A STUDY OF QUANTITY SURVEYORS’ ROLE IN THE IMPLEMENTATION OF PUBLIC PRIVATE PARTNERSHIP PROJECTS

Afeez Olalekan Sanni, Maizon Hashim and Emmanuel Olusegun Akinsiku

1,2Department of Quantity Surveying, Universiti Teknologi Malaysia, Johor Bahru, Malaysia
1Department of Building, University of Lagos, Akoka, Lagos, Nigeria
afaexsanni@yahoo.com, maizohnhashim@gmail.com and eoakinsiku@yahoo.com

Abstract

The procurement of public projects using Public Private Partnership is aimed at achieving value for public money. It is a way of increasing the provision of public works and services without increasing government borrowing. However, quantity surveyors are professionals who specialize in construction cost management and assist clients in achieving value for their money. This paper reviewed the roles of quantity surveyors in the implementation of public projects under public private partnership in Nigeria with the aim of identifying the benefits of their active involvement in the procurement process. This is a report of preliminary study based on literature and interview of selected participants in the implementation of public private partnership projects in Nigeria. The findings showed that few quantity surveyors are involved in the planning and implementation of public projects under public private partnership arrangement. Since quantity surveyors are experts in the contract management, it is recommended that more quantity surveyors should be encouraged to participate actively in the procurement of public projects under public private partnership contracts.

Keywords: Contract management, public private partnership, quantity surveyor, value for money

INTRODUCTION

Quantity Surveyors are professionals who specialize in construction cost management and assist client in achieving value for their money. Quantity surveying is a dynamic profession in the construction industry and the services of quantity surveyors are much needed in the industry and beyond (Abdul Lateef & Paul, 2009). In Austria, despite the fact that the public private partnership (PPP) arrangement is being used to deliver public infrastructure, there are still varied perceptions and definitions of PPP (Susilawati et al, 2009). The term public-private-partnership is essentially a form of collaboration between the public and private sectors, but the definition of PPP has different meaning from country to country (Anadzi & Bowles, 2004). However, public private partnership is defined by the Canadian Council for Public Private Partnerships (2012) “as a co-operative venture between the public and private sectors, built on the expertise of each partner that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards”.

The implementation of construction projects using public private partnership involve various professionals and experts that are experienced in construction contract management. Also, the adoption of PPP for the development of critical social and economic infrastructure across continents in the last two decades had witnessed various challenges while the its implementation in Nigeria has not recorded major achievements. However, there had been appreciable increase in the adoption of PPP for the development of social and economic infrastructure in many countries (Tieva & Junnonen, 2009; and Li et al, 2005). Past studies had identified that inadequate expert knowledge is one of the problems encountered in the implementation of PPP in Nigeria (Awodele et al, 2012; Amade, 2012). Then, the improvement in capacities of participants could be seen as one of the methods to be used in addressing the challenges in the PPP implementation.
Pitfalls in the valuations of properties with trading potential - a viewpoint


preneur and rent requires great skill. In this light, valuers are to equip themselves with training and professional experience to be able to judge accurately, the contribution of each to the business.

REFERENCES
suggested that the strength of tenant demand was the single most important factor affecting the split with ratio of profitability to turnover the second most important.

CONCLUSION AND RECOMMENDATION
The study has so far discussed the nature and characteristics of properties with trading potential. Also, appropriate basis and method for valuation of properties with trading potential are discussed. The study further discussed various pitfalls in valuation of property with trading potential. Being a non-empirical study, the discussions were drawn from various previous studies and professional standards and Guidance Notes. This therefore leaves room for further empirical study on this topic.

The pitfalls discussed are: problem of differentiating between personal goodwill and transferable goodwill; issues with books of accounts; the handing of possible effects of change in market circumstance; assumption that the property should be valued on going-concern basis which may sometimes be confusing. Others are problem with choice of method which may arise as result of problems associated with availability of or appropriateness of books of account, and issues with apportionment of net profit between owner’s remuneration and rent.

The study therefore recommends as follows:

1) There is a need for a clearer definition and distinction between personal and transferable goodwill. Therefore, the available Valuation Standards and Guidance Notes, both local and international, should be reviewed to reflect this so as to have uniformity in practice. Deep knowledge of economic and fiscal policies could also be of help to valuer as this may assist in accessing the likely effects of the economic, environment and other external factors on a particular business so as to be able to distinguish such from personal goodwill.

2) Valuers should not just take the details in the book of accounts for their face value. It is very important that questions are asked to query some of the data provided in the accounts as some of the books might have been purportedly prepared for the purpose of valuation and therefore not the true status of the business. There might also be some salient issues that will not be revealed unless queries are raised.

