2018-09-25

The Nature of Property Valuation for Mortgage Lending Purpose in Case of Bahir Dar City

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JUNE, 2018

BAHIR DAR, ETHIOPIA

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A Thesis Submitted to the Department of Land and Real Property Valuation, Institute of Land Administration, Bahir Dar University in Partial Fulfillment of the Requirement for the Degree of Master of Science in Land Administration and Management

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June, 2018
Bahir Dar, Ethiopia

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Declaration

I, Tirsit Lesanework, have carried out independently a research work on the nature of property valuation for mortgage lending purpose in case of Bahir Dar city in partial fulfillment of the requirement of the Master of Science in Land Administration and Management specialized in Property Valuation, with the guidance and support of the research advisor. This study is therefore my own original work and it has not been submitted for any degree or diploma program in this or any other institutions.

Name: Tirsit Lesanework

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This work has been done under my supervision:

Name (Principal advisor): Belachew Yirsaw (PhD)

Signature: __ ____________________

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Acknowledgement

First of all, my limitless thank goes to the Almighty God, who has been helping me in all aspects of my life including the achievement of this masters program. Along with, I would like to express my sincere and deepest gratitude to my advisor and instructor Dr. Belachew Yirsaw for his unreserved assistance in giving me relevant comments and guidance throughout the study.

My grateful thanks also go to commercial bank of Ethiopia, Dashen Bank, Buna bank and Abyssinia bank employees and management for their positive cooperation in completing the research survey questionnaire, giving the relevant data, and some of whom have spared their valuable time for personal interview.

Finally, I would like to give special thanks to Ato Solomon Dargie for his continuous encouragement and unreserved support throughout my study.

Last but not least, my special thanks goes to my classmate and staffs who sacrificed a lot to support me in exerting unreserved effort and taking extra time in sharing my responsibility during my study.

Table of Contents

List of Tables and Figures

Acronyms

BoFED – Bureau of Finance and Economy Development

CBE - Commercial Bank of Ethiopia

CC - Civil Code

GAVP - Generally Accepted Valuation Principles

IVSC – International Valuation Standard Committee

RICS – Royal Institution of Surveyors

TIAVSC - The International Asset Valuation Standards Committee

ABSTRACT

Lending process is a center of concern for banks as well as the business world. In doing so, Property valuation represents one of the major building blocks of the mortgage system. However, absence of independent valuation organizations and lack of standardize valuation provision are the challenges to calculate the lending value of the property. In this paper, attempts are made to identify the valuation process and the loan characteristics that affect the mortgage lending value of property. A survey study research design of three private and one state Banks were employed in this paper. Field survey, Interviews and questionnaires were used to collect data for the study and the data is carefully analyzed by descriptive statistics .Accordingly, the findings of the study shows that lack of standardized valuation provision for lending purposes and absence of independent valuation organ that could be responsible in regulating and controlling the property valuation practice had high influence on the credit process of the banks.

Key words: Mortgage lending value, Loan policy, Valuation

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

The valuation of a particular interest in land is normally made by reference to its tenure, its use and type of property (Scarrett, 2008).In order to estimate the value of the properties by using those references, information holds the key to better decision making via more reliable analysis. Reliable information is the foundation for good decision making, but does not come easily. Information is based on an assimilation of data - things known or granted as a basis for inference. Therefore, accurate data provide both the foundations and the building blocks for good property valuation. Valuation refers the art, or science, of estimating the value for a specific purpose of a particular interest in a property at a particular moment in time, taking into account all the features of the property and also considering all the underlying economic factors of the market including the range of alternative investments (Millington, 2000).

Valuation of a property may be prepared by different methods. The appropriate application of a method of valuation depends on the nature of the property as well as availability of reliable data. When the value arrived at by different methods are wide apart and judgment cannot fix with reasonable certainty which out of them is close to the most accurate market value, an average of two or more than two methods of valuation is applicable (http://www.realestate appraisal.com [Retrieved on March 12, 2018].In carrying out any valuation assignment, the valuers are faced with a task of selecting the appropriate method to adopt in such assignment. Most valuers often adopt the cost method; some adopt the market comparison approach at the same time other valuers adopt the income approach of valuation (Babawale, 2007).

Valuation plays an important role in the determination of the value of properties either for mortgage, sale, purchase, rental, compensation, insurance, rating, etc. In Ethiopia, banks and mortgage institutions give out loans to real estate developers and investors. In doing so, they often require the services of an estate surveyor and valuers who will determine the value of the property of the borrower to advise them on how much money that will be advanced as loan to such real estate developers or investors. The property whose value is being determined is used as collateral for the loan. Property valuation represents one of the major building blocks of the mortgage system (Wyatt, 2007).

Mortgage is a transaction whereby a borrower, the mortgagor grants an interest in his property to a lender, the mortgagee as a security for the loan. The transaction is always effected by a mortgage deed in which the mortgagor agrees to pay interest on the loan at a given rate percent. The value of a property that used as collateral for the mortgager is called mortgage lending value, Mortgage lending value is essentially required to provide the mortgagee with accurate assessment of the market value of the property so as to relate it to the amount of loan being sought for. It also makes it possible for the mortgagor to know the worth of his security and thereby eliminates the possibility of the lender under assessing it (Olusegun, 2008).

Ethiopian law permits the creation of pledge of personal property. Most loans to business are secured by immovable property. Property mortgage is a means of verifying /securing the ability of mortgagor to return the mortgage loan at the appointed date. Therefore, as principle the basis for the valuation of real property for mortgage purpose is market value of the property. Thus, the open market value is an indication of the assumed best price or basis at which the sale might take place (Elekwachi, 1996). The value of a property may be range rather than spot or single value. But, banks prefer single figure of value estimate to be reported by valuators.

Besides collateral security can basis foreclosure and forced sale value estimated by most appraisers for mortgage purpose in banks. Foreclosure law has however been adopted recently and has modified some of the aforementioned matters as regards banking transactions (Proclamation No. 97/1998). According to Article 3 of this proclamation any agreement whereby the debtor allows the creditor bank to sell the mortgaged or pledged property by auction and transfer the ownership to the buyer is deemed valid notwithstanding (Articles 2851 and 3060 of the civil code). Furthermore this proclamation allows creditor banks to sell a mortgaged or pledged property by giving a notice of 30 days to the debtor. In such cases the sale is deemed to have been executed on behalf of the debtor (Menberestai, 2003).

In Ethiopia mortgage is emanates from contract and from the law or by other some persons in the favor of the debtor. A person may not secure his debt by mortgage unless entitled to dispose of the immovable for consideration. In order to create mortgage debt the property value should be determined in advance of the contract which in turn helps to determine the amount of loan (The 1960 Ethiopian civil code article 3049 (1&2)). Thus, the role of property valuation plays significantly in that it is required by financial institutions for mortgage through financing. In most cases banks and other financial institutions will use the value estimation from the registered valuers (Ogunba, 2007).However; there are no standardized valuation provisions to calculate mortgage lending value of immovable properties for mortgage purpose in Ethiopia. Even some Valuers have often over valued some properties being pledged as security for loans and advances. Therefore, this paper tries to examine the overall valuation process for mortgage lending purpose applied in commercial and private banks' of Bahir Dar city.

1.2. Statement of the Problem

A strong banking system is the backbone for economic growth as well as financial stability and development process of any country. In the case of Ethiopia, after the liberalization policy and transition to a market oriented economic policy, many private and commercial banks have been established and brought a remarkable economical and developmental effect in the country's growth. As the banking sector in Ethiopia is at its growing stage, it has been facing various challenges. One of the biggest challenges is faced in relation to absence of standardized valuation provisions that guide the lending process. In some banks the determination of loan value may have adverse impact on the financial performance of banks as well as the progress of the economy, and hence a matter of great concern for the Ethiopian financial system is crucial (Wyatt, 2007).

The value determined is dictated by a number of factors including legislative and principle based definitions. Even though there are many internationally accepted valuation provisions in Ethiopia, there are no standardized and coherent valuation provisions in relation to the lending process, which constrain property performance analysis and it adversely influences the credibility of the valuers and it also damages the confidence of the borrower in the lending process. The role of valuation for mortgage is, then, put at risk, as the lending institutions might be unable to recoup the delinquent loans from the mortgaged properties. Thus, this study mainly concentrated on the nature of property valuation and its role on the mortgage lending process of commercial and private banks in Bahir Dar city.

1.3. Objectives of the study

1.3.1 General Objectives

The general objective of the study is to examine the nature of property valuation for mortgage lending purpose in case of Bahir Dar city.

1.3.1 Specific Objectives

Specifically this study tries to:

- Assess the current basis to value the property for mortgage lending purpose.
- Analyze valuation provisions and loan polices currently used by the banks.
- Examine the type of properties used by the banks as collateral.

