ structures, Standing Timber, Things that can be easily removed, Physical assets of wasting nature, “Footloose” items, Consumables, Spare parts, Glass items and glassware, Chinaware, Crockery and cutlery and Intangible assets”.

Generally, a Valuation Report for Mortgage Purpose reflects the above technical or professional requirements with reference to International Valuation Standards (IVS Standards), VPGA 2 Valuation of Interests for Secured Lending in RICS Red Book - Global Standards (RICS Standards) and Sri Lanka Valuation Standard- 07, Valuation for Mortgage Purpose (SLV Standards), as appropriate.

Valuation Standards specify that, the Valuer needs to clearly identify property that is to serve as the security with particular care to distinguish between property types where Real Property and Personal Property are combined. Different property types are:

- Investment Properties (Income producing properties),
- Owner occupied Properties (considers property is transferred unencumbered and the owner too is a part of the market),
- Leases Between Related or Connected Parties (if the lease rent exceeds market rents such leases should be disregarded),
- Sales Incentive (Market Value ignores any price inflated by special considerations or concessions),
- Specialised Properties (by definition have limited marketability and significant value only as a part of a business),
- Trade Related Properties (including hotels and other trading businesses, purpose designed for only that use, usually valued based on profitability),
- Development Properties (valuation depends on the state of development of the property at the date of valuation and may take into account the degree to which the development is pre-sold or pre-leased) and
- Wasting Assets (Valuer shall exclude the value of wasting assets in ascertaining the market value under SLVS - 7(3.5)(h).

Now, let us see whether reviews are necessary. The following genuine Cases selected from the writer's experience in reviewing mortgage valuations are presented in aid of exploration. A Case Study comprises Property Valued, Evidence Presented, Valuation, Comments by the Valuer if any, Reviewer's Comments and Justifications as appropriate.

**Case Study 01:
“Laesio enormis” (Laisio Enomis)
Legal Principle**

Property Valued :

A land in extent 1A2R09.47P with a commercial building and a workshop building, located in a rural residential and agricultural area bordering the Lagoon. Property purchased on 23.02.2022 at Rs. 6.0mn. Date of Valuation : 26.08.2022.

Evidence presented:

Land Values : Residential lands are in great demand due to the prevailing scarcity. Smaller parcels of lands are fetching rates ranging from Rs.25,000/= to Rs.100,000/= per perch depending on the location, condition and the extent available.

Valuation:

Land in extent of 1A-2R- 09-47P	
0A - 2R - 00.00P @ Rs. 200,000/= per perch	Rs. 16,000,000/=
0A - 2R - 00.00P @ Rs. 150,000/= per perch	Rs. 12,000,000/=
0A - 2R - 09.4?P @ Rs. 75,000/= per perch	Rs. 6.710.250/=

Total	Rs. 34,710,250/=
Add Value of Buildings	Rs. 11.886.000/=

Market Value Say	Rs. 46,600,000/=

The comments called from Valuer was “The present owner has purchased the property on 23.02.2022 for Rs. 6.0mn. Valuer to comment on “Leasio Enomis” legal principle and resubmit.

What is “Laesio enormis”?(Laisio Enomis) Comments on deed consideration is required under “Laesio enormis” legal principle, because, if the consideration passed in the past Deed is found within 2

years below the half of the market value, the vendor of the said Deed has right to cancel the transfer Deed on the basis of Laisio Enormis. (Laesio Enormis)

In such instances, as a Remedy in a secured lending, it is prudent to the Bank to require applicant to obtain a Title Insurance, if the consideration passed in the said deed is below the half of the market value and to collect a separate letter from Insurance Company covering the Laisio Enormis. If there is a recent development in the land or outskirts within last 2 years increasing the market value, the concept of Laisio Enormis can be ignored. (This should be the advice to the Bank by the Valuer)

Reviewer’s Comment:

For the comments called for, the Valuer’s reply was “Please note that the value stated in the title deed is not considered in my valuation. As the values in general in this area as well as other areas are grossly understated. I think that will be proved if you analyse the deed values in any area. This is done to save money from paying as stamp duty”.

