

## **Margin of Valuation Error Among Nigerian Valuers: Postulating an Acceptable Limit**

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### **Abstract**

Study on margin of error aims at capturing the response of Nigerian valuers and their clients from the financial sector to their permissible margin of error with a view to establishing the bracket outside which the valuer is considered incompetent. The opinion of 300 Estate Surveyors and Valuers were sampled using simple structured questionnaires in five cities in Nigeria. The work also relied on secondary data deduced from previous studies covering clients' response from the financial institutions as they have centralized lending policy across their branches. The paper employed descriptive and inferential statistics to analyze the data. The results revealed that 56.7% of valuers favoured  $\pm 10\%$  and clients between  $\pm 5\%$ - $\pm 13.16\%$ . The study postulated that margin of valuation error of between  $\pm 5\%$ - $\pm 15\%$  should be adopted in the Nigerian setting depending on the complexity of the property and owing to unstable market and dearth of transaction data bank. It recommended that the authorities regulating the practice of Estate surveyors and Valuers in Nigeria should make effort to adopt margin of error principle to ensure standardization of practice in the face of market globalization and sophistication.

**Keywords:** Accuracy, margin of error, valuation, variance

## Introduction

There is an ongoing academic discourse on valuation accuracy related-issues in recent time. This points to the glowing importance of the role valuation plays in all facets of property investment decisions in the financial sector of most economies. In the absence of traded and securitized property markets and lack of transaction-based indices, valuation serves as a proxy for transaction prices. It is also vital in performance measurement, acquisition and disposal of property (Baum, Crosby, Gallimore, Gray & McAllister, 2000). At the same time, valuation practice is bedeviled with accuracy problem which is bothersome to the academia, practitioners, and valuers' clients (mostly lending institutions). Valuation accuracy explains the degree to which valuation correctly identifies the market price where market value is the basis of the valuation, whereas valuation variance measures the difference between valuations by different valuers working on the same property interest at the same time (Crosby, Devaney & Matysiak, 2003; Ogunba & Iroham, 2010). The concept of "Margin of Error" otherwise known as the "Bracket" is closely related to valuation accuracy. Margin of error" or "bracket" is the extent to which a valuation departs from the "true value" of the property. Babawale (2007) defined margin of error as a theoretical bracket placed at equal distance either side of a valuation figure deemed by the court to be correct. The true value of the property as well as the size of the bracket is established by expert witness who is expected to assist the court with an unbiased opinion on the date of the valuer's valuation (Bretten & Wyatt, 2002).

Real estate valuation is a very complex

task and many factors may account for its inaccuracy. Wyatt (2003) noted that inaccuracy can enter the valuation process at any stage from the inception up to arriving at the final valuation. Valuation precludes 100% accuracy as it is a combination of both art and science that involves intuitional judgment as well as expertise. However, intuitional judgment can be subjective while expertise among colleagues in any profession may not be subjective; it nonetheless has never been found in any profession to be absolutely equal in weighting. On the account of the forgoing discussion, literature suggests that different valuers with different expertise and different temperaments for assessing future market behavior and interpreting investment risk may likely arrive at different values over the same valuation brief. Furthermore, the real estate market is generally noted for its imperfections. The property market imperfection is particularly most evident in developing countries where relevant mechanisms for capturing property market transactions in a formal manner are often non-existent. In addition, property characteristics e.g. heterogeneous and fixity property attributes, and the valuers' heuristics tend to introduce valuation inaccuracy as well as variation in value opinions. Thus, no two valuation opinions by different valuers can be exactly equal. However, there is reasonable degree to which a valuation opinion is expected to vary, outside of which the valuer could be considered incompetent and his valuation inaccurate. The range of this plus or minus value fluctuation from the 'actual value' is often referred to as the "margin of error" or the "bracket".