1.4 Research Questions

The study has tried to answer the following research questions:

- What are the bases to value the property for mortgage lending purpose?
- What are the valuation provisions used by the sample banks?
- What type of properties used as collateral?

1.5 Significance of the Study

This study will help financial institutions to take it as an input in identifying major problems related with loan process and analysis performance, which are more susceptive for mistake, errors, discrepancy and fraud. In addition, the outcome of the study will show the strength and weakness of the bank in applying loan policies and valuation procedures, which will in turn, enhance the service giving capacity of banks in efficient and effective way. Moreover, it is significant to the student researchers on indicating the overall activities of banks in lending practice. Finally the study will be used as a reference for further study.

1.6 Scope of the Study

Geographically, the research will be limited in the capital city of Amhara region, Bahir Dar, Ethiopia. Content wise, the study focused on the assessment of the nature of property valuation process for lending practice and its compliance with the need of borrowers as well as the market situation. Also it will try to assess the responsible independent organs to handle the valuation process. Further the study will see the potential means to handle credit risks of the banks.

1.7 Concept and Definition of Terms

Mortgage lending value: The value of the property as determined by the Valuers making a prudent assessment of the future marketability of the property by taking into account long-term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property (Sven and Wolfgang, 2007).

Creditors: Financial institution and financial intermediary that accepts deposits and channel those deposits into lending activities either directly by loaning or indirectly through capital market (http://en.m.wikipedia.org) [Retrieved on March 14, 2018].

Debtor/mortgagor: A **debtor** is an entity that owes a debt to another entity. The entity may be an individual, a firm, a government, a company or other legal person (Yirga, 2009).

1.8 Organizational Structure of the Study

The research paper is organized in such a way that the first chapter introduces the overall nature of the research and explained why the study is important. Chapter two dealt with related literature review on historical perspectives and definition of mortgage lending value; current basis and techniques used in financial institutions. Chapter three deals with method of the research, Chapter Four dealt with data analysis, interpretation and presentation. The last chapter summarized the major findings, conclusions and recommendations of the research paper.

CHAPTER TWO

2. Literature Review

2.1. Overview of Property Valuation

Properties in particular and real estate in general require specialized valuation technique since they constitute unique assets in the community of tradable assets. Real property constitutes an agglomeration of rights, fixtures, the land, building and other aesthetics that are sometimes unquantifiable. Therefore, valuation of real property is a function of the attached rights and the physical features (Adetiloye, 2013).Everything we do as individual or as groups of individuals in business or as members of society is influenced by the concept of value. Value, by itself, can be a subjective concept in that a property will have different values at any point in time according to the purpose for which it is being valued and the circumstances of the party for whom it is being valued (Blackledge, 2009b). A sound working knowledge of the principles and procedures of valuation is essential in all sorts of decisions relating to real estate buying, selling, financing, developing, managing, owning, leasing, trading, and in the ever-more-important matters involving income tax considerations (Pornchokchai, 2006).

Supply and demand within the property market as a whole and in specific submarket will be changing all the time and therefore a valuation is snapshot estimate of exchange price at a particular point in time. Because people tend to buy and use commercial property for a variety of utility and investment reasons, most decisions are made after an assessment of their financial implications. Similarly, while a property is held as a business resource or as an investment asset, its financial contribution will be monitored (Greal, 2001). According to Wyatt (2007) property valuation are financial estimates of the future net befit of purchasing an interest in property, suitably discounted over time to reflect opportunity cost and risk. Consequently, the economic concept of exchange price and opportunity cost are fundamental to property valuation theory.

As described by Hayward (2000) Valuation required for a variety of purpose of which mortgage is the overwhelming purpose. A lender who is offering a loan facility that is to be secured by property will invariably require a valuation of the property to ensure that it represents sufficient collateral. If a borrower defaults then the lender may wish to take possession of the property and sell it in order to realize its value and thus recover the debt. Recent debate in the valuation profession has focused on whether a loan security valuation should be to market value or whether some other basis that reflects the 'forced' sale of the property is more appropriate. A lender who is lending money for property development will clearly wish to be suitably reassured (with adequate allowance for the risk taken) as to the expected value of the completed development (Wyatt, 2001b).

Before a valuation can be undertaken the valuers must identify a particular basis of value. A basis of valuation is a description or definition of a value of an interest in property within a given set of parameters (RICS, 2003).Assumptions may need to be added to the basis when estimating the market value of certain types of property; specialized trading properties were mentioned earlier and these are designed or adapted for specific uses and they often transfer as part of an operational business. There are other bases of value that are used in specific circumstances. These include going concern value, which is the value of the business as a whole and can only apply to a property that is a constituent part of a business (EMF, 2009).

According to Allen (2008), Valuation basis are considered as a very important determinant of mortgage value. The term foreclosure refers to the process of seizing control of the collateral for a loan and using the proceeds from the sale to satisfy a defaulted debt. When a borrower fails to make payment or default on other terms of default on other terms of mortgage, the mortgagee's first option is to do nothing but hopping that the default will be cured in the near future and no further problem with the loan will occur. It is customary for lenders to send a defaulting borrower a rather stern letters, warning the mortgagor to cure the default immediately of the property will be foreclosed. The mortgage will obtain his judgment decree from court at the conclusion of the process. This decree is field with the court and order for direct sale is given at a public auction, this notice of foreclosure sale is made known to defendant and published in newspapers.

Market value, being a basis that corresponds to the concept of value-in-exchange, is the most common but others exist. "Market value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after property marketing wherein the parties had each acted knowledgeably, prudently and without compulsion"(Lovell, 1995).

According to Ajayi (1995), with the mortgage lending value, the main focus is on sustainability. The concept of the mortgage lending value takes into consideration the long-term nature of the property loan. The mortgage lending value is represents the value which throughout the entire life of the loan can probably be achieved for a property that is sold on the free market irrespective of temporary value fluctuations in the respective property market.

As described by Storck (2006) bank valuation serves as an internal regulatory tool for lender that reflect what reasonable amount can be recovered should it be necessary to reclaim and sell the property in a distressed state. This is the reason why the valuation price has to be lower than the market value. A bank valuation also protects the bank from risks. Whereas, market value is simply what the property is being sold for a particular time and in a specific market.

2.1.1 Valuation Methods

Valuation of a property may be computed through different methods. The appropriate application of a method of valuation depends on the nature of the property as well as availability of reliable data when the value arrived at by different methods are wide apart and judgment cannot fix with reasonable certainty which out of them is close to the more accurate market value, an average of two or more than two methods of valuation is applicable. In general there are three internationally recognized methods of property valuation and they are all based on the principle of market comparison. They are sales comparison, income capitalization and replacement cost approach (Apprisal institute , 2001).

Sales comparisons approach: According to Gronow (2002) the method proposes a valuation of properties considering prices of other similar properties in the same location and approximately with the same characteristics within a specific period of time which is naturally short. The comparison is mainly based on: the location, architectural design, use, dimensions (mainly floor area), construction materials, structural design and construction technology. The central task is to systematically collect data on comparable properties. Basically, the factors influencing value have to be weighed against each other (Chakraborti, 2003).To estimate the value of property in sales comprise approach first the valuator research the market to obtain information pertaining to sales, listings, pending sales that are similar to the subject property then he investigate the market data to determine whether they are factually correct and accurate after the relevant units of comparison are determined then the factor of comparisons are easily adjusted and lastly the result from the adjustment is reconciled (Apprisal institute , 2001).

According to Steven (2004) sales comparison is easiest and straight forward and more practical method. But, sometimes it might be difficult to locate enough similar property transactions to draw meaningful conclusions with regards to what the value should be; Market value and price might differ due to "unreasonable" actions by other actors; this technique makes no reference to intrinsic value. If a property's price is reasonable on a comparable basis, it does not necessarily follow that this is reasonable buying or selling price for an individual.

Income approach: In the income capitalization approach, an appraiser analyzes a property's capacity to generate future benefits and capitalizes the income in to an indication of present value.The principle of anticipation is fundamental to the approach. All income capitalization methods,techniques,and procedures attempt to consider anticipated future benefits and estimate their present value. The present value of a property can be considered to be the present value of the future benefits, which are the cash flows and the resale value of the property. The economic rationale of the income approach for existing properties is that no investor will pay more for a property than he/she will retrieve by holding the property (Marial, 2010).

According to Kummerow (2011) the value of property can be estimated by research the income and expense data of the subject property and the valuers calculate the net income (NOI) to analyze the comparables and to arrive at a capitalization rate and method appropriate for the subject property finally the appraiser can apply one of the methods of income capitalization to generate an estimated value of the subject property.