From a Professional Valuer, the reply anticipated was to indicate the actual money transacted by inquiry, and prove the actual Market Value by market data in the area, while advising the Bank to go for a “Title Insurance”. When the rates are varying from Rs. 25,000/= to Rs. 100,000/= per perch for smaller parcels as indicated by him, he has valued the land in extent 249.47 perches for rates varying from Rs. 75,000/= to Rs. 200,000/= per perch.

Nevertheless, there were no Approved Building Plans available and Valuer had considered building value too. He avoided replying for the same when asked for.

So, the Reviewer had to rely on the land value evidence cited by the valuer and

report the Market Value far below 50% what he reported excluding buildings.

As already mentioned, in similar instance as above, Valuers should advise the Mortgagee to obtain a Title Insurance, if the consideration passed in the title deed is below the half of the market value and to collect a separate letter from Insurance Company covering the “Laisio Enormis”. Otherwise, Valuers should prove that, there is recent development in the land or outskirts within last 2 years increasing the market value, by market/sales evidence.

**Case Study 02:
A Wasting Asset**

Property Valued:

A land in extent 28 Acres, containing an abandoned coconut plantation, located in a rural residential and agricultural area bordering Mahaoya in Kurunegala district. Property purchased three months prior to the date of valuation for Rs. 45.0mn by a Limited Liability Company.

Valuation:

Over Rs. 1,200.0mn within four months from the date of purchase.

Approach to the Valuation:

Owner Company has purchased the land for excavating and supplying earth for the construction of Expressway from Mirigama to Kurunegala. The Valuer has valued the content of earth that could be excavated within a total lifespan of 4 years and reported for mortgage purpose.

Reviewer’s Comment:

This is a wasting asset coming within SLVS – 7(3.5)(h) and the Review Panel rejected the valuation.

Wasting Assets are always subject to license by the state. Depending on the

total lifespan of the asset and permanency of getting the license until the end of lifespan, Valuers may recommend a Forced Sale Value, limiting the time period for the recovery of Loan (without considering last 5 years as specified in Valuation of Leasehold interests for mortgage in SLVS 07 – Sec. 3.11), which should be definitely below the Lifepan of the asset as specified in Sec. 6.12 – Wasting Assets under “International Application 2 – Valuation for Secured Lending Purpose IVS 2007”.

**Case Study 03:
Effect of Building Limits**

Property Valued:

A bare land in extent 06.0Perch located facing High Level Road in between Gamsabawa Junction and Delkanda junction in Nugegoda. The Building Limit along the road is 60 feet from the centre of the road and except 10 feet wide strip along rear boundary, aggregating into about one perch, the balance front land is coming within Building Limits.

So, only 01perch of the land is buildable and Building Permit will not be issued by the Local Authority for the entire land. But, the entire 6 perches of land was valued, based on commercial land value evidence in the area. General commercial land value was around Rs. 6.0mn per perch.

What SLVS says:

SLVS 7: Sec. 3.8.2 says as below.

“The Valuer may take into consideration in his valuation any extent of vacant land, falling within Building Limits other than under following circumstances.

- a) Entire land falls within the Building Limits.

- b) Where, the balance land after allowing for Building Limit becomes sterile for building purpose.

However, in such circumstances, such lands may be valued with regard to any permissible use including agricultural activities.”

Reviewer’s Comment:

Valuation was rejected as it does not follow SLVS 7: Sec. 3.8.2. However, Valuer should have considered the suitability of the subject land for “any permissible use” other than developing with a building, preferably for “Parking” which is a burning problem now in commercial belts.

Valuers must totally distinguish the procedure to follow depending on the purpose, i.e. Assessment of Compensation under Land Acquisition Act with reference to Se. 45(3), where effect of Street Lines and Building Limits to be ignored and Valuation for Mortgage subject to SLVS 7- Sec. 3.8.2, already briefly discussed above.