3) Valuers could also demand for book of accounts of previous years (up to three years back) so as to study the trend of profits, expenditure, sales, etc. It is always possible and sometimes prudent (for valuer) to seek information or advice from the client’s accountant or others who may be conversant with the nature of business the property is being used for.

4) Possible effects of change in market circumstances can be captured in the valuation if the valuer can do a thorough market study and market delineation for the business being valued. With this, the valuer would be able to analyze the business capacity and likely share of market the similar businesses under construction can take; and as well, possible advantage they may have over the subject. Therefore, time must be devoted to market analysis and valuer can employ analytical tools like sensitivity analysis to analyze the possible effects of each imaginable changes.

5) Whenever property with trading potential is being valued, especially when ownership of business and that of the property interest are different, the issue of going concern basis should be handled with great care. This will help the valuer to know when the property is to be valued as an asset within a business or to be transferred independently of the business currently in occupation. And, the condition under which the property is valued should be stated clearly in the report.

6) When valuing trade related property for either capital value or rental value, what the valuer is after is nothing but that part of the profit that can be ascribed to land as a factor of production. Therefore, apportioning the profit between the entre-
Pitfalls in the valuations of properties with trading potential - a viewpoint

(v) Methodology
It has been established from the foregoing that the appropriate method for valuing properties with trading potential is the profit or account method. Application of this method relies solely on availability of reliable books of accounts. However, lack of good record of accounts may make valuer consider other methods in carrying out his assignment. Most often, cost method is considered especially when the property is new (Sikich, 1993). However, cost method will not give the value that reflects the nature of the property (i.e., its trading potential). This is because the common feature of trade related properties is that they are purpose-built for specific type of business activity and therefore should not be valued just as any structure on its own. Marie et al. (2001) concluded that the more sophisticated “income-based” income capitalisation methods constitute the most effective basis for a framework on which to derive the open market value for a hotel as an ongoing business entity, but that one or more of the other main valuation approaches should be drawn on in order to effect the reconciliation of a hotel’s final value.

However, it is always a great challenge to valuer when there is no distinct book of account for the business, the property is being used for or the records are lumped up with that of other business(es) belonging to the same owner in a way that it is difficult to distinguish one from the other.

In addition, among other methods open to valuer is the Discounted Cash Flow (DCF) technique. In fact, criticism has been levied by many in the surveying and related professions of the appropriateness of traditional profit account approach (Estates Gazette, 1994) in favour of DCF approach which is now commonly used in US market (Rabianski, 1996). However, it should be made clear here that if a valuer encounters challenge applying profit method in valuing a property, it is expected that greater challenge will be experienced applying DCF approach as this requires even more details than profit method. The DCF analysis is calculated by using a number of estimated future net incomes (profits) (Nilsson et al., 2001) using the present profit as the basis.

(vi) Issues with apportionment of net profit
In the valuation process, valuer is expected to determine rent from net profit of the business. This rent will then be capitalized with appropriate capitalization rate to arrive at the capital value. However, valuers are always faced with the challenges of what percentage of profits should go for rent from net profit also referred to as Earnings Before Interest, Tax Depreciation and Amortization (EBITDA). Traditionally, the practice is to deduct interest on the tenant’s capital at a rate that he might obtain by placing the sum in a secure investment, the remainder is then divided between the tenant (as entrepreneur) and landlord (rent).

There has not been clear consensus from literature on what percentage should go for what (Sayce, 1995; Wyatt, 2007; Ree and Hayward, 2003; Ogunba, 2013). Fifty percent (50%) each is advocated at some quarters while others suggest varied percentages. Also, different types of business properties are valued using different profit basis. For example, Rees and Hayward (2003) opined that taking the shop rent to be say 15-20% of net profit, but, as shop size increases, the profit per unit of floor area decreases as the good range is extended to include items with lower profit margins. Day and Kelton (2007) observed that a 50/50 split is common, although valuers can debate a lower or higher percentage of rent depending on factors affecting demand and supply. A study conducted by Sayce (1995)
profit to any of the goodwill and which may be more or less than their individual contribution to the business.

(ii) Issues with books of accounts
The business books of accounts are the major source of data/information for valuation of trade related property. However, these books are most times fraught with shortcomings. It may be that the books are poorly kept where a lot of data are missing or the information contained in the books are fraudulent. Wyatt (2007) warns that audited accounts are to be preferred but should not necessarily be accepted at face value. It should be borne in mind that profit and loss accounts may be prepared for various purposes and when using them to estimate reasonably maintainable profit, it is important to consider whether the business has more than one property, as consolidated accounts will not apportion expenditure between properties.

