VALUATION VARIANCE OF COMMERCIAL PROPERTIES IN MALAYSIA

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ABSTRACT

This paper investigates the variance in terms of mean difference in valuation of commercial properties between Government Valuers and Private Valuers in terms of Insurance cases and between Declared values and Department's valuations in terms of Stamp Duty cases. The data consists of valuations of commercial properties (shop houses and shop offices). The findings showed that there is no significant difference between the Government Valuers' valuations and the Private Valuers's valuations for Insurance purpose, and also between the Department's valuation and Transaction Price for Stamp Duty purpose. The estimated range of variance for Insurance is between -1.53% and 4.82% and for Stamp Duty is between -3.1% and 2.93%. Seventy five percent of the differences in Insurance valuations is less than 10 per cent. As for stamp duty data, sixty nine percent of the difference is less than 10 per cent. It is also found tha, there is no valuation bias, but normal random differences from the mean value in both cases.

Keywords: Valuation variance, government and private valuers, insurance, stamp duty, Malaysia

INTRODUCTION

The topics on valuation variation and valuation accuracy have been debated extensively by academicians throughout United Kingdom, Australia and the United States since the mid 1980s. Since Hager & Lord (1985) first published a paper on the subject of valuation accuracy, many have debated the outcome of the paper and the methodology employed, more so as it had implications for the professionalism of the practitioners in the field.

Most of the studies can be divided into the two main topics, i.e., valuation variation which deals with the difference between valuation by one valuer and another on the same property, and valuation accuracy which deals with the difference between a prior independent valuation and transaction price on a property. This paper will concentrate on

valuation variation between Government and Private Valuers values/transacted price in terms of the mean difference between the two sets of valuations.

OBJECTIVES

There are three main objectives of this paper. First, is to observe whether there are any difference between valuations by Government Valuers and valuations by Private Valuers on a same property in the case of Insurance data, and between Transacted Price and Department valuations in the case of Stamp Duty data. Next, is to determine the range of difference, and finally, to observe the positive or negative biases in the valuation data. Valuation bias in this context means that there exist a systematically and consistently lower or higher valuation compared to the other set of values.

LITERATURE REVIEW

Previous studies on the subject of valuation variation produced mixed results. Whilst one study found that the valuation of one firm is a good proxy for each other, others found that the extent of valuation variation could be significant.

Brown (1985) analysed valuations of 26 properties valued from 1981-1984 to test whether there exists valuation bias between valuations by the different firms. By regressing the valuation data onto one another, which produced an R-squared of 0.98 (for valuations in 1981 – 1983) and 0.99 (for valuations in 1984), he concluded that there is no bias in the valuations and one firm's valuations are good proxy for another.

On the other hand, studies by Hager & Lord (1985), Hutchison *et al.* (1996), Brown *et al.* (1996) and Crosby and Murdoch (1997) found that there is a large extent of valuation variation. Hager & Lord (1985) analyzed data on valuations of two commercial properties (office and shop) in the United Kingdom by 10 valuers. A simple tabulation of the difference in values between the valuers showed that the extent of valuation is beyond the ± 5% mark originally perceived. The office values differ as much as 24% (values range from £780,000 and £630,000), whilst the shop values differ as much as 45% (values range from £450,000 and £655,000).

Similar to the approach undertaken by Hager & Lord (1985), Hutchison *et al.* (1996) analysed 446 valuations of retail, office and industrial properties in fourteen main centers throughout the UK. The results showed that 80 percent of all valuations for rack rented interest and 90 percent valuations for the reversionary investments produced a variation of less than 20 per cent from the mean capital value, which is far in excess of the contention that valuers can value within 5-10 per cent of market value.

Using a technique called bootstrapping, Brown *et al.(*1998) analysed data taken from the IPD Annual Index from 1980 to 1995 of the performance of a typical commercial property held by UK institutional funds for uncertainty in valuations (uncertainty in valuations means the difference between the valuations from the mean value), and found that the uncertainty in valuations is much higher than anticipated; i.e. only 1 chance in 10 that valuations will lie within 5% of the mean valuation and increases to 1 chance in 5 that valuations will lie within 10% of the mean valuation. This is against the belief that valuers should be able to value within a range of 5 – 10% of the mean value.