Sophistication on the part of valuers' clients in UK, Australia and US, probe into valuation approaches and accuracy of the

valuation (Brown, 1985; McAllister, 1995). Should valuation practice leave valuers' clients with the perception that valuation and the valuation processes cannot be relied upon, it will pose a great danger to the specialization that confers prestige and professional independence on the valuation profession. This by implication may mean valuers losing face with their clients, leaving them with no option than relying on other professionals to place value on real estate. As clearly demonstrated in the legal tussle that lasted for almost two decades between the Estate Surveyors and Valuers and the Nigerian Engineers on who should value plant and machinery. The valuers won by provision of the law (Decree 24 of 1975 now CAP III LFN 1990), which empowers them to place value on all interests in land and landed properties. It is important to checkmate the scenario that will bring to question the competence of the valuers and subject the profession to ridicule. The way to maintain public confidence in valuation services is to establish an acceptable margin of error beyond which valuations should be considered unacceptable and the valuer considered incompetent. This paper aims at capturing both valuers' and clients' permissible margin of error with the view to identifying the level of dissatisfaction with valuers' report in the Nigeria context. It is against the foregoing that this study seeks to provide answers to the following questions: To what extent are the valuers aware of the concept of margin of error? What is the valuers' acceptable margin? What is the clients' acceptable margin of error? How has the court established margin of error? What is the implication of the margin of error to the valuers?

### ***Margin of Error Established by Courts***

Studies on margin of error find their root in the heat of debate on valuation accuracy and variance which the court in UK tried to establish whether or not the valuer was liable for negligence in his valuation. The English Court first established the margin of error principle in the case of *Singer & Friedland Ltd v John D. Wood & Co* [1977]. In that case, a professional negligence action was brought against the valuer in considering whether he exercised reasonable care and expertise in carrying out a valuation. Watkins J. Summarized the evidence advanced by the expert valuation witnesses in that case thus:

“The permissible margin of error is said by Mr. Dean (the independent expert witness), and agreed by Mr. Ross (the employee of the defendants whose valuation provoked the legal action), to be generally 10% either side of a figure which can be said to be the right figure i.e so I am informed, not a figure which later, with hindsight, proves to be right but which at the time of valuation is the figure which a competent, careful and experienced valuer arrives at after making all the necessary inquiries and paying proper regard to the then state of the market in exceptional circumstance the permissible margin, they say, could be extended to about 15%, or a little more either way”.

Thirty six years after the popular decision in *Singer & Friedlander Ltd*, there has been steady increase in the number of cases in UK and Australia based on the earlier decision of the court in UK. The most important element the court looks at in each margin of error case is the size of the bracket appropriate in that circumstance. In the case of *Trade Credit Ltd*

vBaillieu Knight Frank (NSW) Ltd [1985], (a case concerning rodeo property) the court permitted  $\pm 15\%$  margin of error as indicated by expert witness evidence. Similarly, in *Private & Trust Co. Ltd. v S (UK) Ltd* [1983], the trial judge Rice J accepted margin of error of  $\pm 15\%$  on either side of the bracket. Whereas in *Banque Bruxelles Lambert SA v Eagle Star Insurance Company Ltd and others* [1994], where the valuation of three office properties produced differences from market price in the ranges of between 39% and 74%. The judge, Phillip J upheld that such differences were outrageous and highly unacceptable.

The permissible margin of error will depend in each case on the nature and complexity of the property. Cases involving commercial properties are recorded in *Corisand v Druce & Co* [1979], where the plaintiff agreed that  $\pm 15\%$  was appropriate for the valuation of a hotel premises. Also involving commercial property in Australia is the case in *Interchase Corporation Ltd v CAN 010087573 Property Ltd & others* [2000] QSC013, where the court ruled that 7% was appropriate, being the mid-point of various ranges of valuation obtained.

In cases involving residual valuations, the courts show some willingness to accept higher margin more than 10% on the ground that residual valuations are susceptible to change in the underlying assumptions. In *Nykredit Mortgage Bank Plc. v Edward Erdman Group Ltd* [1996], the Court of Appeal ruled that: when two valuations were compared and showed a difference in gross development value of 17%, with almost identical costs and profits, which led to a difference in residual land value of 114%, the judge considered this as absurd. In the same vein, the trial judge in *Nykredit Mortgage Bank Plc. v Edward*

*Erdman Group Ltd* [1993, unreported] disallowed a margin of more than 15% on complex residual valuation. While in similar case, *Mount Banking Corporation Ltd. v Cooper & Co.* [1992] 2 EGLR 12, 17.5% was accepted by the plaintiff on a residual valuation. The English courts and the courts in Australia had adopted the principle of margin of error to establish negligence actions against the valuer and this position precludes accuracy in valuation (Crosby, Lawers & Murdock, 1986; Brettens & Wyatts, 2002).