Also, owners of small scale and family run businesses may use some personal items and capital to run the business and these may not reflect in the annual accounts. Such costs are supposed to be added to the working expenses. But where the valuer might not have this information, value estimate may be based on false/incomplete information.

Sayce (1995) opined that establishing a maintainable net profit is crucial to the computation and it is this computation that can lead to wide levels of disagreement. Establishment of net profit from gross and concluding the level of sustainable profit were also identified as the elements within the calculation most prone to inaccuracy by Sayce (1995). This is as a result of the fact that books of accounts are deficient in information required to guide valuer appropriately in this wise.

(iii) Possible changes in market circumstances
Valuers are also faced with challenges of what are likely to be the effects of possible changes in the market circumstances when carrying out valuation of trade related properties. The market circumstances here refer to factors such as on-going and proposed projects on similar business within the neighborhood; possible reactions of customers and suppliers to change in business ownership (as the valuation is to be based on Reasonably Efficient Operator and not the present handler), change in government policy, e.t.c. Measuring the possible effect of these on the business prospects and income may be a challenge to the valuer. For example, hotels and petrol stations under construction have potential of reducing the market share of the subject property/business by increasing local competition. Banning of smoking and alcohol intake will have drastic effect on businesses of bars and clubs. Also, some customers are patronizing a particular business because of the present handler and will stop transacting with the company immediately the person they are faithful to is no more handling the business. Identifying remote cases like these and accurately provide for such in the valuation is may pose a great challenge to valuer.

(iv) Going Concern Assumption
Sometimes it is confusing when reference is made to a real property interest in a business being valued as a going concern. Real estate, or an interest in it, cannot be going concern but a business that occupies it may be (IVSC, 2012). This is because the property can be transferred independently of the business in occupation especially where the operating business and the real property interest are of different ownership.

Consequently, property with trading potential can be valued either on the assumption that it is an asset within a business that is transferred as a going concern, or on the assumption that it is to be transferred independently of any business currently in occupation or that it is transferred following the closure of any business currently in occupation (IVSC, 2012). Different circumstances may warrant any of these assumptions and each will result in dif-
performance of the current operator may be used as a starting point for assessing the trading potential of the property. This will then be adjusted for typical revenues and costs to arrive at a fair maintainable trade. For example, adjustment should be made for additional revenue, or cost attaching to the brand or personal reputation of a current operator that would not transfer to a buyer of the property interest.

Real property interest in the business is valued as a going concern. The IVSC glossary defines “Going concern” as a business enterprise that is expected to continue operations for the foreseeable future. Like any other class of property, valuation of properties with trading potential may be required for different purposes like mortgage, taxation, rating, sale, purchases insurance etc.

**PITFALLS IN THE VALUATION PROCESS**

The practice of valuation with respect to properties with trading potential is fraught with various challenges, problems and controversial issues. Valuing this class of specialized properties requires the valuer to be well armed with information and training so as to be professionally sound to do justice to such assignment. Because of the specialized nature of this type of property with little or no market comparables, most of the challenges and problems are hidden in the basic processes, basis, methods, assumptions and disclosures. Some of these pitfalls are hereby discussed below:

(i) **Treatment of personal goodwill and business goodwill**

Here, personal goodwill refers to non-transferable goodwill while business goodwill is the transferable goodwill. The principle is that personal goodwill of the present business handler (personal) should be excluded from the valuation while business goodwill (business) should be included. Personal goodwill includes personal reputation of the present business handler that has brought profit to the business over and above market expectation while business/transferable goodwill arises as a result of property specific name and reputation, customer patronage locations, products and similar factors. Most times, valuers always find it difficult distinguishing what percentage of the profit is attributable to which of these types of goodwill. Also, the explanation of the difference between the two is not comprehensive enough even in the Guidance Note.

A practicing firm in UK, Taylors Business Surveyors & Valuers, in response to IVSC discussion paper on valuation of trade related property, commented that “we believe GN12 to be a fundamentally sound document, but requires further explanation of the difference between personal goodwill and transferable goodwill”. The comment also concluded that the key to making the judgment of whether goodwill is transferable or not is in full understanding of the operation of the business itself and the market within which it operates. This may therefore require that a valuer has an in-depth understanding and knowledge of the market and sector within which the trading property operates to be able to accurately assess its fair value.

Aluko (2009) also stated that properties with trading potential are sold on the market as a package that makes a separate identification of the constituent components such as goodwill, plant and machinery, etc. difficult; therefore, if the goodwill is personal to the owner, it is not transferable. In such case, necessary adjustments must be made in the valuation. Valuers are therefore faced with the problem of how to make this justifiable adjustment.