Later, Crosby and Murdoch (1997) did a study on valuation variation on valuations of eight portfolios. Two independent valuations were obtained for the commercial investment valuations, which include a retail, office and industrial property by one firm (firm A) and the others by four other firms. The valuation by the firm A is used as the base valuation. The findings showed that the average variation is 8.7% where 68 per cent of the valuations have differences of less than 10%, and 90 per cent of the valuations have differences of less than 20% from the base valuations.

Further to the above findings, from the questionnaire survey, showed that, within the courts, expert witness valuations deviated by an average of +22 per cent to -22 per cent across a range of residential and commercial property valuations and at the same time, the respondents admit that the acceptable variation for expert witness should be less that +/- 20 percent.

As for the range of acceptable variance, Crosby (2000) noted that the UK courts appear to accept a level of between 10 -15 per cent either side of a notional correct value as the normal margin of error or bracket, whilst groups of valuers at several seminars in the UK accept a bracket of +- 10 percent as acceptable parameters. The IPD/Drivers Jonas (2003) study on variance in valuation which looked into the spread of variation between actual sale price and preceding valuation found that around 65% of valuations are within +-10% of agreed price.

METHODOLOGY

The methodology involved analyzing valuation data in Malaysia collected from the Valuation and Property Services Department (VSPD). These valuations are for Insurance and Stamp Duty Purposes.

VPSD is a government agency under the Ministry of Finance. Its main function is to provide valuation and property services to the government, as a centre for property information and to provide training and research in valuation. The Board of Valuers, Appraisers and Estate Agents (BOVEA), set up under the purview of the Ministry of Finance, regulate the Professional conduct and ethics of valuers as well as setting standards for professional practice. The Director General of VSPD sits as chairman for the board. The valuation profession is represented by the Property Consultancy Valuation Surveying Division in the Institution Surveyors Malaysia, i.e. the professional institution representing the surveying profession in Malaysia.

Insurance cases

These are valuations of investment properties belonging to licensed insurers referred to by Bank Negara to the VPSD for verification. This is in relation to Section 44, Part IV of the Insurance Act 1996 (Act 553) pertaining to the valuation of assets and determination of liabilities of a licensed insurer.

Part VI of the Insurance Regulations 1996 (P.U.(A) 653), which deals with the Valuation of Assets, states that the licensed insurer is required to revalue its investment property once every 3 years or earlier if its market value depreciates by more than 10 per cent. Further, in a guideline to licensed insurers, it is also stated that they need to submit a revaluation involving transactions of investment properties between related companies to Bank Negara. This is to ensure that the transacted price is at arm's length.

Investment property, as defined by section 6 part VI of the Insurance Regulations 1996, means:-

i) an immovable property forming part of the assets of a life insurance fund;
ii) an immovable property forming part of the assets of a general insurance fund or a licensed local insurer's shareholder fund or a licensed foreign insurer's working fund , which is not a self-occupied property (immovable property of which more than 50 per cent of its floor area is occupied by the licensed insurer).

Information on Insurance data cases are retrieved from files kept at the VPSD Head Quarters. The files consist of valuations of insurance cases with dates of valuations from 1999 to 2005 (at the date of data collection). Information on these cases can be obtained from each individual file opened for each property to be valued (assuming that each property is held under one land title).

As at June 2005, there are approximately 300 files of insurance cases at Headquarters. Although the cases involved a broad spectrum of properties, i.e. retail unit, commercial, purpose built office, industrial, agricultural and residential properties, only 2 – 4 storey shop house/ shop offices were selected for this study, as these types of properties are the most common type being valued for insurance purpose.

From a population of 300 files of insurance cases, a total of 100 sample files were picked at random from the shelves for data collection, out of which, 51 files were 2 – 4 storey shop house/shop offices. Information about the valuations of the 51 commercial properties (shop houses and shop offices) was then analyzed for this study.