**Case Study 04:
Effect of Building Limits when Existing Buildings are ignored**

Property Valued:

A Restaurant Building and Land located bordering Mahaoya in between Mahaoya and Colombo – Kurunegala main road beyond Alawwa town. The Building Limit along the main road is 50 feet from the centre of the road and the reservation along Mahaoya is overlapping the Building Limits.

The Restaurant Building in the land was Semi-permanent nature and also Unauthorised.

Valuer ignored the existing building in his valuation due to above two reasons and valued on the land based on commercial land value evidence.

What SLVS says:

SLVS 7: Sec. 3.5(c) and (e) state to exclude the values of “Semi-permanent Buildings” and “Unauthorised Buildings” respectively.

Reviewer’s Comment:

Accepted that the buildings cannot be considered.

Anyhow, when buildings are not considered, Valuer has to see whether the land is affected by Building Limits/River Reservations, as the Planning Authority will not allow construction of buildings in a land fully covered by Building Limits and River/Oya reservation.

Valuation for land, based on commercial value was rejected as it does not follow SLVS 7: Sec. 3.8.2(a), i.e. “entire land falls within the Building Limits”. However, Valuer should have considered the suitability of the subject land for “any permissible use including agricultural activities”.

Same as Case Study 03, Valuers must totally distinguish the procedure to follow depending on the purpose, i.e. Assessment of Compensation under Land Acquisition Act with reference to Se. 45(3), where effect of Street Lines and Building Limits to be ignored and Valuation for Mortgage subject to SLVS 07, already briefly discussed above.

**Case Study 05:
Accuracy of calculations, the reasonableness of the data, the appropriateness of the methodology, compliance with client guidelines, regulatory requirements and professional standards.**

Property Valued:

Ceypetco Filling Station and Electrical and Power Tools Shop and Land, located in a Pradesiya Sabha area along a main

road, about 3km away from a major town of a district. Filling Station is with a canopy of 1,100 sq.ft. and the three storied commercial building behind is with a floor area of 3,100 sq.ft.

Valuer adopted both “Investment Method” and “Contractor’s Method” to arrive at the Market Value. To ascertain the Market Rental Value of the property, Valuer has analysed accounts for three years from 2018 – 2020.

1. Valuation on Investment Method:

Nest Profits from Filing Station	Rs. 15,220,064.00
Net Profits from Electrical and Power Tolls Shop	<u>Rs. 96,352,000.00</u>
Total	Rs. 111,572,064.00
Less – For Tenants Capital – (10% of Rs. 521,500,000/=)	<u>Rs. 52,150,000.00</u>
Divisible Balance	Rs. 59,422,064.00
Less – Tenant share @ 40%	<u>Rs. 23,768,825.00</u>
Annual Rent	Rs. 35,653,239.00
Rent per month	Rs. 2,971,103.00
Say	Rs. 2,970,000.00
Annual Net Income	Rs. 35,649,000.00
Capitalize @ 6% Y.P. (2½% Annual Sinking Fund)	<u>16.0483</u>
Value	Rs. 571,961,412.00
Value Say	Rs. 571,000,000.00

2. Valuation on Contractor’s Method

Land – 0A0R27.58P @ Rs. 800,000/= per perch	Rs. 22,064,000.00
Building, Canopy and Parking Area	<u>Rs. 24,050,000.00</u>
Total	Rs. 46,114,000.00

Present Value of the Plant and Machinery	<u>Rs. 9,578,000.00</u>
Rs. 55,692,000.00	

Valuation Reported

Market Value	Rs. 571,000,000.00
Forced Sale Value	Rs. 565,000,000.00
Insurance Value of Buildings	Rs. 23,350,000.00

Reviewer’s Comment:

Ceypetco Filling Station is a “Trade Related Property (purpose designed for only that use, usually valued based on profitability), and the Valuer has adopted the same principle to value it.

But, the Electrical and Power Toll Shop is housed in a general commercial building. Can it be valued on “Profit Basis” and can there be a monthly rent of Rs. 2,970,000/= for both, where Shop reflects a rental value six times of the Filling Station, calculated on normal net profits. When accounts are analysed to arrive at Rental Value, Goodwill too should be excluded, but not done so.

