Client Pressure in Residential Valuations – Evidence from Singapore

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Abstract

In an increasingly competitive market, valuers have been known to succumb to client pressure in order to maintain their market share. This paper examines the empirical evidence of this phenomenon in the Singapore residential market. A sample survey of valuers was conducted to ascertain their views and experience with regards to client pressure, the source of such pressure, and the types of threats or coercions used by clients. A behavioural experiment was also included for the respondents to role-play the decision of a valuer under pressure from clients. The incorporation of two non-valuation factors allows a test on the significance of these factors and their interaction effects on the decisions of the respondents. The results of the logistic regression model indicated that the decisions of valuers on whether to alter appraised values upon clients' requests are not affected by the amount of pressure perceived or the risk of being subject to disciplinary actions by the regulatory institutions.

Key words: valuation, client pressure, competition

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Introduction

The valuation profession in Singapore is structured along similar lines as those in the UK, US and Australasia. Valuations are usually performed by valuers who are employed by real estate consultancy firms, which generally provide the entire range of real estate services, including valuation, property management, agency and marketing, and investment counseling. There are currently some 60 real estate consultancy firms, of which about three quarters provide valuation services. Besides the valuers employed in these private-sector real estate firms, there are also valuers working for financial institutions, developers and other organizations with real estate related businesses. There are also valuers employed by the government and other public-sector bodies such as the Housing and Development Board, which is responsible for the provision of public housing, and the Jurong Town Corporation, which is the largest industrial landlord in Singapore. As at 2001, there were about 500 licensed valuers in Singapore [1]. Under the Appraisers and House Agents Act 2000 Cap 16 (formerly the Auctioneers' Licenses Act 1906), valuers who wish to practice, i.e. provide valuation services, are required to obtain a license from the Inland Revenue Authority of Singapore (IRAS), while those who are employed in the other organizations and in the public sector are not required to have one. One of the requirements for licensing is membership of the professional body, the Singapore Institute of Surveyors and Valuers (SISV).

This study focuses on valuers who provide valuation services to clients. The range of such valuation services is wide: covering statutory valuations, which are governed by statutes and legislation, to non-statutory valuations, which include all the different types of properties for various purposes. Of the latter, the majority of valuation assignments received by the private-sector valuers are that of residential properties for mortgage loan consideration (Gelbtuch and Mackmin, 1997). Given that this forms the bulk of private-sector valuation work, it is natural that competition amongst valuation firms for established clients, particularly, the financial institutions or lenders, is very keen. To this end, there has been increasing anecdotal evidence of valuers succumbing to client pressure in order to retain their clients.

This study aims to survey the real estate consultancy firms providing valuation services to identify and measure the impact of client pressure on the valuation of residential properties for mortgage loan purposes. It seeks to determine whether valuers perceive that pressure from client is evident, and if so, the impact of such pressure.

Literature Review

Increasing competition is a phenomenon that is experienced in every kind of business and industry, including valuation. In open economies, profitability will attract new entrants

[1] Source: Inland Revenue Authority of Singapore, the licensing Authority for appraisers and house agents.

and thereby reducing the share of business of the original players. Similarly, the provision of valuation services has witnessed increasing competition in Singapore over the years. Complaints of valuers undercutting fees to compete are common. Rumours of valuation firms allowing their clients, especially those who provide them with a substantial number of assignments annually, to state their own values abound on the grapevine. Such allegations of undercutting of fees and value "fixing" have undermined the professional reputation of valuers. While there is little concrete evidence of these complaints, a series of letters were published in the local newspaper alleging valuers were being controlled by developers in the valuation of residential properties for sale in 1994 (Straits Times, 1994). More recently, in November 2001, a letter to the Business Times was headlined "Scrap valuation of real estate". In both cases, a member of the public was unhappy with what he or she felt was the way valuers "pushed up" prices to satisfy their clients. These instances succeeded in reinforcing the notion that valuers are really not so independent and that they would succumb to some form of client pressure.

The real estate literature shows that similar problems are being experienced by valuers and appraisers in other countries. Amongst the earliest commentary on this problem James Graaskamp believed that users of appraisals were the major culprits of the demise of the appraisal industry (Fraser and Worzala, 1994). The lender can control appraisers by "shopping" to find an appraiser willing to provide the desired value, or threaten to withhold payment for a lowball appraisal. The lender can, as small appraisal firms fear, threaten to cut off future business if a value is not high enough to make a given loan. Smolen and Hambleton (1997) found that almost 80% of the respondent appraisers in their study agreed with the statement that "appraisers are sometimes pressured by clients to alter their values. Rushmore (1993) examines the ethical issues involved with performing appraisal services for hotels and points out that some lenders are more interested in inflated appraisals rather than those that are based on an unbiased, objective study. The pressures, exerted by the clients, on the appraisers can sometimes be subtle and indirect, while occasionally they can be obvious and abusive. Martin (1997) reports that the first situation which comes to mind for most appraisers, when they speak of ethics and ethical conduct in the property valuation profession, is rendering a value estimate that accommodates the desires of a specific individual instead of one that is impartial, objective an independent.