Unlike Hutchinson et al (1996) where the valuers are pre-selected to do the valuation at no cost, valuers doing the valuation in this survey are those appointed and paid to do so by the insurance companies. These valuations which were submitted to the Valuation and Property Services Department are then revalued by valuers in the government sector. The valuations which were valued by the private valuers and valuations by the government valuers are then analysed.

Stamp duty cases

Transacted properties are subject to stamp duty. The assessment and collection of stamp duties is provided in the Stamp Act 1949. The Valuation and Property Services Department is responsible to determine the fair market value of properties transacted.

The Valuation and Property Services Department functions for stamp duty purposes under authority from the Collector of Stamp Duty as provided for under section 3A (4) which reads "for the purpose of ascertaining the market value of any property, the collector may in writing authorize any valuer employed by the Government whether he be a public officer or a person privately practicing as a Valuer, to exercise any of the powers conferred upon the Collector by this section".

Data of transacted properties or known as stamp duty cases for this study were obtained from the VSPD branch office in Kuala Lumpur. These data were downloaded from the Valuation Information System (VIS), i.e. the Departments computerized valuation system. The VIS compiles statistics of valuation cases done in each branch office in the country since 1998.

Since, commercial properties of 2 – 4 storey height were selected for the insurance cases, the same property type were selected for the stamp duty cases so as to have a similarity. Only data from the Kuala Lumpur office branch were analysed, as there are sufficient sample of data of the selected group of property to be found in this branch office.

A total of 13,568 cases of stamp duty cases were recorded in the Kuala Lumpur office in 2003, out of which 1,767 cases or 13% are commercial properties. Residential properties contributed about 82% of the total transactions and the rest are industrial and development land.

The commercial properties consist of various commercial types. Only those in the shop/house/office category were selected. A total of 900 data comes under this category.

Further filtering was done to eliminate unreliable and unsuitable data as below:

i. only those with valuation dates from 1.1.1994 were selected
ii. cases with no declared values(transaction price) were eliminated
iii. only full share valuation are considered

Finally, a total of 194 data were selected for analysis.

For the stamp duty cases, variant are based on the difference between the declared value (transaction price) and the valuation by the Department (Government Valuers value).

ANALYSIS OF RESULTS

Fifty one transactions of Insurance cases and one hundred and ninety four transactions of Stamp Duty cases sourced from the Valuation and Property Services Department were analysed. Table 1 shows the characteristics of the sample data.

Table 1: Details of Sample Data

	Insurance	Stamp Duty
Number of Transactions	51	194
Type of Properties	2-4 storey shophouse/shopoffices (consists of mid and corner units and some with basements)	2-5 storey shophouse/shopoffices (consists of mid and corner units and some with basements)
Location	Various towns in Malaysia (inclusive Sabah and Sarawak)	Located in Kuala Lumpur Federal Territory
Land Area	Between 93 sm - 330 sm	Between 90 sm - 350 sm
Building Area	Between 206 sm - 1360 sm	Between 200 sm - 1500 sm
Range of Values	Between RM280,000 – RM6,100,000	Between RM200,000 – RM5,500,000
Valuation Date	Between 30 June 1999 – 30 June 2005	Between 1 Jan 1994 – 31 Dec 2003

A test of normality for the difference between Private Valuer's valuation and Government Valuer's valuation is carried out for Insurance Purpose and the difference between Transaction Price and Government Valuers Value for Stamp Duty purposes is carried out.

The results are as follows:

Purpose	K-S Statistic	P- Value	Conclusion
Insurance	1.041	0.229	Normal
Stamp Duty	0.329	<0.001	Not Normal

Since the data for Insurance is normally distributed, a parametric one-sample t-test is carried out, whilst the data for Stamp Duty is not normally distributed, so a non-parametric paired samples test is carried out.

Insurance purpose results

Table 2: Descriptive Statistics of Sample and Test of Difference Between Private Valuers valuation and Government Valuers valuation.