In addition, one of the key findings of the research by Dunse et al., (2004) is that valuers expressed considerable unease with the apportioning of market value between tangible assets and goodwill, and, there was no consensus on how (or if) goodwill could be measured reliably. Because of these uncertainties, valuer may ascribe a percentage of the net
are two ways to do this. Firstly, capitalize the adjusted net annual profit at a suitable yield derived from market evidence; secondly, assume that a percentage of the adjusted net profit is retained by the business operator as remuneration for risk and operation and for interest on any capital invested in the business.

Here, the role of valuer is not one of accountant but interpreter of financial and physical information and for this a high level of market research is required, together with a clear understanding of the nature of the business (Sayce, 1995).

(viii) APPROPRIATE METHOD, BASIS AND PURPOSES

Application of right method and basis is of utmost importance to any valuation exercise. Unless investors are confident in the acceptability of the valuation method they may remain “suspicious” of the product (Sayce, 1995). It is clear from above discussion that the appropriate method that determines rent from profits in occupation of the business tends to be in favour of profit method. UK valuation textbooks (Marhal & Wihamson, 1996; Rees & Hayward, 2000) advocate the simple earnings multiplier approach (commonly referred to as the profit or accounts method) where the revenues and expenses of the business are analyzed to determine an adjusted net profit. This method is based on the reasoning that the business premises is able to provide the tenant not only an income that will compensate him for operating the business, but also a surplus that he would be prepared to pay for the right to occupy the property, which is equated with rental value (Ogunba, 2013). Sayce (1995) also asserted that the methodology adopted for valuation of commercial leisure property (trade Related property) has been the profits method. Sayce (1995) also stated that this method is regarded as being specialist, with most valuers receiving only nominal training in the method during their formal education. The method also holds assumption that the value of the property is dependent on the level of profit that can be sustained from a business to be conducted in such property and that the value is thus the entire “operational entity”. The property asset is therefore perceived as integral with the business and operates as a “shell” within which profit is generated (Sayce, 1995). However, there has also being advocates for application of other methods like Discounted Cash Flow (DCF); analysis of comparable transactions, or a combination of these (RICS, 1994) in valuing properties with trading potential. DCF technique is also supported by the British Association of Hospitality Accountants (1993) and the US literature suggests that it is the most common method adopted in North America (Rushmore & Baum, 2001). The method arguably provides better advice to clients and lending institutions regarding future profitability and considers future cash flow in more details. However, profit method is most supported for valuation of properties with trading potential. “Both Guidance Note (GN) 12 and the draft International Valuation Standards (IVS) 232 recognised that a distinct valuation method under the income approach was frequently used for trade related property. … This method was tentatively referred to in the draft IVS 232 as the ‘profits method’ (IVSC, 2012).

Valuations of properties with trading potential are always based on assumptions that there will be a continuation of trading by a Reasonably Efficient Operator (REO), with the benefit of existing licenses, trade inventory, fixtures, fittings and equipment and with adequate working capital. The value of the property including transferable goodwill is derived from an estimated maintainable level of trade. If the valuation is required on any other assumption, the valuer should make it explicit through disclosure (IVSC, 2007). If actual trading performance by the present manager in excess of that of an average Reasonably Efficient Operator (REO) is considered, then this may lead to an estimate of existing use value rather than market value (Ogunba, 2013). The acceptable standard is that valuation is done on the basis of trading potential of the reasonably efficient operator rather than the actual level of trade under the existing ownership. Most of the time, valuer will be called upon to value property with existing trade. In this case, the actual trading
land. The emphasis of the cost method is asset replacement, which is cost of construction less depreciation, and it does not take care of future income that the property may be able to generate. Typical investors in trade related property generally base their investment decisions on economic factors like expected net income and return on investment. Because, cost approach does not reflect any of these income related consideration, it is less relevant for valuation of trade related property.

(vi) Residual method
Changes in supply and demand may influence the development value of a piece of land to an extent that competition may increase the value of the land for reasons that have little to do with its current use, and it is the valuation of these potential development rights to which the valuer is called upon to estimate. Therefore, the valuer may be able to arrive at such a value by direct comparison with the sale of other similar property. However, obtaining comparable evidence of development land values is very difficult as each site differs widely in terms of size, condition of the site, potential uses, design, permissible density of development, restrictions and so on, making adjustments to a standard value almost impossible.