Besides the US, Levy and Shuck (1999) confirm the widely belief that valuations are indeed influenced by clients in their study through in-depth interviews with practicing valuers in New Zealand. Their study found that the primary factors affecting the degree to which clients influence valuations are, the type of client, the characteristics of valuers and valuation firms, the purpose of a valuation, the information endowments of clients and valuers. One important issue highlighted is the ethical dilemma faced by valuers as a result of relying on client-supplied information, which could be bias through omission, intentionally or otherwise.

The first use of an experimental behavioural methodology to study client pressure on appraisers was carried out on the commercial appraisal industry by Kinnard et al (1997). A behavioural experimental design was utilized to test whether client size or value adjustment size affects the likelihood that commercial appraisers agree to client-requested valuation adjustments. The findings indicate the presence of a significant amount of client pressure with 41% of the respondents stating that they would revise their value estimates when requested by their clients, even without supportive evidence. The size of the client, i.e. the importance of the client to the firm, is significant in affecting the valuation decisions of the respondent appraisers. Using a similar methodology, a study by the same authors was carried out on the residential appraisal industry (Worzala et al 1998). In this case, the results indicate that the respondents were not influenced by either the client size, the value adjustment requested, or the interaction of these two factors. However, over 95% of the respondents indicated that they had experienced client pressure.

Methodology

A sample survey was carried out to examine the extent to which clients of valuation firms apply pressure on appraisers to modify their appraised values. Valuers were selected randomly from the 47 firms registered with the SISV. The survey is made up of two parts to determine, firstly, the existence of client pressure and, secondly, the likely impact of client pressure. To determine whether client pressure exists, the survey queries the valuer's experience with client pressure, the sources of such pressure, the type of threats or coercion used by the clients, and whether they were aware of other valuers complying with and succumbing to clients' demands.

To determine the likely impact of client pressure on the appraisal, a similar behavioural experiment used by Worzala et al (1998) is employed. It takes the form of a scenario where respondents are asked to role-play the decision of an appraiser who is subject to an ethical dilemma. The valuer-client conflict arises when the valuer arrived at a value lower than what the client wants. Just before the deadline for the submission of the valuation, the client provides the valuer with new, additional market data from a competing appraisal firm. Incorporation of the unverified data would increase the value of the subject property. The valuer has tried but cannot verify the new information in the time remaining for the mandated delivery of the valuation report. The delivery deadline is firm and the valuer cannot delay in order to complete the verification of the new data. Respondent valuers are asked to decide whether they would accept or deny the client's request to modify the appraised values, i.e. to revise the report and incorporate the new data provided by the client or submit the report as it is.

Client pressure is measured by two factors: the amount of pressure and the risk that the valuer will be subject to disciplinary action. The amount of, or potential for, client pressure is considered to be directly proportionate to how much of the valuer's business or revenue the client provides. In this regard, client size, measured as a percentage of the appraisal firm's annual revenue, is used as a proxy for the amount of pressure that a valuer may perceive from the client. In this study, the size of client is categorized into small (clients who provide 5% or less of the revenue) and large (clients who provide 30% or more of the revenue).

The other factor is the risk that the appraisers will be subject to disciplinary action by the SISV if they were to violate their professional ethics. As the professional body regulating valuers, the Institute can take fraudulent valuers to task by suspending or terminating their membership and hence, the forfeiture of the license to practice as the licensing authority requires all licensed valuers to be members of the Institute. This risk element is proxied by the amount of value adjustment requested by the client, i.e. the greater the adjustment, the greater the risk. The amount of adjustment is categorized into small (5% or less) and large (15-20% of the valuer's initial value).

Using these two proxy measures, client pressure is analysed based on four different scenarios: a small client requesting a small adjustment; a large client requesting a small adjustment; a small client requesting a large adjustment; and, a large client requesting a large adjustment.

Table 1: Scenarios Combining Size of Client and Amount of Adjustment

		Size of Client	
		Small	Large
Amount of Adjustment	Small	Case 1	Case 2
	Large	Case 3	Case 4

The four scenarios were randomly but equally divided amongst the sample. Each appraiser received only one scenario to eliminate the possibility of the identification of the manipulation of the variables.