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

I. Method of Banks Valuation

In arriving at the appropriate value of mortgaged property there are three approaches to value: cost approach, sales comparison and income capitalization methods. The cost method is based on the understanding that market participants relate value to cost. It is used to value properties that seldom change hands in the property market. It should be noted that besides giving effect to individual ideas, cost approach may not be appropriate since mortgage is an investment in the open market. Sales comparison method work well for assessing the value of collateral but adopting this approach for a forced sale valuation is usually more difficult. Furthermore, income approach used for valuing mortgaged properties since income producing properties.

Inaccuracy in valuation estimate is caused by using different inputs in valuation equation. In investment method, the major inputs for determining capital value are; gross income, outgoing and yield. Ogunba (1997) and Ajayi (2003) noted that the mode of determining the values of these variables in the investment valuation formula differ widely from time to time. On cost method of valuation, some practitioners source their cost inputs from Quantity Surveyors, others from builders and contractors. The analysis of cost from diverse sources is bound to produce varying result and these would lead to divergent valuation estimates. Where this is the case the valuer will resort to adjustment of the value to arrive at that pre-conceived amount without necessary analytical judgment.

A valuation for mortgage purposes or the need to assess the equity component of a real property is prefixed on the assumption of a need to recover funds by the sale of the property in the event of default or the need to realize the equity. To recover funds the property will be sold in that market which the property is a component part. Therefore it is imperative that the methods chosen take off that market behavior. That is the predicted price reflects market behavior and the methods used are capable of explanation therefore embedding the process in positive economics (Farrel, 2003).

The question as to which of the market inference models or methods is superior will be dictated by the market type, characteristics of the property and the amount of data available for analysis. In a commentary Lusht (1997) observed that direct sales comparison is subjective, that is the application of this model is often based on an extremely limited number of transactions from which a prediction is made that cannot be supported by scientific principles and therefore has a high opinion component and is subjective. Advances in computer technology and greater availability of data facilitate the application of statistical models in particular, regression analysis. Although increasingly used in mass valuation for such applications as the rating of property by taxing authorities, regression analysis is not the preferred choice of most valuers. This is possibly due to the need to acquire statistical and computer skills (Dotzou, 1997).

Choice of methodology will be dictated by the client's instruction and the purpose of the valuation. In addition the characteristics of the real estate, its market type and the data available for analysis will also determine the methodology and process. However the choice will also reflect the competence and skill of the valuers. Bon bright as early as 1932 found it necessary to stress that the appropriate method will depend on the purpose of the valuation and that purpose and methodology should be compatible with the instructions and the definition of value directing the most appropriate method or methods. In Ethiopia, According to proclamation No. 455/ 2005 and regulation No.135/ 2007 were issued; all valuations depend entirely on the cost approach. Due to lack of up-to-date information about the comparable property, instability of the local market, lack of similar comparables are difficulties to apply other methods (Lipscomb, 1990.).

2.1.2. Factors that Affect Mortgage Value

In carrying out valuation practice certain features are responsible for the problem of accuracy and irrationality. According to Ogunba and Ojo (2007), inflation in Nigeria has resulted in a reverse yield gap situation since the beginning of the recession of the 1980s which has been responsible for the invalidation of rules of thumb previously held in stable market conditions. This has resulted in confusion among valuers as to the ability of the investment method of valuation to produce accurate results.

Another cause of inaccuracy in mortgage valuation has to do with the use of different methods of valuation for the same property even when the basis of valuation is open market value. Ajayi (1998) recommended the use of investment method of valuation by valuers when determining open market value for income producing properties. However, because of the influence of the reverse yield gap which the investment method inadequately account for, many practicing valuers use the cost method as a preferred method to determine open market value of properties.

The other is a heuristic situation it is a situation where a valuer forms a preconceived opinion on the worth of a property to be valued and the works as to arrive at that pre-conceived value. Some cases arise where the client is aware of the worth of his property before the actual valuation is carried out. Where this is the case the valuer will resort to adjustment of the value to arrive at that pre-conceived amount without necessary analytical judgment. Also the increasing rate of client influence especially in mortgage valuation is very challenging. In this situation the valuation calculation cannot be accurate.

As described by Vince Mangionin (2016) on “The Evolution of Valuations for Mortgage Lending Purposes” A survey and interviews are used to examine the practices of valuers in undertaking valuations and specifically look at the cognitive factors which impact the judgment of valuers in selecting the evidence which underpins the value determined. This paper examines the valuation of property for mortgage lending purposes, the practices used by valuers; information and evidence relied upon in the valuation process and defines the challenges confronting valuers. It articulates the transfer of risk to valuers as contractors to lenders since the 1990s when valuations ceased being conducted by valuers directly employed by lenders. The result of the study demonstrates that elements of automation and improved information may assist in the valuation process; however it is the ultimate judgment of valuers which impact the value determined. It further finds that valuers use alternate methods of valuation in determining value where possible and that in the case of direct comparison method, a unit of comparison is further evolving in supporting the valuation process.

The determining factors that influence the value of real property are an element of great importance in the valuation work. In general, the main factors influencing property value can be classified as internal and external. Internal factors are factors that cause changes in mortgage value of property and variations in value between properties size, age, condition, internal specification and configuration. External factors are not specific to a particular property but relate to the appropriateness of method of mortgage valuation, inflation, the ultimate judgment of valuer, property market as a whole or at least to a market sector.

Influences on value can be classified as property-specific or market-related. Property-specific factors relate to the property itself and market-related factors to the market as a whole. Valuation methods have developed over the years to help the valuers quantify the effect of geographical, legal and physical influences on value. The wider market factors are less to do with the valuation itself and more to do with context and form part of the cognitive background that valuers bring to a valuation, including market knowledge and an awareness of the current legislative framework, environmental policy and economic activity (Fraser, 1993).

2.1.3. International Valuation Standards

Rapid economic changes taking place in the 1970s served to enhance the recognition given by market participants to the importance of professional property valuations. The quickening pace in the globalization of investment markets further underscored the need for internationally accepted standards for reporting the value of property. It became obvious that without international valuation standards there was considerable potential for confusion. Differences of viewpoints among national professional valuation bodies might lead to unintentional misunderstandings. In response to this situation, members of a technical committee of the Royal Institution of Chartered Surveyors (RICS) and representatives of U.S. appraisal organizations began a dialogue in the late 1970s, which led to the founding of The International Assets Valuation Standards Committee (TIAVSC) in 1981(Boulevard, 2009).

The IVSC has long recognized the diversity of purposes for which property valuations are required, including use in financial statements, decisions on loans and mortgages secured by property, transactions involving transfers or ownership, and litigation and tax settlements. Beyond Standards, the IVSC began publishing Applications dealing with valuation for financial reporting and secured lending purposes, as well as Guidance Notes regarding specific valuation issues and the applications of Standards in more specific business and service-providing situations (Beale, 2015).

The development of the International Valuation Standards (IVS) has been guided by three principal objectives first, To facilitate cross-border transactions and contribute to the viability of international property markets by promoting transparency in financial reporting as well as the reliability of valuations performed to secure loans and mortgages, for transactions involving transfers of ownership, and for settlements in litigation or tax matters; second, To serve as a professional benchmark, or beacon, for Valuers around the world ,thereby enabling them to respond to the demands of international property markets for reliable valuations and to meet the financial reporting requirements of the global business community; and To provide Standards of valuation and financial reporting that meet the needs of emerging and newly industrialized countries(TIAVSC, 1995)

The International Valuation Standards represent accepted, or best, practice in the Valuation profession, also known as Generally Accepted Valuation Principles (GAVP).Valuers compliance with the IVSs may be voluntary, mandated by law or regulation, or at the instruction of clients, intended users and/or national societies or organizations. Having no enforcement power of its own, the IVSC looks to national institutes and financial professionals and authorities to enforce standards. It is intended that the International Valuation Standards and the national standards of respective Member States shall be complementary and mutually supportive (Boulevard, 2009). The IVSC advocates that differences between statements and/or applications of national and International Valuation Standards be disclosed

In general, Valuation Standards are the foundation of the property valuation process and are relevant to many other aspects of the land reform program including the professionalization of real estate services, legislative reform and educational training. Their application will improve the accuracy, quality, fairness, and transparency of valuations and valuation reporting, which in turn will lead to greater confidence and reduce financial risk for those using them. In particular, the adoption by the public sector of a uniform set of valuation standards which is consistent with international best practice will provide consistency within local government assessors and national government agencies develop a wider understanding by the general public and help to provide equitable solutions to those affected by valuations. At the same time it will afford greater protection for government from financial loss due to conflicting approaches, misunderstandings, or negligence (Apprisal institute , 2001). Perhaps most importantly, the adoption of these standards is a major achievement in the harmonization of valuation service provision in the Philippines with international best practice and their impact will be felt across the valuation profession.