The method is based on the assumption that an element of latent or residual value is released after development has taken place. The value of the site in its proposed state is estimated, as are all of the costs involved in the development, including a suitable level of return to the developer. If the value of the completed development is greater than its cost to build, the difference, known as the “residual values”, is the value of site. This method is mostly applied in development appraisal and viability studies.

(vii) Profit Method
This is a valuation method where the income/profit from the use of property is capitalized to arrive at its capital value. The value of trade related property depends on various factors which combined to produce a potential level of business. Comparison with other similar properties is mostly impracticable. Therefore the value must be determined from the actual level of business profit achievable using the property. Mostly, valuers are familiar or primarily associated with the valuation of interests in land and buildings, but certain properties are being used for certain businesses that have a monopoly element with strong influence on the trading results. Profits method is most suited in this circumstance. The types of properties that fall into the category which this method can be used are properties with trading potential. For example Gillham (1998) opined that for great majority of traditional pubs in town and country the profits method remains the best method.

The basic approach involves using the final accounts or other trading information to find the gross and net profit. Allowances are then made for interest on the tenant’s capital employed in the business and remuneration for the management expertise. The remaining amount (referred to as the “divisible balance”) is then assumed to be available for an equitable division between the business trader and the property based on the contribution of each to the business. This method values the property by isolating a portion of the available profit as rent for the premises in which the business takes place. It is therefore based on two economic assumptions; firstly the business makes a profit and, secondly rent is a surplus paid out of this profit (Wyatt, 2007). The accounts are often adjusted and the reason for adjustment is to provide an adequate reward to the tenant for running the business, while properly reflecting the contribution of landlord in providing the premises.

Mainly, there are two major steps involved in this method. First is to estimate a reasonably maintainable annual profit generated by the business by referring to income, expenditure and the operator’s capital as contained in the company’s annual accounts: second is to use the adjusted net annual profit to determine a capital value of the property, and there
Pitfalls in the valuations of properties with trading potential - a viewpoint

Therefore, the type or class of property contributes to the choice of method in valuation.

(iii) Comparable method
Comparison method is based on the economic concept of substitution that knowledgeable and prudent person would not pay more for a property than the cost of acquiring an equally satisfactory substitute. It is the method used when market data is properly verifiable and can be analyzed as good evidence of the market values of the subject property. However, the problem associated with the accessibility to transaction and valuation data is that many view this information as confidential, making it difficult to obtain (Sayce, 1995). Therefore, where there is lack of sales data, like in Nigeria, the method is difficult to use. Even in Europe, reliable sales data are often difficult to obtain (Nilsson, et. al., 2001).

The approach is concerned with what the market has (recently) been prepared to pay for a similar property, without consideration as to the cost of replacement or future income generation potential (Sikich, 1993). Comparable properties are selected on the basis of their elements of comparison which include the key transaction information such as the date, price paid, market rent and yield as well as the determinants of value such as size, location, use, age, condition and tenure. Using the method therefore calls for a lot of adjustment on the available data, and where (such) numerous adjustments are required, the method is unlikely to give reliable estimates of market value (Andrew et al., 1993). Rushmore and Rubin (1984) also submitted that for larger and more complex investments such as shopping centers, office buildings, and hotels, where the adjustments are numerous and more difficult to quantify accurately, the market approach quickly loses its reliability. Also, the nature of specialized property is that the type of property concerned does not transact sufficiently to be able to determine value by comparison of previous sales (French, 2004). However, the principle of comparison underpins all valuation methods as it surfaces in some of their components.

(iv) Investment method
The principle of investment method is that property is regarded as an investment, yielding regular income in form of rent or profit accruing from it. The method is mainly used to value properties held as investments. The operation of the method involves the determination of annual value which the property can or might produce or annual return on the money expended in buying the investment which will have to be capitalized using appropriate rate of interest in arriving at the capital value of the property.

The calculation of the present value of the cash flows is often referred to as capitalization. To calculate the present value of a property investment, the valuer needs to know the net income, (the income receivable after deductions of any repairs, insurance, services, rates, head rents and other rent charges), the period for which the income will be received and the yield.

(v) Replacement Cost Method
This method is used to value specialized properties that seldom change hand in the market probably because there is no clear market demand for them. Consequently, there is little or no comparable evidence for which comparison method can be used. A property might be specialist because its use requires it to be constructed in a particular way, including highly production specific manufacturing plant such as chemical works and oil refineries; public administration facilities such as prisons, schools and colleges, hospitals town halls, art galleries and court facilities, and transporting infrastructure such as airports and railway building (Wyatt, 2007). Property can also be specialized by virtue of its size or location. When these types of property are valued, what is calculated is not actually a market value but a replacement cost for the improvements that have been made to the