#### *Academic Debate on Margin of Error*

Discussions on margin of error in the academia find its origin in the early works of Hager and Lord (1985). Hager and Lord whose work in U.K elicited much of the work in valuation accuracy adopted a wide range of  $\pm 5\%$  either side of the true value, Baum and Crosby (1988) considered a margin of error of up to  $\pm 15\%$ . Matysiak and Wang (1995) found that the probability of achieving a selling price within  $\pm 10\%$  of the valuation estimate was only 30%, and 55% within  $\pm 15\%$ , while 70% within  $\pm 20\%$  of the valuation estimate. Hutchison, Macgregor and Nanthakumaran (1995) surveyed five national valuers and five local valuers for each of 14 centres in UK, seeking valuations at no fee. The study found differences in the variance of valuation between national and local valuation firms to be 8.86% respectively. Their findings revealed that over 8% of all the valuations produced a variation from the mean of less than 20%. Crosby, Lavers and Murdoch (1998a) examined 30 UK court cases between 1977 and 1998 and found that 75% of the decisions fall within 10%-15% bracket and none is beyond 20%. Bretten and Wyatts (2002) in a study of stakeholders in U.K on the acceptable margin

of error reported that 40% of the respondents favoured  $\pm 10\%$ , 36% of the investor considered  $\pm 5\%$  as permissible, while 25% of the valuers considered  $\pm 15\%$  as acceptable margin of error.

In Australia, Parker (1988) in a similar study adopted  $\pm 5\%$  to  $\pm 10\%$  as margin of error, with a mode of 5% and arithmetic mean of 6.04%. The first study on valuation accuracy and variance in the US was done by Cole, Guilkey and Miles (1986). They found out that the appraisal value was on average with over 75% difference from the sale price. A range of  $\pm 18$  to  $\pm 20\%$  was found.

Ultimately, there is no consensus in the academia as to what should be the acceptable margin of error as this depends on the nature and complexity of the property.

### *The Margin of Error (bracket) Debate in Nigeria*

Research investigating valuation practice in most of the developing countries is scanty and just beginning (Adegoke, Olaleye & Oloyede, 2011). Babawale (2007), noted that cases of professional negligence involving valuers in Nigeria are scanty and the few ones known as at today, none has gone beyond the disciplinary committee of Nigerian Institution of Estate Surveyors and Valuers (NIEVS). What makes the concept of "margin of error" an underlying principle in establishing professional negligence in U.K, Australia and U.S is the enormous court pronouncement. There are no such known records of court adjudication in Nigeria involving property valuation (Babawale, 2007, Ifediora, 2010). The low level of market sophistication and investors' awareness probably permits the practice of estate surveying and valuation to enjoy the atmosphere of "next to best" thing in

practice. However, with globalization and sophistication on the part of investors demanding standardization of professional practice, how long would this situation last? Murdock (2002) observed:

Once upon a time, the members of learned professions enjoyed an aura, if not of inevitability, then at least of unchallengeability. No longer; in our increasingly consumerist and compensation-conscious age, professionals from surgeons to accountants are viewed as mere service-providers with the same obligation as to the standard of those services as greengrocer's bearers for the quality of its vegetables. No profession is exempt (even the long standing immunity of barristers and other advocates has recently been swept away) and surveyors and valuers are finding themselves in the firing line in every aspect of their work. Fifty years ago, the vast majority of reported actions brought against the property professionals arose out of residential building surveys. Today, the picture is very different: residential, mortgage valuations, once regarded by general practitioners as a safe, albeit modes, source of income have become a very thorny thicket as both lender clients and house purchasers have been quick to pounce on any error in the report and turn on the surveyor. Even more worrying, in terms of the size of claims and their potential impact on professional indemnity insurance premiums, has been the growth in claims by financial institutions which, having lent on the security of

commercial property when times were good, learn to their cost that markets fall as well as rise, and seek to lay off their losses on their professional advisers (especially valuers) when their property company borrowers default.