2.2 Overview of Ethiopian Mortgage System

2.2.1. Mortgage and its Source

The word mortgage is a French law term meaning "death pledge" meaning that pledge ends (dies) when either the obligation is fulfilled or the property is taken through for closure(http://en.m.wikipedia.org /wiki/mortgage loan[Retrieved on March 12, 2018] Mortgage can have different meanings, depending on the context of the legal system with in which it is defined. Most western countries falling in the family of common law legal system define mortgage as "a special contract by which the borrower conveys to the lender a security interest in the mortgaged property (Yirga, 2009). On the other hand in countries continental legal system, mortgage refers to the immovable used as a security. Marcel Planiol, a renowned French scholar define mortgage as:

"A real security which without presently dispossessing the owner of the property hypothecated permits the creditor at the due date to take it over and have it sold in whosoever hands it is found and to get paid from the process by preference to the other creditors"

According to American property law, a mortgage occurs when an owner (usually of fee simple interest in reality) pledges his or her interest (right to other property) as a security or collateral for a loan. Therefore mortgage is an encumbrance (limitation) on the right to property just as an easement would be, but because most mortgages occurs as a condition for new loan money, the word mortgage has become the generic term for a loan secured by such real property. As with other types of loans, mortgages have an interest rate and are scheduled to amortize over a set period of time typically 30 years. All types of property can be and usually are secured with a mortgage and bear an interest rate that is supposed to reflect the lender risk (Santomero, 1997).

The act of borrowing and lending is a daily transaction activity within the ambit of financial institutions, especially banks apart and beyond this, two private individuals may legally entered into a contract of loan .Once such transaction (contract) has been entered in to, the main concern for the creditor would be insuring the performance of the obligation of the debtor as contract of the loan (Yirga, 2009).

Mortgage borrowers can be individuals mortgaging their home or they can be businesses mortgaging commercial property (for example, their own business premises, residential property let to tenants or an investment portfolio). The lender will typically be a financial institution, such as a bank, credit union or building society, depending on the country concerned, and the loan arrangements can be made either directly or indirectly through intermediaries. Features of mortgage loans such as the size of the loan, maturity of the loan, interest rate, method of paying off the loan, and other characteristics can vary considerably. The lender's rights over the secured property take priority over the borrower's other creditors which means that if the borrower becomes bankrupt or insolvent, the other creditors will only be repaid the debts owed to them from a sale of the secured property if the mortgage lender is repaid in full first.

Under Ethiopian legal system mortgage may emanate from a contract, law or curt judgment or arbitral award. Ethiopian mortgage system adheres to the lien theory. As stated above in Ethiopia, mortgage may result from a law or judgment /arbitral award/apart from being created by agreement. In Ethiopia it was the 1960 civil code that has for the first time, incorporated detail provisions that govern mortgage. There are two instances where by a mortgage may emanate from law /i.e. legal mortgage/ (1960 C.C of Ethiopia).

The first is contract of sale of an immovable. Article 3042 of the civil code provides that whosoever sells an immovable shall have legal mortgage on such immovable as a security for payment of the agreed price and for the performance of any other legal obligations laid down in the contract of sale.

Secondly where there is a partition of jointly owned immovable, a partitioner has a large mortgage on the immovable allotted to his co- partitioners in accordance with the act of partition and such mortgage shall secure the payment of any dispossessed of any property allotted to him (civil code art 3045). A judicial mortgage is created in relation to a judgment by a court or arbitration tribunal (civil code 3044). A contractual mortgage is created as the name indicates when there is a contract or other agreement creating a mortgage which shall be of no effect unless made in a written form. Pursuant to article 3045(2) a contractual mortgage shall be of no effect unless it specifies in Ethiopian currency the amount off claim secured by mortgage. Obviously a mortgage contract is created as a result of an agreement between the claim holder (creditor) and the debtor (mortgagor). A person may not secure his debt by mortgage unless he is entitled to dispose of the immovable for consideration, though a mortgage may be created by the debtor himself or by some other person on favor of the debtor .such person may secure the debt of another by mortgage where he is entitled to dispose of the immovable gratuitously (civil code art 3049).

2.2.2. Properties eligible for collateral

According to William (2007), collateral is any asset of value that can be pledged by the borrower(s) as security that the loan will be re-paid in full and with interest. Collateral requirements in the process of borrowing for a business can range up to and above hundred percent of the loan principal. This percentage depends again on the amount of risk that the lender calculates that his institution is exposed from this particular loan and the accumulation of all loans currently in process.

Collateral assets can be in the form of real property owned, inventory of the business, cash savings or deposits, stocks /bonds equity in home equipment and like assets both tangible and non-tangible. The value to be placed on a collateral asset in the securing of a business loan is usually estimated or appraised by the lending institute.

In Ethiopia generally immovable properties, machines, permanent trees and others are used for mortgage purpose and being valued by the appraisers to determine the amount of mortgage loan. All banks have their own governing law/ rule which is consistent with the government laws. The governing principle states that how the property being valued, type of properties to be valued, method of valuation used the credit policy of the bank, and directives of the municipality.

The 1960 civil code of Ethiopia has incorporated detail provisions that govern mortgage system for the first time. Based on article 3048 of the civil code the act of creating the mortgage shall clearly specify the immovable mortgaged. In Ethiopia generally immovable properties and machines, permanent trees and others are used for mortgage purpose and being valued by the appraisers to determine the amount of mortgage loan. In practice both movable and immovable properties are used as collateral. Such as; Buildings/houses, motor vehicles, deposit in banks, local and foreign bank guarantee, a written undertaking issued by a local or a foreign bank as a guarantor of the borrower and business mortgage if 20% construction is complete.

2.2.3. Types of Loans

A) Secured loan

A secured loan is a loan in which the borrower pledges some asset (e.g. a car or property) as collateral. A mortgage loan is a very common type of debt instrument, used by many individuals to purchase housing. In this arrangement, the money is used to purchase the property. The financial institution, however, is given security a lien on the title to the house until the mortgage is paid off in full. If the borrower defaults on the loan, the bank would have the legal right to repossess the house and sell it, to recover sums owing to it (Elekewachi, 1996).

In some instances, a loan taken out to purchase a new or used car may be secured by the car; in much the same way as a mortgage is secured by housing. The duration of the loan period is considerably shorter often corresponding to the useful life of the car. There are two types of auto loans, direct and indirect. A direct auto loan is where a bank gives the loan directly to a consumer. An indirect auto loan is where a car dealership acts as an intermediary between the bank or financial institution and the consumer (Jemal, 2003).

B) **Unsecured**

Unsecured loans are monetary loans that are not secured against the borrower's assets. These may be available from financial institutions under many different appearance or marketing packages: credit card debt, personal loans, bank overdrafts, credit facilities or lines of credit and corporate bonds (may be secured or unsecured).Interest rates on unsecured loans are nearly always higher than for secured loans, because an unsecured lender's options for recourse against the borrower in the event of default are severely limited. An unsecured lender must sue the borrower, obtain a money judgment for breach of contract, and then pursue execution of the judgment against the borrower's unencumbered assets (that is, the ones not already pledged to secured lenders). In insolvency proceedings, secured lenders traditionally have priority over unsecured lenders when a court divides up the borrower's assets. Thus, a higher interest rate reflects the additional risk that in the event of insolvency, the debt may be uncollectible (Worku, 2010).

2.2.4. Stakeholders in Mortgage

A. Creditors

A bank is a financial institution and financial intermediary that accepts deposits and channel those deposits into lending activities either directly by loaning or indirectly through capital markets, a bank links together customers that have capital deficits and customers with capital surplus.(http://en.m.wikipedia.org /wiki/loans [Retrieved on March 22, 2018].Due to their influential status within the financial system and up on national economies, banks are highly regulated in most countries, most nations have institutionalized a system known as fractional reserve banking in which banks hold only a small reserve of funds deposited and lend out the rest for profit(Fikru, 2009).

Banks are the primary users of mortgage system in any country through the only ones. When the mortgage arises from law or curt decisions it so happens that the lender is either private individual or even the state. When mortgage arise from the contract of loan, banks come in to picture as a creditor in many instances. In any case a lender has a stake on the mortgage system in two different stages. 1st before the contract is entered in to, the lender must have through and accurate information of the borrower.2nd once the contract is concluded, banks should be certain enough that the system will protect their right of preference and pursuit over the mortgaged property (Yirga, 2009).