When Valuer was asked to substantiates the rental value of the Shop building based on market evidence and also to comment on unreachable or distant difference of ten times between two results on two different methods, Valuer was unable to give an answer for months and ultimately the Bank had to abandon granting the facility.

Sec. 10.4. - IVS 105 - Valuation Approaches and Methods states as below.

“Valuers are not required to use more than one method for the valuation of an asset, particularly when the valuer has a high degree of confidence in the accuracy and reliability of a single method, given the facts and circumstances of the valuation engagement.

However, valuers should consider the use of multiple approaches and methods and more than one valuation approach or method should be considered and may be

used to arrive at an indication of value, particularly when there are insufficient factual or observable inputs for a single method to produce a reliable conclusion.

Where more than one approach and method is used, or even multiple methods within a single approach, the conclusion of value based on those multiple approaches and/or methods should be reasonable and the process of analysing and reconciling the differing values into a single conclusion, without averaging, should be described by the valuer in the report”.

Assessment of rental value for general commercial properties should be based on Market Evidence, namely prevailing rental comparisons in the market for similar properties and also the Valuers must distinguish the difference between “Trade Related Properties” and “Owner occupied Commercial Properties”.

**Case Study 06:
Effect of Wrong Wordings and Lack of Valuer Comments on Market Evidence**

Property Valued:

Industrial Property in extent 5A0R28.94P with 9 buildings, including a Factory and a Warehouse, situated in a locality characteristics rural residential, interspersed with a few light industrial projects. Ultimate access to the land is 10 – 15 feet wide road off a Prdesiya Sabha road, about 150m away from a RDA road. The buildings are scattered around the central part of the land, which has been cut, leveled and made flat. Valuer has computed the extent of flat portion of land and the “SLOPPY” portion of land and found extents to be as below:

Flat portion (including the portion on which the buildings stand and paved area for easy vehicular movements) – **Approx. 480 perches.**

“**SLOPPY**” and undulating vacant land – **Approx. 350.6 perches.**

The Valuer says “the only realistic approach to the valuation of this industrial complex is to adopt the Contractor’s Method, alternatively designated as the Land and Building Method of valuation”.

Valuer further says, having familiarized himself with contemporary commercial land values in this locality and taking into consideration the lie, shape, size and location of the land, it is his opinion to adopt a rate of **Rs. 335,000/=** per perch is fair and reasonable.

Thus, he valued this property on **08.03.2021** as below.

Land	828.94 perches @ Rs. 340,000/= per perch	Rs. 281,839,600
Buildings		Rs. 168,736,650
Capital Value (Land + Buildings)		Rs. 450,576,250

Market Value	Rs. 450,000,000
Forced Sale Value	Rs. 425,000,000
Insurance Value	Rs. 180,000,000

At the time, there was no Review Panel in the Institution and a facility has been disbursed based on the above Valuation.

Again on **07.04.2022**, the same Valuer has valued the same property and the Valuation reported was as below.

Market Value	Rs. 525,000,000
Forced Sale Value	Rs. 500,000,000
Insurance Value	Rs. 195,000,000

Reviewer’s Comment:

Once the second valuation on 07.04.2022 came to the Review Panel (established after the first valuation on 08.03.2021, following comments were made.

1. Valuer has adopted a flat rate of Rs. 415,000/= per perch for a land in extent 828.94 perches which is over 5 acres.
2. A part of the land is “SLOPPY”(‘wet with rain-pools’ – Oxford Dictionary)
3. To our knowledge (Valuation Review Panel), the general land value in the area is around Rs. 225,000/= per perch for small blocks around 15 – 20 perches.
4. No ages of the buildings given. No depreciations.
5. According to the Sec. 12 : 11 of the Title Report, originally the land was a paddy land. Therefore, “Clearence Certificate” from the AC/DC of Agrarian Development Department should be obtained before granting the facility.

When the report was referred back to the Valuer, he deleted one “P” from “SLOPPY” and said it is a “SLOPY” land and following comments were given.

