Basics of Year's Purchase

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1 author:

Betasha Felix Chawaza
Federal University of Technology Minna

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PRESENTS

BASICS OF YEAR'S PURCHASE (YP)

BY

Betasha, Felix Chawaza
(B.TECH. ESTATE MANAGEMENT AND VALUATION)

E-mail:Betashafelixchawo@gmail.com
Twitter/Facebook:@iamchawaza

https://orcid.org/0000-0001-6331-948X

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Betasha, Felix Chawaza
(B.TECH Estate Management and Valuation)

E-mail:Betashafelixchawo@gmail.com
Twitter/Facebook:@iamchawaza

Department of Estate Management and Valuation,
School of Environmental Technology,
Federal University of Technology,
Minna, Nigeria.

BASICS OF YEAR'S PURCHASE (YP)

Every investment on planet earth has a price of purchase. This price can or may be seen as its capital value. An investor about to purchase an investment may want to know the maximum amount he can pay to purchase the investment. Now, Year's Purchase is a capitalization factor and a multiplier which when applied to the Net Income it gives the capital value. It is occasionally known by different names depending on the subject country. In Nigeria, it is known by valuers as Year's Purchase (Y.P). To determine the year's purchase of an investment, the investment must produce an income (Net Income). Net Income is the actual income received from an investment after all expenses have been deducted. Expenses is known as expenditure or outgoings example: Salary, Wages, Service charge, Electricity bills, Utility bills, Tax, Etc.

Mathematically;

Net income= Income received - Outgoings.

Basically, Year's Purchase can be in three aspects:

- When an investment is having a capital value and a net income.
- When an investment is yielding a particular amount periodically.
- When there is a deferred value of a future sum that will be received from an investment and when there is an amount invested periodically for a particular purpose e.g maintenance.

- **When An Investment Is Having a Capital Value And a Net Income**

When the capital value and a Net income is known, it can be used to determine the capital value of another investment within that category.

Assuming your friends P,Q and R having a commercial complex each at same particular business district, you want to purchase a commercial complex too at that same location and you obtain the following information from them;

S/N	Capital Value (♯)	Net Income (♯)
P	$50x10^6$	$9x10^6$
Q	$30x10^6$	$6.5x10^6$
R	$25x10^6$	$5.5x10^6$
S	?	10×10^6

Note; S is an assumption of the property you want to purchase.

With the information provided above, the Year's Purchase of P,Q and R will be 50÷9=5.6, 30÷6.5=4.6 and 25÷5.5=4.5 respectively.

Hence, the capital value of S=56×10^6 using the YP of P because the net income of P and the Net income of S are within the same range which means the commercial complex P and the commercial complex S are similar.

- **When An Investment Is Yielding a Particular Amount Annually**

The years purchase of an investment here is directly proportional to its yield. Government might agree to give a certain interest annually to any individual who purchase its commercial paper.

Assuming you purchase a government bond at the rate of **♯20x10**^{3} which will be yielding **6%**

return on investment annually, the Year's Purchase based on this aspect will be **100÷6=16.7.**

This aspect is applicable to any investment especially if it an income yielding one.

- **When There Is a Deferred Value Of a Future Sum That Will Be Received From An Investment and When There Is An Amount Invested Annually For a Particular Purpose (Maintenance).**

You can easily know the YP of an investment under this circumstance using the valuation table. When Present value of ♯1 (PV) multiplies the Amount of ♯1 per annum it produces the Year's Purchase (Y.P) which can also be called present value of ♯1 per annum of the investment.

Assuming PV and Amount of ♯1 per annum in each case 10 years at 6% interest.

PV=0.5584

Amount of ♯1 per annum=13.1808

Therefore, YP=7.3601 this can be used to determine the capital value of an investment having similar attribute.

YP under the valuation table can be referred to as present value of ♯1 per annum.

Based on this work, the basics of Year's Purchase is only discussed. Knowing this basics Can help an investors determine how much they can bid to purchase an investment even if the fund will be on mortgage basis.