B. Debtor

Establishing an efficient mortgage system is equally beneficial to the debtor /mortgagor. Because in a contemporary mortgage system the mortgagor retains the title /ownership over the mortgaged property and keeps possession and is even able to dispose of the thing or grant a new right of mortgage. Over all the debtor remains to be the master of the mortgaged property so long as he doesn't default as per his agreement with the mortgage. Every mortgage has the right or duty of paying back his debt not out rightly but annually or bi annually or so as agreed in the contract of mortgage. The amount of debt obtained from a contract of mortgage may be considerably less than the value of the property mortgaged. In other words the mortgage may not fully absorb the value of the mortgaged property (Yirga, 2009).

C. Third Parties

Though a property is mortgaged, it is not out of market. As mentioned before one of the major benefits of mortgage to the debtor is that it enables him to sell the mortgaged property at any time, which means that a property encumbered with a mortgage may get into hands of third party through conveyance. But when a third party is to buy a mortgaged property, he should be availed with the information on the amount of debt with it is charged. Such information should be really available at registry of immovable; otherwise the mortgagor being possessor of the property, would have the possibility of deceiving third party acquiring such property by presenting himself as owner of the property without any encumbrances what so ever .Additionally a third party acquiring mortgaged property shall have the possibility of clearing the encumbrances by paying the debt, to the extent of the value of the property and become the owner of such property free of any encumbrances. This is to be attained by establishing a system where by the mortgage follows the property and not the debtor (Greenbaum & Thakor, 2005).

D. The State/Society

An efficient mortgage system is not simply an interest of the parties to the mortgage contract and third parties acquiring a mortgaged property. The public at large has also a stake on how a mortgage system of a given country operates; this assertion along with its justification has been squarely put as follows. Those persons who are neither creditors nor debtor, nor owners of the immovable mortgaged are indirectly interested in the good organization of the mortgage system. A good mortgage system lowers interest rates, diminishes usually and procures a greater value to the owner of the land by the debtor fails to perform the principal obligation(Fredric, 2004).

2.3. Related Previous Empirical Studies

Many researchers have studied the valuation process for the lending process from different perspective and in different Social, political and economic environment. Some of the studies which are related and useful for this study are discussed herewith.

European Mortgage Federation (2009) carried out an investigation on the Valuation of Property for Lending Purposes in Europe. The study revealed that accurate and transparent property valuation is essential to the mortgage lending business as it promotes confidence in the collateral system. In this respect, property valuation represents one of the major building blocks of the mortgage system. The lender requires certainty that the asset being taken as a guarantee for a housing loan is of a certain value and will cover losses should the loan default. This confidence in the property value is one of the elements, which make mortgage debt a low risk, inexpensive way of providing housing finance and which in turn makes homeownership a reality for many throughout Europe. The need for transparency is therefore ever growing as the frontiers of the single market push further outwards and as cross-border activity increases. The result shows that transparency in valuation techniques and methodologies across borders would significantly further reduce the risks associated with mortgage lending. These reductions in risk will lead to greater confidence in European property markets on the part of homeowners, mortgage lenders and investors.

Obse M. and Eshetu (2019) made a research on the "Determinants of credit constraints in Ethiopia" This thesis is carried out using the Ethiopia Socio-economic survey (ESS). The survey is conducted by the Central Statistics Agency of Ethiopia (CSA) in collaboration with the World Bank Living Standard Measurement Study-Integrate Survey of Agriculture (LSMS-ISA). There are total of 433 enumeration areas (EA) represented in the survey with 290 from rural areas, 43 from small towns and the rest from major urban areas. The EA are spread evenly across the 9 regional states and the two chartered cities weighted by population, and contain data from 15 households each. The survey is thus designed and conducted to be representative of the entire country. Sampling design was selected by multi-stage, cluster design.

For this study, the aim has been to identify determinants of credit constraint in Ethiopia. This includes investigation of variables such as the valuation process, loan policies and the characteristics of borrowers and lenders. Regression based on bivariate probit model with sample selection using maximum-likelihood estimations has been performed on the dataset. Descriptive methods shaded additional light on the available survey. The study uncovered that age, gender, education of the household head along with the size and location of the household influenced the households' fate in the credit market. The findings of this study revealed that lack of standardized valuation provision and dignified loan polices are the main obstacle for the financial institutions to give appropriate amount of loan value for the creditors.

Źróbek *et al* (2013) was made their study on "Valuation for loan security purposes in the context of property market crisis. The case of the United Kingdom and Poland" This paper attempts to demonstrate the main reasons for interest in this field by referring to the situation in Poland and the United Kingdom. Moreover, the conditions of valuation for loan security purposes in Europe have been outlined, as well as the new challenges that property valuers have to face. Questions regarding unified and harmonious valuation standards have been presented in relation to international, European and domestic professional standards and legal regulations. The conclusion addresses further challenges of property valuation that must be tackled urgently, because valuation results are strictly connected with the profitability and safety of investments in the property market. Furthermore, the paper emphasizes that uncertainty in the valuation process also needs to be taken into account, as the appraised properties secure loans given by institutions funding their development.

Bioye Tajudeen Aluko (2007) Implications of the current trend in mortgage valuation practice in Nigeria, the study examined the mortgage valuation process including sources of valuation instruction ,bases and methods being adopted and their implication on lending decisions and valuation profession in the study area. To accomplish the study, questionnaires were randomly administered on samples of estate surveying and valuation firms and lending institutions respectively in Lagos metropolis. The data emanating there from were analyzed using frequency distributions, ranking mean and relative important index ranking. The study, prima facie established that mortgage valuation has been an important input in lending decision. It further showed the implications of the blind adoption of the cost approach, inconsistency among valuers and non inclusion of insurance valuation in the mortgagee valuation process.

A research was also done by Vince Mangionin(2016) on **"**The Evolution of Valuations for Mortgage Lending Purposes" A survey and interviews are used to examine the practices of valuers in undertaking valuations and specifically looks at the cognitive factors which impact the judgment of valuers in selecting the evidence which underpins the value determined. This paper examines the valuation of property for mortgage lending purposes, the practices used by valuers; information and evidence relied upon in the valuation process and defines the challenges confronting valuers. It articulates the transfer of risk to valuers as contractors to lenders since the 1990s when valuations ceased being conducted by valuers directly employed by lenders. The result of the study demonstrates that elements of automation and improved information may assist in the valuation process; however it is the ultimate judgment of valuers which impact the value determined. It further finds that valuers use alternate methods of valuation in determining value where possible and that in the case of direct comparison method, a unit of comparison is further evolving in supporting the valuation process.

CHAPTER THREE

3. Research Methodology

3.1. Description of the Study Area

Amhara National Regional State is the second largest region in its population, next to Oromiya region. The region covers an area of about 156,960 square kilometers, and its altitude ranges from as low as 500 meters to 4620 meters above sea level at the Peak of Ras Dashen Mountain which is Ethiopia's highest and Africa's fourth highest mountain. The region is divided into 11 administrative zones, more than 100 rural and urban Woredas, and about 3000 rural kebeles. According to the 2007 national population and housing census, the Amhara Region had a counted population of about 17.21million, of which males constituted 50.2% and the balance 49.8% was the share of females. Out of the total population of the region 87.4 percent live in rural areas. The population growth rate from 1984 to 1994 is 5.4 percent and from 1994 to 2007 is 13.4 percent (BoFED, 2017).

Bahir Dar is the capital city of Amhara National Regional State (ANRS) and is the seat of the regional government and respective sector offices too. The city is one of the main tourist destination points in the historic route to tourist attraction sites of the country in general and Amhara Region in particular. It is endowed with natural beauty and is the place where the largest and one of the few highland lakes in the country, i.e., Lake Tana is found.

Bahir Dar's core city is found in the center of Bahir Dar Metropolitan City Administration. Astronomically, it is located at the geographic co-ordinates of 11° 38' north latitudes and 37° 15' east longitudes and at an average altitude of 1830 m. In relative terms, Bahir Dar City is located at the distances of 567 km along Addis Ababa. Its location at this spot favors the city with many and multi-faceted opportunities like water resources, suitable topography, favorable climate to live, to serve as a center for northwestern Ethiopia and so on. The core city has an estimated area of 15,455 hectares, 17.2% covered by water (Lake and River).

Bahir Dar has a border line tropical savanna climate very close to subtropical high land. Afternoon temperatures are very warm to hot year round, and morning temperature cool; h however, the diurnal range is much larger in the largely cloudless dry season (National metrology agency, 2015).