1. The problem I see in this episode is that the lack of understanding the valuer’s terminologies and methods of valuation hence unwanted questions are being asked leading to wastage of time in your decision making.
2. For example, when I say INSITU VALUE it embraces age, condition and depreciation of the building. (Reviewers observe, no mention about “Insitu Value” in either of his reports and Review Panel does not understand how a Valuer decides on Depreciations and Insurance Value without ages of the buildings).

Reviewers’ Recommendation to the Bank:

1. Required data for reviewing the valuation, such as market evidence for land values (as the purchase price

of 40.0mn in 2015 had increased by the Valuer to Rs. 281.8mn in 2021 and again to Rs. 344.0mn in 2022), ages of the buildings, details of Building Plan approval and Certificate of Conformity, are not there in both reports.

2. So called “Insitu Value” is an end result or residue of GRC (Gross Replacement
3. Cost) after allowing for depreciations, based for Insurance Value. Nevertheless, as we (VRP – Valuation Review Panel) understand, the Bank has already granted facilities based on Valuation Report on 2021.
4. Therefore, we are reluctantly inform the Bank that VRP is unable to review the valuation Report in 2022.

Further, Sec 1.2 -SLVS – 20 – Valuation Reporting – Capital Valuation, states “Valuer also has to careful to use the correct syntax, punctuation, spelling and grammar”.

Some Valuers value “Bear Lands” too instead of valuing “Bare Lands”.

It is not reiterating to emphasise Valuers to strictly follow Sec 1.2 -SLVS – 20 – Valuation Reporting and always Valuations should be based on market evidence, not imaginary, where Valuars should be capable of detailing out market comparisons.

**Case Study 07:
How to Value a Freehold Interest in a Property When a Lessee is occupying it on an Indenture of Lease.**

Property Valued :

Commercial Property in extent 0A1R18.75P with a “Good type 4 storied shop building occupied by a reputed company as a Super Stores” located in a well- developed suburban town in a

Municipality in Western Province.

Floor Area – Main Building

Ground Floor	8,738 sq.ft.
1st, 2nd & 3rd Floor	5,952 sq.ft each
Total	26,594 sq.ft.

The entire building is occupied by “Arpico Super Centre” since 2002 on 15 years renewable lease. Current passing rent is Rs. 787,500/= per month since 15.07.2020 for a period of 3 years.

Stating that “current rental value of shop properties around the area is very high and according to available information there are rents paid amounting to over Rs. 150/= per sq.ft. per month for ground floor shop space, the Valuer has adopted Rs. 150/= per sq.ft. for Ground and First Floors, Rs. 80/= per sq.ft. for second and third floors and estimated the rental value of the Building at Rs. 2,944,400/= per month against a passing Rent of Rs. 787,500/= and calculated the Market Value of the property on Investment Basis at Rs. 604,737,600/=. On the Contractors Basis Market Value calculated was Rs. 784,196,000/=.

Thus, the Valuation Reported was Market Value Rs. 700,000,000/- and Forced Sale Value Rs. 675,000,000/-.

Reviewer’s Comment:

Valuer to do the Valuation subject to the prevailing Lease Agreement and resubmit.

Second Valuation:

In response to above comments, Valuer amended the Valuation by capitalizing the passing rent of Rs. 787,500/= for unexpired 2 years (Questionable as only half a year was there to end the passing rent by July 2023) as Term Value and capitalizing the estimated rent of Rs. 2,944,400/= for perpetuity after 2 years as Reversionary Value (even without deferment for 2 years).

Thus, the Valuation Reported was Market Value Rs. 560,000,000/- and Forced Sale Value Rs. 550,000,000/-.

Forces Sale Value assessed by the same Valuer in 12/2018 was Rs. 400.0mn and the Review Panel decision at that time was Rs. 275.0mn as Forced Sale Value.