With the increasing awareness of the services of estate surveyors and valuers coupled with the distress in the financial institutions it is just a matter of time that valuers in Nigeria like their counterparts in the developed countries, will find themselves in the firing line and accountable to their clients for every aspect of their professional service rendered. In Nigeria today, an attempt in the academia has been made to probe issues related to valuation accuracy/inaccuracy; competence of the valuers; valuation methodology issues; and quality of valuation reporting as measured against standards (see Igboko, 1992; Ogunba, 1997; Ogunba and Ajayi, 1998; Aluko, 2000; Aluko, 2004; Gambo, 2010; Babawale, 2012) to mention but a few. In Nigeria, studies by Ogunba and Ajayi (1998) and Ajibola (2006) revealed an outrageous figure in valuation variance. Ogunba and Ajayi (1998) reported 33.43% for residential property at Victoria Island and 36.47% for residential property at Ikoyi, all in Lagos. A similar study by Ajibola (2006) in Lagos metropolis got  $\pm 24.82\%$  for Ikoyi and  $\pm 51.54\%$  for Ojodu. The studies show that valuation as at present is not a good proxy for sale and mortgage transactions in Lagos.

As with the case in the U.K and Australia, so is the position in Nigeria; there is no consensus on acceptable margin of error as the debate is gradually emanating among the academia. Ogunba (1997) undertook the pioneering study on valuation accuracy and variance in Nigeria using Lagos metropolis as

the study area and adopted  $\pm 5\%$  as the permissible margin of error. Later, Ogunba and Ajayi (1998) in a similar study in Lagos metropolis came up with  $\pm 5\%$  as the margin of error. A further study by Ogunba (2004) expanded the scope of his earlier study to cover six states in the South-Western region of Nigeria and established a margin of error of  $\pm 10\%$ . A more recent study by Ogunba and Iroham (2010) tried to establish an acceptable margin of error captured the perception of the accredited banks in Nigeria as well as the opinion of the valuers. Their study demonstrated that the acceptable margin of error as suggested by valuers falls in the region of 11.1% and the client (banks) accepted 13.16%. A more recent study by Adegoke, Olaleye and Oloyede (2011) maintain a different position to what Ogunba and Iroham (2010) suggested and recommended to the Nigerian Institution of Estate Surveyors and Valuers to adopt so as to checkmate negligence in valuation. Adegoke et al. (2011), captured the perception of broader category of lending institutions who are valuers' clients on their permissible margin of valuation error. They reported that majority of the financial institutions did not agree with the literature establishing 10% as the acceptable margin of error. They found that majority of the financial institutions (53.33%) accepted 5% as their region to which a competent valuation should fall within. However, Adegoke et al. (2011) did not take into cognizance that the reported 10% margin of error in the literature depends on the nature and complexity of the valuation assignment or as deemed fit by the court premised by the expert witness evidence. All the early studies on valuation accuracy and variance were carried out in Lagos metropolis and subsequently Ogunba and Iroham (2010)

expanded the scope to include major urban centres in South-West which is not significantly different from the metropolitan Lagos in behavioral characterization of the valuers. This study extended the geographical coverage of valuation accuracy and variance study in Nigeria by capturing data from estate surveyors and valuers both in the Southern and Northern parts of the country, including FCT Abuja in order to ensure a balanced study, result of which could be of wider applicability across Nigeria.

### Research Method

The study is a basic survey research by design which is a fact-finding research that explores a phenomenon. The populations of the study include estate surveyors and valuers in private practice and banks who are their clients. The study area covers five cities in Nigeria namely: Lagos, Abuja; Kano, Jos and Bauchi. Earlier studies on valuation accuracy and variance-related issues in Nigeria by Ogunba (1997); Ogunba and Ajayi (1998), Babawale (2008); Ogunba and Iroham (2010); and also Ajibola (2010) were based on metropolitan Lagos and generalized. Akinyemi (2009) warned that generalizing findings for a city like Lagos has the propensity of glossing over regional peculiarities which could be vital for optimum decision. It is against the foregoing caution that this study expanded the geographical scope, choosing Lagos which has 53.3% of the registered Estate Surveyors and Valuers firms in the country (Babawale, 2008), to represent the bulk of the Estate Surveying and Valuation practice in the South; Kano which is the commercial capital of the North to stand in for North-West; Bauchi to cover North-East; Jos city the capital of Plateau State to represent