Regarding the study area population size, according to the National Population Census conducted in 2014, Bahir Dar had a total population of about 220,344, in 2015 it was 251,449,and in 2016 it is 286,945. With an annual growth rate of 4.5%, it is estimated that the population of this City would reach 300,000 by the end of 2017(CSA, 2007)

In order to investigate the study, Bahir Dar city is selected purposely with the following rationales. First, there is high demand to access money from financial institutions. Secondly, data can be easily accessed and collected. Thirdly, the city is endowed with natural resources so many investors are interested to engage into manufacturing and investment sector. In support of this, banks play significantly to raise funds for the investors; lastly, the banks are not still aware of how they can to compute the mortgage lending value.

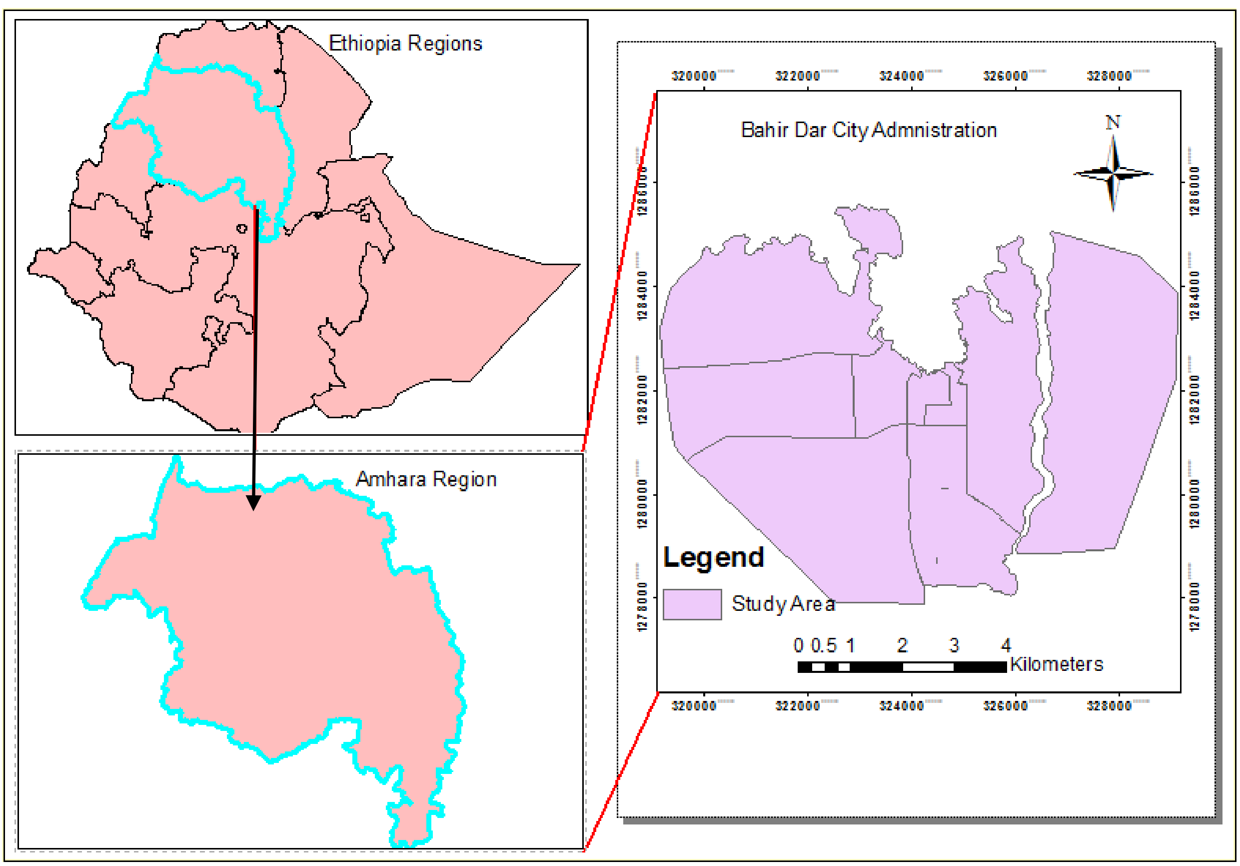

Fig3-1: Location of the study area Source: Author developed

3.2. Data Source

Both primary and secondary data are used for the study. The primary data obtained from valuators and borrowers of the bank through questionnaires, and interview made to the manager of credit department respectively. Secondary data source such as the banks' annual reports, valuation provisions, manuals, articles, journals and other published and unpublished documents relevant to the study were used to the study.

3.3. Methods of Data Collection

In order to collect the required information from primary and secondary sources, the following methods were applied. Primary data were collected from both open and close ended questionnaires and by conducting interview. Questionnaires distributed for all valuers who are available at the time of data collection and for 99 sample borrowers: interview conducted to the manager of the credit department of the bank. Secondary data source such as the banks' annual report, manuals, articles, journals and other documents relevant to the study were reviewed.

- Questionnaire: Both close ended and open ended questionnaires are prepared and distributed to sample respondents. Closed ended questions are prepared and distributed for the credit department staffs in order to collect information related to the loan process. Open ended questionnaires also prepared and distributed for the sample borrowers and valuers in order to get detail information about the valuation process.
- Interview: Credit department managers interviewed in order to collect information related to the procedure by which the responsible organ is applying in order to determine the mortgage lending value of the property.
- Field observation: The researcher observes the lending practice and the valuation process followed by the sample banks.

3.4. Sampling Technique and Sample Size Determination

As it has been explained in the preceding section, different methods used to gather data from different sources. In order to increase the accuracy of the study, reasonable samples were taken from the selected case study area. So, the numbers of borrowers who lend money from the banks are found to be relatively large in size and live in scattered areas. Thus, systematic random sampling method is appropriate and applied. In addition to this, the researcher use purposive sampling techniques in order to determine the sample size of banks to be studied. In Bahir Dar there are 15 different banks (commercial bank of Ethiopia, Dashen bank, Birhan bank , Nib international bank, Wegagen bank, Zemen bank, Abyssinia bank, Oromia international bank, Awash international bank, Bunna international bank, Debub Global bank, Anbesa bank, Development bank of Ethiopia, Enat bank, Abay bank) that are accountable for the national bank. From those banks, three private and one public bank selected purposively. Commercial bank has 14 branches in Bahir Dar city, from those five branches with a large number of borrower are selected. In addition to this two Dashen bank branches, two branches from Abyssinia bank and Bunna bank main districts are selected with the same rational.

The number of property valuers and higher officials of the credit department are small in size and easily accessed, all of them who are available during the interview time are included in the sample. since, the total number of population is known, the sample size of borrowers needed for the study can be determined with the formula below at confidence interval of 95% and with the error e=0.08.The numbers of borrowers in the sample bank are large in number so i prefer borrowers who run their business in Bahir Dar city.

$$n = \frac{N}{1+Ne^2}$$

Where; n= sample to be determined

N= Total population

e = Expected error

$$= \frac{196}{1+132(0.08)^2}$$

$$= 99$$

Table 3-1 Sample selection

Sample banks	Total population	Selected samples
Commercial bank	97	49
Dashen bank	60	30
Buna bank	20	10
Abyssinia Bank	19	10
Total	196	99

Source: Field survey, 2018

3.5. Data Analysis and Presentation

In order to answer the basic research questions, the researcher use both qualitative and quantitative data analysis techniques. The quantitative date collected from the sample respondents were analyzed by using numerical description like percentage and average. The responses that are collected from close-ended questionnaires have been analyzed quantitatively and data collected from interview, open ended questionnaires, banks' annual report, manuals, articles, journals and other documents relevant to the study are analyzed qualitatively. The Result obtained from the study is presented by using tables and percentages.

CHAPTER FOUR

4. Result and Discussion

This chapter deals with data analysis, interpretation and presentation of the data gathered through questionnaire, field observation and interview. A total number of 99 questionnaires distributed for the sample borrower of commercial bank of Ethiopia, Dashen bank, Abyssinia bank and Buna international bank and for eight professional who works as a valuer in the sample banks. In addition to this, interview were conducted with the manager of the credit department, credit relationship officers, recovery department employees and with credit analyst employers, out of the distributed questionnaires all most all of them (both valuers and borrower's) cooperated in filling and returning the questionnaire.

4.1 General Information of Borrowers

No	Question	Alternatives	Frequency	%
1	Gender	Female	85	85.9
		Male	14	14.1
		Total	99	100
2	Age	18-30	5	25
		31-50	37	37.37
		51-65	56	56.56
		>65	-	-
		Total	99	100
3	Educational status	Illiterate	6	6.1
		Primary education	62	62.6
		Diploma	29	29.3
		Above	2	2
		Total	99	100
4	Household size	1-5	92	92.9
		6-10	7	7.1
		>10	-	-
		Total	99	100
5	Marital status	Single	12	12.12
		Married	77	77.7
		Divorced	6	6.06
		Widowed	4	4.04
		Total	99	100

Source: Field survey, 2018

4.1.1. Questionnaire Response Rate and Interview Success Rate

The questionnaire was distributed to sample borrowers of four banks selected purposively; of which three private banks and one public bank. Out of the 107 questionnaires physically distributed to the target population, one hundred five (105) usable responses were collected. This represented a response rate of 98.1% [105/107*100] and that is 1.9 percent of the questionnaires were not returned at all.