Reviewer’s Comments:

1. Information in original report dated 13.10.2022 and the new report dated 26.10.2022 are contradictory, especially of passing rents (originally Rs. 1,000,000/= per month and later Rs. 787,500/- per month).
2. Reversionary Rent assessed by the Valuer is baseless and very high with compared to passing Rent of Rs. 787,500/= per month. Valuer has not considered demand in the open market for huge buildings suitable for Super Markets, as only three such companies, namely Arpico, Cargills and Keels are there in the country, having Super Market chains. Therefore, rental value for small buildings cannot be compared with a huge building covering a Floor Area of 26,594 sq.ft. .
3. Reversionary Value has not been discounted to reflect the Present Value.
4. This is an investment property and as agreed rents are there, Investment Method of Valuation would have been the best method. As Cost is not Value, Contractor’s Basis of valuation should have adjusted to reflect the market conditions, preferably by giving an end allowance.
5. Based on the Review Panel Decision in December 2018 and considering the appreciation of property values too up to end 2022, the Review Panel decided Market Value at Rs. 425.0mn and Forced Sale Value at Rs. 360.0mn.

Is it possible a Valuer to deviate from existing rental clauses in an Indenture of Lease and do the Valuation on estimated rent, specifically not assessed based on market rental comparisons? Can a Valuer assess a rent of a huge building, having an extraordinary floor area, based on rentals of average/small size shop buildings? Can a Valuer ignore “Term Value” and “Reversionary Value” in a leased-out property and just capitalize an estimated rent by a capitalisation rate/Years Purchase in perpetuity? To all the questions, answers are given above.

**Case Study 08:
Valuation of a Cattle Farm on Income Basis.**

Property Valued:

Cattle Farm in extent 7A0R00P with all necessary buildings to run the farm. Market Value assessed by the Valuer was Rs.105.0mn on Profit Basis and Rs. 59.0mn on Contractors Basis.

Ultimately he recommended the Market Value at Rs. 105.0mn and the Forced Sale Value at Rs. 97.5mn, based on the Profit Basis.

Profits calculated on the basis of daily production of Milk. Generation of profits is purely based on the Livestock, but only the land and buildings to be mortgaged without the Livestock.

Reviewer’s Comment:

A Forced Sale situation will arise if payments of loan defaulted by the Mortgagor and by the time, Livestock will not be there as only the land and buildings have been mortgaged. Can the FSV reported by the valuer be realized in the future? Therefore, at least an end allowance should have been made for the cost of Livestock. When the Valuer was asked to clarify, no response from him for a long period of time. Ultimately the Bank

abandoned granting the facility.

Valuers should be careful when valuing special type of properties for mortgage purpose, especially on Income Basis, when non-mortgageable items are involved. Livestock cannot be mortgaged and the base for the income is cattle. “Alternative Use” described under mortgage valuation principles too is a remedy for this type of properties, other than making an end allowance.

**Case Study 09:
Valuation of an Apartment Building under Construction.**

Property Valued:

A condominium apartment Complex comprising G+14 with roof terrace, accommodating 99 residential apartments on 4th to 14th floors, commercial units on the ground floor and car parking on 1st to 3rd floors.

Project was funded by a Bank. As at the date of valuation, building was under construction and work completed up to about 65% including entire super structure with 85% brick works.

Valuation reported by the Valuer was Rs. 1,350.0mn as Market Value and Rs. 1,150.0mn as Forced Sale Value.

Reviewer’s Comment:

Valuer to report whether any advance money collected by way of pre-sale agreements by the Developer and if there is any, to adjust the valuation accordingly and resubmit.

The Valuer’s reply was as below.

Second Valuation:

“As per the information available with regard to the advance payment received by the Developer from pre-sales of the Apartment units, the developer has

already collected Rs. 1,206,521,338/- as at the date 01.10.2020. Accordingly, it is shown that collected advance payment is almost 92% of the Market Value and 5% more than the Forced Sale Value reported for the property”

Reviewer’s Comment:

Valuation Review Panel pointed out the following two Court Cases on Condominium apartment Units.

1.This is an apartment complex situated in Colombo 6 and having 51 occupants living in the complex. The mortgage provider has taken it as a collateral even after knowing that all 51 occupants have entered into sales agreements with the Developer. According to Attorney-at-Law the Developer put out advertisements on the paper and collected money from the prospective residents.