North-Central; and Abuja the Federal Capital Territory of Nigeria. According to NIESV Directory (2009), the sample frame of the Estate Surveying and Valuation firm in the study areas is 325. However, a more recent survey revealed that the sample frame in the study area is 628 (Dugeri, 2011). To cover the study areas effectively, 345 simple structured questionnaires were administered to capture the response of Estate Surveyors and Valuers; 300 were found useful for the study constituting 47.77% of the sample frame and about 87% of the response rate in the study area which is in line with Nwana's (1981) recommendation of 40% for a population of few hundreds. The questionnaire item elicited opinion of values as against sale prices; level of valuers' awareness of margin of error; valuers' opinion of permissible margin of error etc. The study also relied on secondary data from previous research on clients' margin of error as the banks have a common lending policy across their branches in the country. The data was analyzed and presented using frequency tables and simple percentages.

### Results and Discussion

*Table 1: Valuers' level of awareness of margin of error (bracket)*

Level of Awareness	Frequency	Percentage
Well Informed	35	11.67
Informed	160	53.33
Indifferent	25	8.33
Not Informed	80	26.67
Total	300	100

**Table 2:** *Valuers' opinion of values equating to sale prices*

Opinion	Frequency	Percentage
Strongly Agreed	6	2
Agreed	120	40
Indifferent	80	26.67
Disagreed	60	20
Strongly Disagreed	34	11.33
Total	300	100

**Table 3:** *Valuers Acceptable Margin of Error*

Margin of Error	Frequency	Percentage
0-5	60	20.0
6-10	170	56.7
11-15	20	6.7
16-20	50	16.6
Total	300	100

**Table 4:** *Valuations Within 10% Margin of Error by Valuers*

Valuation attribute	Frequency	Percentage
Always (100% of the time)	0	0.00
Most times (75% of the time)	160	53.33
Some times (50% of the time)	90	30.00
Rarely (25% of the time)	32	10.67
Never	18	6.00
Total	300	100

It is evident in table 1 that valuers are aware of margin of error principle, with 65% of the

valuers with varying degree of awareness. However, 26.67% of the valuers indicated that they are not aware of the operation of the margin of error principle. Table 2 indicates that 40% of the valuers agreed that valuation is a good predictor of market prices, whereas, 20% disagreed that valuations do not equate sale prices. It is also observed that 20% of the valuers strongly affirmed that valuations equate sale prices as opposed to 11.33% who frowned at valuation as a good predictor of sale prices. The result in table 3 reveals that majority of the valuers (57.7%) accepted  $\pm 10\%$  as the permissible margin of error within which a competent valuation should fall; 20% indicated a margin of  $\pm 5\%$ ; 6.7% settled for  $\pm 15\%$ ; while  $\pm 16.6\%$  allowed for  $\pm 20\%$  margin of error. This result concurs with Crosby et al. (1998b) showing none of the valuers accepted margin of error to be above 20%. The result also shows that valuations do not always fall within 10% margin of error as revealed in table 4. The extent to which valuations fall within 10% bracket was measured and 53.33% of respondents indicated that most times it falls within the region of 10% bracket; 30% suggested that it is sometimes within 10% bracket; 10.67% opined that 10% margin of error can be rarely achieved; whereas, 6% never fall within the 10% bracket as presented in table 4.

Adegoke et al. (2011) in table 5 captured the perception of 45 lending institution of mortgage valuation with a view to establishing their perception of permissible merging of error among lenders. They reported that lenders were not satisfied with the position of the literature establishing  $\pm 10\%$  as margin of error as the majority of the lending institutions (53.33%) choose margin of error of  $\pm 5\%$ . While Ogunba and Iroham (2010) clearly showed mean



margin of error of 13.16 from valuation of other firms and a standard deviation of 2.27. This implies clients' margin of error is 11.1% with standard deviation of 2.05, thereby establishing 13.16% as margin of error required by the bank.