All most all of projected interviews, were successfully conducted, giving a success rate of 97.7 percent. One interviews were unsuccessful because of the targeted interviewees were time constrained and unwilling to respond when they are free. Despite this, the target population was fairly represented considering that Directors or managers who are relevant to the study were interviewed.

4.1.2. Field of Specialization

Availability of professional valuers and transparency in valuation techniques would significantly further reduce the risks associated with mortgage lending. These reductions in risk will lead to greater confidence in the property markets. Valuers who specialize in real estate economics, land administration and real property valuation are much more capable to work as professional valuers but, the result in the study area shows that all most 75% of sample valuators specialized in engineering and the remaining 25% were specialized in accounting and finance. In the study area some banks Mortgaged properties such as building values were estimated by appraisers, who came from Addis Abeba. This makes the valuation system of those properties to be time consuming and coasty in the study area.

Table4-4: Field of Specialization

		Frequency	Percent
Valid	Engineering	6	75.0
	Accounting and Finance	2	25.0
	Total	8	100.0

Source: Source: survey outcome and SPSS computation

4.1.3 Work Experience of Valuators

Valuers give professional advice to individuals and business that buy, sell and rent land and property and also valuers should be aware of the issues that can influence the value of the property to be used as collateral for the banks. In relation to this, a work experience equips valuators with a certain soft skills such as team working, communication skill and understanding the working environment. Table 4.2 shows that 75 % of the respondents have 1-5 year work experience and almost 12.5% of the respondents have 6-10 year work experience and the same percent of respondents have less than a year work experience. But there is no respondent who has above 10 year work experience. From these it is possible to conclude that valuers in the bank have low working experience.

Table4-5 Working Experience

		Frequency	Percent
Valid	< 1 year	1	12.5
	1 – 5	6	75.0
	6 – 10	1	12.5
	Total	8	100.0

Source: Source: survey outcome and SPSS computation

4.2. Properties eligible for Collateral

As indicated by the respondents 4.04% of the respondents were using their movable properties as a collateral, 2.03% of the respondents use both movable and immovable properties as collateral and the largest portion or 93.93% of the sample respondent in the bank were using their immovable property such as building. Appraisers put the reason for this is that; Because of the immovable nature of the properties banks prefer to use those properties as guarantee. The type of collateral for a loan may be predetermined based on the loan type, such as with a mortgage or an auto loan, or may be flexible, such as a collateralized personal loan. For a loan to be considered secure, the value of the collateral must meet or exceed the amount remaining on loan. An increase in collateralization of much of immovable properties for borrowing money from banks would minimize credit risk for banks.

Table4-6: Types of properties

		Frequency	Percent
	Movables	4	4.0
Valid	Immovable	94	94.0
	Both	2	2.0
Total		100	100.0

Source: Source: survey outcome and SPSS computation

4.3. Basis of Valuation

In the study areas, Mortgage is a means of verifying and securing the ability of mortgagor to return the mortgage loan at the appointed date. Therefore as principle the basis for the valuation of real property for mortgage purpose is current market value of the property. In order to determine the mortgage lending value of the property valuers in the study area first inspect the condition of the collateral and they estimate the market value by considering the internal and external conditions of the property, after that they multiply the lending limit with the market value to calculate the mortgage lending value. During my survey i understand that they implicitly consider the location factors it is because the value of property which found at the center and somehow far from the center are not the same still the condition of the house is similar. To get the mortgage lending value of the collateral they multiply the lending limit with the market value of the property.

Table: 4-7 Basis of value

		Frequency	Percent
Valid	Market value	8	75.0
	Forced sale value	0	0
	Mortgage lending value	0	0
	Total	8	100.0

Source: survey outcome and SPSS computation

4.4. Factors that Affect Mortgage Value

According to the data collected from the sample banks internal factors influence the value of properties 75% and the remaining 25% of the properties values are affected with the internal conditions of the properties. From the following we can conclude that when the properties are valued for mortgage purpose the internal condition of the properties play a significant role.

Table4-8: Factor that affect mortgage value

		Frequency	Percent
Valid	Internal factor	6	75.0
	External factor	2	25.0
	Total	8	100.0

Source: survey outcome and SPSS computation

4.5. Methods of Valuation

In the study area it is significant to note that while a greater proportion of the respondent 75% agreed that cost approach is most frequently employed in mortgage valuation practice, about the remaining 22.5% and 2.5% of the respondents adopted the income and the sales comparison approach. The respondents contend that the property market in the country is not well developed and, as such, there are not market data on which other methods could be based. Hence, it is not unlikely that the respondent banks are trying to over protect their client interest, in return a higher figure of value than the other two methods. The value of real property is the function of the property's physical, and legal characteristics and it exclude the location factor .The physical characteristics include the age, size, design and construction quality of the structure, as well as the size, shape, and other natural features of the land. But, in mortgage valuation property valuators implicitly consider location factors when it is residential property, the locational characteristics include convenience and access to places of employment, schools, shopping, health center, and other places important to households. The locational characteristics of commercial properties may involve visibility, access to customers, suppliers, and employees, or other availability of reliable data and communications infrastructure.

4.6. Independent Valuers

According to Daniel (2009), in Ethiopia, there is neither an independent and developed valuation system, nor are there available professionals in the field. The reason may be related to the fact that land is not a privatized property in Ethiopia, which has resulted in the non-development of prolific real property market in the country. Although the Federal Expropriation Proclamation assumes the existence of certified appraisal professionals and a nationally adopted uniform formula for valuation (Art. 9(1) of Proc. 455/2005), this seems a dream to many today. In any case, the Ministry of Federal Affairs has been given the task of developing the capacity of a valuation system in the country, in collaboration with appropriate federal and regional government organs. In the meantime, however, valuation has to be carried out by committees comprised of different experts of different backgrounds who have the relevant qualifications (Art. 9(1) of Proc. 455/2005).

As shown in the table, All the respondent banks always rely on in house valuers retain by them while the remaining three points like Independent valuer from the list obtained from the professional institution or regulatory body and Borrower's valuer are not charged with the responsibility of mortgage valuation assignment as the result revel from the respodendent banks prefer its own professional valuer, as we see the role of independent organ and individual borrowers are very limited. The independency of in house valuers who works as a professional valuer in the bank is questionable. It may make the value of the properties to be more biased.

Table4-10: Independency of valuers

		Frequency	Percent
Valid	Independent valuer from the list obtained from the professional institution or regulatory body	0	0
	Borrower's valuer	0	0
	In – house valuers (staff)	8	100.0
	Total	8	100.0

Source: survey outcome and SPSS computation

4.7. Valuation Provisions

Lending policies should be clearly defined and set forth in such a manner as to provide effective supervision by the directors and senior officers. The board of directors of every bank has the legal responsibility to formulate lending policies and to supervise their implementation. In the sample banks there is no standardized valuation provision in relation to the lending policies. A lending policy in the study areas are like a static document, but it must be reviewed periodically and revised in light of changing circumstances surrounding the borrowing needs of the bank's customers as well as changes that may occur within the bank itself.

4.8. Challenges Faced during Mortgage Valuation

In the study area the problem encountered during the valuation process include absence of continuous valuation education and training absence of independent institution, lack of orderly constituted or structured continuous professional development regulations, lack of professional standards and property market price information asymmetry or lack of transparent property price information, among others. Appraisers in the bank faced many problems when they value the property for mortgage purpose. The major problems were shown as bellow in the table. As shown from table 4-12, 25% of problem faced on Absence of continuous valuation education and training, 12.5% of the respondent result shows that absence of independent organ that would check the fairness of the collateral value and similarly 12.5% of the appraisers disagree with customers up on completion of the valuation and almost 50% of valuation problems are encountered due to lack of up to date information about the properties.

Table4-11 challenges faced during mortgage valuation

		Frequency	Percent
Valid	Absence of continuous valuation education	2	25.0
	Absence of independent organ	1	12.5
	Disagreement with customers	1	12.5
	Lack of up-to-date information	4	50.0
	Total	8	100.0

CHAPTER FIVE

5. Conclusion and Recommendation

5.1. Conclusion

The 1960 civil code of Ethiopia has incorporated detail provisions that govern mortgage system for the first time. The survey revealed that sample banks are not currently reflecting appropriate methods and information contents in their mortgage valuation and there is not independent organ that would check the fairness of the lending value. In the study areas all most all banks mostly use cost approach. Most of the appraisers in the banks use cost approach to value the properties, which is mostly not advisable for old and income generating properties. The use of cost approach for old properties may cause great difference in the real value of the property due to missing of appropriate information about the old materials in the open market. In relation to valuation provisions there is no standardized valuation provision in relation to the method to the method of valuation, the basis to estimate the value and about the overall professional qualification about property valuers.