A logistic regression model is used to test whether client size, amount of adjustment or the interaction of these two variables is associated with the valuer's decision to revise the appraisal or not. The statistical model to be tested is as follows:

$$P_i = b_0 + b_1(X_1) + b_2(X_2) + b_3(X_1X_2) + \text{error term}$$

Where,

P_i = dependent variable for appraiser i where, 0 = appraiser chooses to leave the report as it is and 1 = appraiser chooses to revise the report

X_1 = independent variable representing the client size where, 0 = small, 1= large

X_2= independent variable representing the size of adjustment where, 0 = small, 1= large

X_1X_2 = interaction of the two factors, client size and the size of adjustment

Findings

Of the 47 selected valuers from all the firms registered with SISV, 34 responded, giving a response rate of 72%. Amongst the respondents were principals and partners of the firms, directors and managers of the valuation department and valuation officers. The majority of them have more than 5 years experience, of which 15% have more than 15 years of experience. In terms of the size of the firm, most of them (56%) are with firms with less than 5 valuers. Only 12% of the respondents have more than 10 valuers in their firms.

The survey findings are reported under four main headings: experience with client pressure, sources of client pressure; type of client threats or coercion; and, awareness of other valuers complying with and succumbing to clients' demands.

Experience with Client Pressure

The respondents were asked to agree or disagree with the statement that "valuers are sometimes pressured by clients to modify their appraisal values". Of the 34 respondents, only two said that they disagree with the statement. An overwhelming 29 of them, or 85%, agreed with the statement, while three were neutral. This reflects the kind of environment in which valuation, like other forms of services, is being conducted. Even though most of the clients, especially the financial institutions, are fully aware of the regulatory rules of the profession, yet they pay scant attention to them. It also reinforces the competitiveness of the market place.

The second question sought respondents' view on the level of client pressure they had experienced over the years. The large majority thought that it had been more or less the same over the years. This somehow contradicts the notion that with increasing competition, valuers would experience greater pressure from clients. Perhaps such a problem has been around for some time and when the economic climate heats up, the problem would surface and the signal got louder.

The third question is more forceful in asking whether the respondents had experienced clients insisting them to modify their estimate in the past year. Corroborating the answers to the first question, a large majority of 76% replied in the affirmative. Client pressure therefore seems to exist in the appraisal industry and, indeed, quite pervasive, based on the experience of the respondents.

Sources of Client Pressure

Respondents were asked to identify client groups, which are most likely to exert pressure, such as modifying the appraised value. A total of seven categories were provided: banks, developers, finance companies, Housing and Development Board (HDB), insurance companies, private individuals and others. The HDB acts as a client for public housing flats, which are sold on the secondary market and which require a market valuation for application of a housing loan from HDB. The percentage of respondents who identified these categories as a source of client pressure is given in Table 2.

Table 2: Sources of Client Pressure by Different Client Groups

CLIENT GROUP	**Frequency (% of response of 34 respondents)**
Private individuals	26 (76%)
Banks	18 (53%)
HDB	13 (38%)
Finance companies	8 (24%)
Developers	6 (18%)
Others (e.g. housing agents)	1 (3%)
Insurance companies	0

Except for private individuals, the three lending institutions, i.e. banks, HDB and finance companies, are amongst the main sources of client pressure according to the respondent valuers. For private individuals, the likely reasons for them asking valuers to modify the estimate are their ignorance of the professional regulations and their desire to obtain what they want. For the lending institutions, it clearly reflects a prevalent practice of asking for modifications as they see fit as against trusting the professional judgment of the valuers.

Type of Threat or Coercion

Two main types of threat were identified for the respondents: to reduce the number of future valuation assignments and to engage other firms to do the job. About one third of the respondents cited the presence of each of these two types of threat, while slightly more than half said that no threats were used. Clearly, the threats represent the economic power of the client over the service provider. They carry grave financial implications for the valuation firms because it would mean loss of potential fees and market share if the clients were to carry out the threats. While slightly more than half of the respondents claimed that they have not experienced actual threats, it does not mean that client pressure does not exist. Other forms of implicit remarks made by the clients, such as “we are very important to your firm as a whole”, were shared by some respondents during the survey.

Awareness of Other Valuers Complying with Clients’ Demands

The respondents were also asked whether they suspect some valuers in the industry who are complying with clients’ demands to modify their appraised value. Nearly all the respondents (85%) answered in the affirmative. This reflects the pervasiveness of the problem in the appraisal industry in Singapore.