Table 3 shows the valuers' acceptable margin of error as established by the study's empirical findings. The mean margin of error is  $\pm 10.01\%$  and the mode is  $\pm 10\%$ . The range of the margin of error is  $\pm 15\%$ . This is consistent with the recommendation of the court in UK in *Singer & Friedlander Ltd. V John D Wood* [1977] 2 EGLR 84, the court allowed  $\pm 10\%$  margin of error extending up to  $\pm 15\%$ .

Reconciling our empirical result of acceptable margin of error with previous studies, Hager and Lord (1985) reported  $\pm 5\%$ , Baum and Crosby (1985) suggested  $\pm 15\%$ ; in Australia, Parker (1988) captured valuers and investors popular opinion which favoured between  $\pm 5\%$  and  $\pm 10\%$ ; Ogunba and Ajayi (1998) established  $\pm 5\%$ ; Ogunba (2004) later upgraded to  $\pm 10\%$ ; Ogunba and Iroham (2010) reported  $\pm 11.15\%$  and  $\pm 13.16\%$  between valuers and clients while Adegoke et al (2011) reported  $\pm 5\%$  among clients. From court precedence and academic literature, this paper postulates that an acceptable "margin of error" (bracket) of  $\pm 5$  and  $\pm 10\%$  for simple structures is reasonable while  $\pm 15\%$  for complex structure with unusual features is realistic outside which a valuer is considered incompetent. Culson J reviewed the case law on the appropriate margin of error and found that, as a matter of general principle, the position to be taken from the authorities was thus:

- i. For a standard residential property, the margin of error may be as low as  $\pm 5\%$
- ii. For a valuation of one-off property, the margin of error will usually be  $\pm 10\%$

- iii. If there are exceptional features of the property in question, the margin of error could be  $\pm 15\%$ , or even higher in an appropriate case.

Watkins J. concluded in *Singer & Friedlander* that "any valuation that falls outside the permissible margin of error brings into question the competence of the valuer and the sort of care he gave to the task in valuation".

## Conclusion

Property valuation precludes 100% accuracy. This stemmed from fundamental principles in valuation studies that the term value has no exact definition. It follows that valuation is an opinion, an art which involves intuitional judgment and not an exact science. However, this is no license for valuers to carry out valuation without the requisite expertise and competence as their opinion of value is a basis for several investment decisions (especially in commercial lending), for which reason a permissible margin of valuation error should be established outside which a valuer is considered incompetent and thereafter liable for negligence in tort. This paper extends the debate on margin of valuation error in valuation practice in Nigeria by extending the geographical coverage of the study beyond the study area covered by previous studies. The study revealed that most valuers (56.7%) favoured  $\pm 10\%$  margin of error while there is no consensus to what clients consider appropriate as acceptable margin of error. It was found from previous studies that clients considered  $\pm 13\%$  as acceptable margin of error while a more recent survey revealed clients perception to be  $\pm 5\%$ . This study shows a slight difference in valuers' perception of margin of valuation error from previous

studies, probably due to its wide geographical coverage. Over the years, a handful of valuers indulge in fraudulent practice, bloating valuation figures in consideration for fees. It is stating the obvious to say that the sophistication on the part of valuation clients and dwindling financial sector of the economy, demand standardization of practice along national and international boundaries. This paper will serve as a clarion call to the appropriate authorities regulating professional practice of Estate surveyors and Valuers- in Nigerian context, The Nigerian Institution of Estate Surveyors and Valuers, and The Estate Surveyors and Valuers Registration Board of Nigeria to tighten standards by applying the margin of error principle in establishing professional negligence. The institution should support research and embark on enlightenment campaign as reasonable numbers of practicing valuers are not aware of the operation of margin of error principle. This paper will maintain that, considering the volatile nature of Nigeria's property market and the absence of established data bank a margin of error of between  $\pm 5\%$  and  $\pm 15\%$  should be allowed depending on the complexities of the property in question, outside which a valuer is considered incompetent.

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