Both state and private banks in the study area use both immovable and movable properties as collateral and it is clearly stated on their loan polices. But, mostly banks use immovable properties as collateral it is because immovable properties are much more secure to return back the loan value for the banks. Real property appraisers in the study area did not work in their specialized field. All of the sampled appraisers specialize in civil engineering and accounting, this may considered as one obstacle for the valuation process in the study area. Absence of continuing professional development by way of workshop, seminars and conference, greatly enhance the quality of mortgage valuation and consequently lending decisions.

5.2. Recommendation

Based on the finding of the study the researcher recommends the following points.

- The property valuation system in banks should be improved in order to value the properties market value. When the Property valuators estimate the market value of the properties they should use appropriate valuation methods based on the type, use and nature of the property. All factors that affect property's value must be considered at the valuation date.

- Banks should adapt appropriate mechanisms that could enable the borrowers to participate during the valuation of the property for mortgage lending purpose.
- Ethiopian Bankers Association and National Bank of Ethiopia should establish an independent organ that would check the appropriateness of the value estimated by the professional valuers.
- A joint professional standard committee needs to be set up and internal regulatory mechanism for valuers should be emerging.

Limitation & Implication for Future Research

The findings of this study were limited to the issue of nature of property valuation for mortgage lending purpose in private and state banks of Bahir Dar city which is based on experienced staffs' observation and limited to some documents analysis. One of the limitations of this study was the sample. The sample was only taken from three private and one state bank of Bahir Dar city. So,

- It is recommended for future researchers to look in to large sample size including other banks and branches to generalize the findings that can work in the broad context and will provide more significant factors to derive relevant policy actions.
- It is also recommended for future research on detail statistical analysis is appropriate on the topic.
- In addition to these additional macroeconomic and microeconomic factors that affect the mortgage lending value of properties in relation to the valuation process in Ethiopia should be studied further. So, I recommend that similar studies should be conducted on the topic.

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Appendix A

Bahir Dar University
Institute of Land Administration
Department of Land Administration and Management
Post graduate Program (MSc) in Property Valuation

Questionnaire for Borrower's from Bank

Dear Sir/Madam

I am undertaking a research project entitled on the "nature of property valuation for mortgage lending purpose" Knowing the role of valuation for lending purpose will have a paramount important to the bank, to borrowers, to government and others. More over the result of this study will be used as additional reference for those who want to conduct detailed research on the area. To this end, I have prepared a self – administered questioner to help me gather the pertinent information from the selected sample borrowers. The quality of the result of this research is based on the accuracy of the information you provided. Eventually, I promise you, the information you will provide me is going to be reported and communicated in aggregate and utmost care will be taken for its confidentiality.

Thank you for your kind cooperation

I. General Information

1. Age ______

1.2. Sex

A) Female B) male

1.3. Marital Status

A) Single B) married

C) Divorced D) widowed

1.4. Education

A) Illiterate B) primary education (1-8)

C) Secondary education (9-12) D) tertiary educations (above grade 12)

E) Others (please specify) ____

1.5. Household Size _________________

II. Detail Information

1. For how many years you have borrowed the money?

A) 1-5 years C) 10-20 years

B) 10-15 years D) If other please specify__________________

2. What types of property you secured as collateral?

A) House C) Car

B) Residential property D) If other please specify____________________

3. For what purpose you lend the money from the bank? ________________________________

4. Do you participate since the loan value for your property estimated by valuers?

A) Yes B. No

5. If you participate, what is your role in the valuation process of the property?_______________

6. Do you think that the method the valuers use to appraise your property is appropriate?

A) yes B) No

7. If your answer in Qno 7 is no, what will be the appropriate method for you? ____

____

8. Do you know about how the mortgage lending value of your property is calculated?

A) Yes B) No

Appendix B

Bahir Dar University
Institute of Land Administration
Department of Land Administration and Management
Post graduate Program (MSc) in Property Valuation

Questionnaire for the Credit Department

Dear Sir/Madam

I am undertaking a research project entitled on the "nature of property valuation for mortgage lending purpose" Knowing the role of valuation for lending purpose will have a paramount important to the bank, to borrowers, to government and others. More over the result of this study will be used as additional reference for those who want to conduct detailed research on the area. To this end, I have prepared a self – administered questioner to help me gather the pertinent information from the selected sample borrowers. The quality of the result of this research is based on the accuracy of the information you provided. Eventually, I promise you, the information you will provide me is going to be reported and communicated in aggregate and utmost care will be taken for its confidentiality.

Thank you for your kind cooperation

1. In what position you are working in the bank?

   A. Valuation Expert C. Branch Manager

   B. Loan Officer D. Other please specify

2. How long do you work in this position?

   A. 1 – 5 years C. 11-15 years

   B. 6-10 years D. >15 years

II. Valuation Experts

3. What is your specialization area?

A. Engineering C. Land Administration

B. Computational science D. Accounting and finance

B. If any other please specify___________________________________

4. How long do you work in this position?

   C. 1 – 5 years C. 11-15 years

   D. 6-10 years D. >15 years

5. Have you taken any training?

   A. Yes B. No

6. If you say yes in what type of training you participate?

   A. Local B. Regional

   C. National D. International

7. What types of properties used as collateral?

   A. Immovable B. Both

   C. Movable D. If other please specify

8. What types of immovable properties mostly valued for lending purpose?

   A. Residential C. Retail

   B. Commercial D. Office building

   E. If any other express ____

9. What type of valuation method do you apply?

   A. Cost approach C. Sales comparison approach

   B. Income approach D. All

   C.

10. Is it the same for all type of property being valued?

A. Yes B. No

11. How do you calculate the lending value of a property?

B. A) As some percent of market value C. Limited by the banks

C. B) Depends on your interest D. If any other -----------

12. What is the basis of valuation for determining the lending value of the property?

A) Market value C. Mortgage lending value

B) Forced sale value D) If other ___________________

13. Is there any provision that guides to determine the MLV of the property?

A) Yes B) No

14. If your answer in Qno 12 is yes, what is that provision

____

____

15. Did you apply all the valuation procedure effectively?

A. Yes B. No

16. If your answer in Q.No12 is no why not you apply the procedures effectively?

A. Lack of up to date information C) Lack of personal commitment

B. Unfavorable working environment D) If other_____________________

17. What type of difficulties you face during the valuation process?

____

____

____

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____

Appendix C

Bahir Dar University

Institute of Land Administration

Department of Land Administration and Management

Post graduate Program (MSc) in Property Valuation

Questionnaire for the Credit Department

Dear Sir/Madam

I am undertaking a research project entitled on the “nature of property valuation for mortgage lending purpose” Knowing the role of valuation for lending purpose will have a paramount important to the bank, to borrowers, to government and others. More over the result of this study will be used as additional reference for those who want to conduct detailed research on the area. To this end, I have prepared a self – administered questioner to help me gather the pertinent information from the selected sample borrowers. The quality of the result of this research is based on the accuracy of the information you provided. Eventually, I promise you, the information you will provide me is going to be reported and communicated in aggregate and utmost care will be taken for its confidentiality.

Thank you for your kind cooperation

I. Credit Department Manager

1. what is the role of credit department for the bank?____

____

____

2. Are there any existing laws that govern valuation method effectively?
   A. Yes B. No
3. If your answer in Qno 3 is yes what type of specific issues included in the provision?____

____

____

____

____

____

4. What are the bases for the valuation provision?
   A) International valuation provisions
   B) Other bank experience
   C) loan polices
   D) if other ______________
5. What are the requirements to lend money from this bank?____

____

____

____

____

6. How the interest rate is determined?
   A. Depends on inflation rate
   B. Limited by government
   C. Depends on your interest
   D. If any other ____________________
7. Is there any specific organ that can to work with a credit risk in your bank?
   A. Yes B. No
8. What is the role of that organ

____

____

9. How do you analyze the risk before you lend money for borrowers

____

____

____

____

____

____

10. What is your measure, if borrower cannot return the loan on appointed date?

A. Immediately taken the property C. Void contract

B. Give warning D. punished by money

F. If any other ____

11. What type of problem you encountered during the mortgage lending process?

____

____

12. ____

____

____

____

13. Is there any independent organization that can to check the fairness of the MLV or to estimate the MLV by its own professional?

____

____

____

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