After registering the sales agreements, without the consensus of residency occupants, the Developer went to Mortgagee for the mortgage. The Mortgagee, knowing that the sales agreements were registered, mortgaged the property. The occupants have no outstanding payments to be settled to the Developer and therefore, they filed a petition in court against this mortgage which happened without their knowledge. Plaintiffs sought the Commercial Court’s intervention to prevent the Mortgagee from proceeding with Parate execution and to restrain Developer from further alienating of the Complex.

So, the Commercial High Court of Colombo issued an enjoining order restraining the Mortgagee from auctioning the complex. Plaintiffs further noted that the Mortgagee has failed in its Fiduciary Duty as a Bank by executing the mortgage bond.

2.In “Mallika Fernando Vs. Nagesh Fernando (CA 979/79 DC Colombo

16894/L – March 26, 2001) it was held that non registration of a condominium property will not invalidate a legally binding Deed of Conveyance under which, a sections of a building had been gifted to different parties.

In this case, the plaintiff and the dependent, both signed and accepted a Deed of Gift of the Donor whereby a section of the building, which were not properly subdivided under a registered Condominium Plan, had been gifted to the Donees. They are thus considered to be co-owners of the building and not as owners of individual units.

Reviewers noted that, the base for a condominium property is the Plan of Subdivision. This is referred to as the “Condominium Plan” in respect of completed buildings, a “Semi Condominium Plan” in respect of a partially constructed/completed buildings, and a “Provisional Condominium Plan” in the case of a building which is yet to be constructed.

Title cannot pass to a buyer of a Condominium Unit unless and until the “Plan of Subdivision” has been registered in terms of the Apartment Ownership Act, giving recognition to Condominium Units reflected in the plan of subdivision as individual immovable property.

Thus, in view of the above two cases, the VRP noted as below.

1. The developer has already collected Rs. 1,206,521,338/- by pre-sales and as the building was under construction, even at the date of valuation, there cannot be having a “Condominium Plan” registered, other than a “Semi Condominium Plan” if any, as assumed. So, the prospective purchasers might have not received ownership to individual

apartment units and thus, they have become “Co-owners” of the building.

2. Firstly, in such an event, Bank has to take all pre-sale purchasers, as co-owners, as parties for the Mortgage Bond.
3. Secondly, total pre-sale money collected should be deducted from the Market Value and decide on Market Value which will be Rs. 143,478,662/= (Rs. 1,350,000,000/= less Rs. 1,206,521,338/-) rounded off, say Rs. 143.5mn. Subsequently the Forced Sale Value too should be adjusted accordingly, say Rs. 120.0mn or so.

What would have happened if secondary loan was granted based on Forced Sale Value reported, i.e. Rs. 1,150.0mn?

When valuing Condominium properties, “Provisional Condominium Plan” provides base for “mortgage land only” for providing ‘finance for the project for the developer, where building is yet to be constructed’.

In case of a partially constructed/ completed buildings “Semi Condominium Plan” is the base and when doing a valuation at this stage, Valuers should investigate whether there is any “pre-sale” advances collected from prospective buyers and if so, valuation should be adjusted accordingly and also the mortgagee should make aware of the same as they become co-owners.

If the base is the “Condominium Plan”, only unsold units, for which no pre-sale advances collected, can be considered for the valuation.

Case Study 10:

Theory : “Although the aim of the valuer is to provide an estimate of market value, it should not be assumed that each valuer’s opinion will be the same. Different valuers could arrive at different opinions of

value because they are making estimates and there is normally room, within limits, for differences of opinion”. (Modern Methods of Valuation – Eleventh Edition – Chapter 1- Principles of Valuation – 4. Value and Valuation)

Property Valued:

A Land in extent 1Acre3Rood14.2Perches, i.e. 294.2 Perches. This is a defaulted case and following valuations had been taken for internal purposes by the Bank. Total outstanding is around Rs. 57.5mn.

Valuer 1 – Description – “...an irregular shaped block of land.... A part of the southern boundary is fronting to Ja-ela canal... Water table is 05 – 10 feet from the surface.....it needs at least 2-3ft. earth filling before starts any construction works....”