No. of Samples	51 cases
Range of Difference	-32.84% to 37.57%
Below GV	20 cases
Above GV	27 cases
Same as GV	4 cases
Within 10% difference	38 cases (75%)
Within 15% difference	45 cases (88.23%)
Within 20% difference	48 cases (94%)
Mean difference	19,444.77
t-statistic	1.602
p-value	.115

GV= Government Valuer

As the calculated *p*-value (0.115) is greater than .05, the test suggests that the mean value is not significant different from 0% (at 95% significant level). In other words, there is no difference between the government valuation and the private valuers valuation.

The estimated range of variance is between -1.53 and 4.82%. The Private Valuer's valuation differs between 1.53% lower and 4.82% higher than the Government Valuer's valuation. However, results of the mean absolute difference for the estimated range of variance between the Private Valuer's valuation and Government Valuer's valuation is between 4.77% and 9.7%.

As for valuation bias, it is found that:

- 27 out of 51 valuations are valued higher than the government valuations
- 20 out of 51 valuations are valued lower than the government valuations
- 4 out 51 valuations have no absolute difference

Therefore, it can be concluded that there is no systematic bias in the private valuers valuations.

Stamp Duty Purpose results

Table 3: Descriptive Statistics of Sample and Test of Difference Between Declared Value and Valuation By Department

No. of Samples	194 cases
Range of Difference	-91% to 95%
Below Dept.'s Valuation	77 cases
Above Dept.'s Valuation	58 cases
Same as Dept.'s Valuation	59 cases
Within 10% difference	134 cases (69%)
Within 15% difference	153 cases (78.9%)
Within 20% difference	165 cases (85.1%)
Mean difference	13,627
t-statistic	-.856
p-value	.392

As the calculated *p*-value (0.392) is greater than .05, the test suggests that the mean value of the difference between the Transaction Price and Valuation By Department is not significant different from 0% (at 95% significant level). There is no difference between the transacted price and the valuation by the department.

The estimated range of variance is between -3.1% and 2.93% . The transaction price differs between -3.1% lower and 2.93% higher than the Department's valuations. However, results of the mean absolute difference for the estimated range of variance between the transacted price and Department's valuation is between 8.17% and 13.4%.

As for valuation bias, it is found that:

- 77 out of 194 declared values are higher than the Department's valuations
- 58 out of 194 declared values are lower than the Department's valuations
- 59 out 194 declared values have no absolute difference

Therefore, it can be concluded that there is no systematic bias.

CONCLUSION

The results of this study shows that there is no significant different between the valuations by the government valuers and the private valuers for the Insurance cases and between the transaction price and the Department's valuation for the Stamp Duty cases. This is highly likely due to the following reasons:

i) in both cases, the valuations by the private valuers and the transacted price are known by the government valuers
ii) there is no tax implications on valuation for Insurance and for stamp duty cases, although there are tax implications, these transactions are at arm's length
iii) the department's policy to report the private valuers' valuations/ transaction price within a 10% difference might contribute to the fact that 75% of the differences are within the 10% range for the Insurance cases and 69% of the differences are within the 10% range for the Stamp duty cases.

Therefore, it can be concluded that there the extent of variation amongst Malaysian valuers in these category of commercial properties is insignificant. There may be some extreme values, but most of the values tend to differ at less than 10%.

Since the results for this study show that the variant is mostly within the 10% of both sides, it corresponds with the findings of the UK research where the acceptable parameter is within the 10% bracket.

However, a valuation variance study for other purposes of valuations, are likely to produce different results. Valuation for land acquisition cases; for example, difference between Government valuers valuation and Private valuers valuation for compensation for land acquired for purposes allowed under the Land Acquisition Act 1960[Act 486], are most likely to be significantly different, which is currently evidenced by the increasing number of cases going to court for settlement.

This study is merely looking into valuation variance for two purposes of valuations and the results are not so comprehensive to conclude that the extent of valuation variance in Malaysia is insignificant. Further studies should be undertaken to incorporate all purpose of valuations, which would hopefully yield a detailed result.

There is also no systematic bias in the valuations, in the sense that valuations by the department are sometimes lower and higher than the private valuers/ transacted price.

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