Measurement of Client Pressure

The respondents were given a case scenario in which they were asked to role-play an appraiser who has to make a decision as to whether to modify the original estimate based on the client's request and additional information provided by the client. Seventy-nine percent of the respondents decided to turn their original report in without modification while the other 21% chose to revise their report and incorporate the new information. A few respondents provided additional comments: two chose to turn in the original report unless they were given more time to verify the data while another felt that the original report should be submitted with an addendum setting out a full statement of the unverified data and the circumstances, with the appraiser's opinion of the revised appraisal value if the new data is incorporated. The distribution of responses for the four different scenarios is given in Table 3.

Table 3: Frequency Distribution of Respondents by the Four Scenarios

		Size of Client	
		Small	Large
Amount of Adjustment	Small	Yes* = 1; No* = 7	Yes = 3; No = 7
	Large	Yes = 2; No = 6	Yes = 1; No = 7

* Yes = Revise report; No = Turn report in as it is

The responses are then run on a logistic regression model, which tests the significance of client size, size of adjustment and the interaction of the two variables in affecting the appraiser's decision of whether to revise the report as a result of the client's request. The results of the regression are presented in Table 4.

Table 4: Results of the Logistic Regression Model

	b	SE	Wald	Df	Sig	Exp (*b*)
X_1	1.099	1.272	0.745	1	0.388	3.000
X_2	0.847	1.345	0.397	1	0.529	2.333
X_1X_2	-1.946	1.852	1.104	1	0.293	0.143
Constant	-1.946	1.069	3.313	1	0.069	0.143

The results show that neither the size of the client nor the amount of adjustment is significant in affecting valuers in their decision to respond to the client's request to modify the original value estimate. The interaction of these two variables is also not significant in affecting the valuers' decision. The logistic regression test shows that while valuers claim that they have experienced pressure from client, their reaction is usually not to compromise their professional objectivity and independence, regardless of the size of the client or the amount of adjustment requested by the client.

Conclusion

This study examines the extent to which the issue of client pressure is prevalent in the Singapore valuation profession. The emphasis is on valuers who provide valuation services for residential mortgage loan purposes. The study seeks to determine whether clients of appraisal firms pressure the valuers to modify their value estimates in their reports. The likely impact of client pressure, as measured by the size of the client, i.e. the importance of the client to the appraisal firm in terms of the proportion of assignments it provides to the firm, as well as the amount of adjustment requested, is also explored.

Valuers are often placed in an ethical dilemma: to yield to clients' demands to modify their appraisal reports or to stick to the professional standards and code and stand by their original valuation. Although valuers are obligated to provide independent opinions of values, they are also inclined to satisfy the clients' interest in order to strengthen business relationships. Therefore client pressure can have an adverse effect on the objectivity of valuers, and in turn the reputation and image of the profession.

The survey findings revealed that 85% of the respondents agreed with the statement that valuers are sometimes pressured by clients to modify their valuations. The pressure is most likely to come from the groups of client comprising the lending institutions, including banks, finance companies and the HDB, besides private individuals, who probably out of ignorance of professional regulations, often asked valuers to modify their valuations. Although about half of the respondents could not cite any actual threats, about one third of them had experienced threats to reduce future assignments or engage their competitors. Apart from their own experiences, a large majority of 85% suspect that some valuers in the profession are yielding to clients' demands to modify their valuations.

In the analysis of the factors contributing to client pressure, four possible scenarios were equally distributed amongst the sample. The scenarios are based on a combination of small and large client and small and large adjustment. The results show that 79% of the respondents decided to turn in the original valuation report while the other 21% would revise the report. The logistic regression model, however, shows that neither client size nor the amount of adjustment has a significant effect on the decision of the valuer. The interaction of both variables is also not significant.

While valuers may not modify their valuations on account of the size of the client or the amount of adjustment requested, on the whole, the study has produced empirical evidence to suggest that client pressure does exist in the valuation of residential properties for mortgage loan purposes in Singapore. The following comments by one of the respondents aptly sum up the current situation: "It is something that is very much part of the job. Competition is such that nowadays banks will simply tell valuers that if they do not support their values, another firm will. Being very rigid and inflexible will only cause valuers to lose business. It is therefore a balance between keeping your clients and maintaining your professionalism." To this end, SISV as the regulatory body would need to ensure that rigorous enforcement of professional standards is maintained. At the same time, measures should be taken to educate the general public, particularly lending institutions, on the need for professional and independent valuations.

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January 2002

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