Valuation – as at 29.09.2018

Land – Extent 294.2P @ Rs. 375,000/= p.p.	Rs. 110,325,000
Less - for clearance & earth filling @ Rs. 35,000 p.p.	Rs. 10,297,000
Value of the property	Rs. 100,028,000

Valuer 2 - Description – Irregular shaped block of land bordering the Dandugama Ela and the land lies almost flat in level with the water level with the ela on the southern boundary. ...the land lies dry in dry weather and just on shower of rain, the land gets water logged. The subject property in the first instance is not a suitable subject to be taken as security for a mortgage. There is hardly any forced sale value in this property. I do not see any convenience possibility of filling the land for development....the subject property as it stands at date lying in level with the water in the canal is more suitable for agricultural purposes.

Valuation – as at 27.11.2018

Land – Extent 294.2P @ Rs. 30,000/= p.p.
Rs. 8,826,000

Reviewer’s Comment:

1. Only the first valuation came to the Review Panel in 2018 and the valuation has been reviewed based on the valuation given by the Valuer.

2. Subsequently, another Valuation has been taken by the Bank from the second Valuer, two months later, which has not been referred to the Review Panel.

3. For further review by the Bank, in 2023, again a valuation has been taken from the second Valuer and in his Valuation Report, while confirming the earlier description of the property, he further stated that “The subject property remains in the same low line (may be low-lying) submerged state almost in level with the water level of the canal”. Valuer confirmed same valuation done in 2018, i.e Rs. 8,826,000 @ Rs. 30,000/= per perch for agricultural purposes.

The acts of Valuer 1, do not come within the text of the Modern Methods of Valuation quoted above. This is a gross violation of rules of “Ethical Behaviour” by the Valuer. SLVS 24 – 3.3 says “Valuer shall at all times maintain a high standards of honesty and integrity and shall not act in a manner that is misleading or fraudulent. He shall always act in a way that promotes trust in the valuation profession”. Nevertheless, as Chartered Valuation Surveyors, we are bound to follow five ingredients of “Professional Ethics” of RICS, i.e. Act in a way that promotes trust in the profession, always provide a high standards of professional service, act with integrity, take responsibility and treat others with respect.

4. CONCLUSION

Is Reviewing of Valuation necessary or not to safeguard the interests of the Mortgagees, taking Real Estate as collaterals?

Valuation is a process of finding the Present Value of a future income stream of an interest in a property, based on the past information. In achieving the outcome, fundamentals of valuation are significant. Consistency, Objectivity and transparency are the main three factors fundamental to building and sustaining confidence and trust in valuation. Their achievement, both to form sound judgments and to report of value clearly and unambiguously to clients depend on, possessing and deploying the appropriate skills, knowledge, experience and ethical behavior.

“Quidquid agas, prudenter agas, et respice finem” (Chinese) - “Whatever you do, do cautiously, and look to the end”. The threat of an action for “Negligence” is one of the great perils facing all professionals today. Even Valuers are not an exception. Not following correct procedures is one of the main courses of Negligence. Courts are aware that valuations are matters of informed opinions. If the opinion is not based upon, proper referencing of the site, knowledge of legal principles affecting the valuation, expressing value ranges in the particular locality preferably based on market data and the like, the valuation may be called into question.

In this juncture, Valuers are protected, shielded and safeguarded by the correct following and adaptation of Valuation Standards and Ethics, determined locally by the Institute of Valuers of Sri Lanka (IVSL), internationally by the Royal Institution of Chartered Surveyors (RICS – UK) and above all, globally by the International Valuation Standards Committee (IVSC).

If I reiterate on the Guidance by IVSC “because of the need to ensure the accuracy, appropriateness, and equality of Valuation Reports, valuation reviews have become an integral part of professional practice. In a valuation review, correctness, consistence, reasonableness, and completeness of the valuations are considered”.

On the face of above analysis, let the Mortgagees taking Real Estate as collateral for disbursement of loans to decide whether Reviewing of Valuation is necessary or not.

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