Commercial property loan valuations in the UK : implications of current trends in practice and liability.

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Abstract

This paper is the second of two papers which aim to examine the major legal liability implications of changes to the commercial property loan valuation process caused by the recession in the UK property market and to make recommendations to valuers and their professional institutions to improve the quality of the process and the result.

The objectives of this paper are to address a number of the practical implications of changes to the loan valuation process within the context of legal liability. The results of an interview survey of lenders and valuers are reported and analysed. The survey examined the loan valuation process including the selection and instruction of valuers, bases of valuation and valuation reporting.

In the selection and instruction process, the findings of the survey reveal two potential problems within the valuer/lender relationship. First, valuers still occasionally accept instructions from borrowers and this could lead to a conflict of interest as lenders may rely on the survey. Second, the occasional lack of formal instructions prior to the delivery of reports casts doubt on the valuer's ability to correctly identify the needs of clients.

Regarding the basis of valuation, it was found that valuers are providing valuations on bases which they do not think are appropriate. Valuers may be legally liable if they do not inform clients of their reservations and this situation must be urgently addressed.

The survey also confirms previous research that valuation reports are considered to be light on contextual information concerning markets.

The paper concludes by making a number of specific recommendations concerning possible improvements to the commercial property loan valuation process.

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1. Introduction

In a previous paper, specific issues concerning the legal liability implications of changes to the valuation process caused by the recession were examined and a number of research questions raised. The conclusions to that paper were that there was:

(i) a potential conflict of interest caused by valuers accepting instructions from borrowers rather than lenders or the choice of valuers by lenders being influenced by the borrower, and

(ii) a duty of care by the valuer and there were a number of principles underpinning the standards required of the valuer in carrying out that duty.

A number of more specific research questions are raised by the discussion of the market background, the institutional response and the legal liability principles and case precedents set out in that previous paper. They can be summarised as follows:

(i) If a potential conflict of interest arises if valuers are instructed by borrowers, is there any evidence that borrowers instruct valuers or influence the instruction process?

(ii) If formal instructions should be received and clarified before undertaking the job or releasing the report, is there any evidence that valuers undertake valuations and issue reports before receiving formal written instructions?

(iii) If the valuer has a duty of care to advise the client of any doubts regarding aspects of the task, is there any evidence that valuers have doubts regarding any aspects of the loan valuation process and that they appreciate the need to pass any doubts on to clients?

(iv) If the valuer has a duty of care to offer advice, interpret information, draw conclusions and make recommendations, is there any evidence to suggest that valuers offer such advice proactively?

(v) If the valuer is under a duty not to adhere slavishly to guidance notes and apply them when inappropriate, is there any evidence that valuers apply the guidance notes even if they feel they are inappropriate?

In order to answer these questions, a semi-structured interview survey was undertaken during the latter part of 1995 and the first half of 1996 with valuers and lenders in the UK. The results of this survey were analysed in conjunction with one other survey looking at specifically valuation reports, not specifically investigating loan valuations (Crosby, et.al, 1995).

After a small pilot study was undertaken, the main survey comprised 27 valuers and 9 lenders. The valuers were located in central London (15) and 4 each in the North, Midlands and South of England. The 9 lenders were spread amongst the high street clearing banks, overseas banks, specialist commercial lending institutions and building societies involved in commercial property lending.

The interview schedules for both valuers and lenders included questions regarding the selection and instruction of valuers, bases of valuation and valuation reporting.

Within the schedule, valuers were asked specific questions concerning the source of the preliminary contact, the source of initial instructions, the source, timing and format of formal instructions and the timing of delivery of reports.

They were also asked specifically for their views on the new basis of valuation, ERP, and whether these views were passed onto clients if instructions varied from their beliefs of the most beneficial basis to clients. The valuers were also asked questions regarding the professional institution guidance notes and their status and whether they would depart from those notes if they believed they gave wrong advice. Another set of questions related to the information in reports and whether they would offer information not asked for by clients if they thought it was in the clients' best interests.

The lenders were asked similar questions concerning the instruction process and the basis of valuations. Lenders were also asked for their opinion of the quality of valuation reports and the information contained therein and how they could improve the overall service.

2. The Study Findings

2.1 The selection and instruction of valuers

The findings have been divided into a number of sections, although the valuation process is interactive and, in some cases, this division is artificial. These sections are; identification of suitable valuers, selection of the valuer, procedures adopted when receiving instructions and procedures adopted when instructions are amended.

2.1.1. Identifying suitable valuers

Previous research (Crosby, et al., 1995) suggests that cost, reputation of the firm and reputation of the individual valuer are the major influences concerning the choice of valuer for a wide range of types of work from a wide range of clients. The lender survey showed that 89% of lenders had a formal panel of valuers which they used to identify suitable valuers. One lender (11%) did not employ a formal panel, but was, by limiting its valuation work to a small number of firms, effectively operating an informal panel. It would appear that most lenders will usually give valuation work to valuers on their panels, whether formal or informal; however, the number of panel valuers varied considerably between lenders, with panel sizes ranging from four to over one hundred and fifty valuers.

The number of valuers on a panel appears to depend upon the nature of the lenders' lending activities. Specialist commercial property lenders preferred to keep panels smaller. One respondent suggested that lenders who specialise in low volume/high value loans desire to know the valuer personally, so that a good working relationship can develop. It was also revealed that, by keeping the number of panel valuers to a minimum, the lender was better able to secure co-operation from the valuer concerned, by exerting pressure if need be.

Generally speaking, it appears that the lenders use their panels and identify from them the valuation firms with whom they are prepared to deal. The requirements a valuer must satisfy to be included on a panel vary considerably. Five of the lenders (56%) only use individual valuers within firms and suggest that if the valuer changes firms, then the new firm would likely become a panel valuer, so confirming the results of previous research that the individual is at least as important as the firm.

2.1.2. Selecting a suitable valuer

Being on a lender's panel does not guarantee the valuer work from that lender; it merely means that the valuer will be considered. Four lenders (44%) would consider letting the borrower select a valuer if the valuer is already on their panel. The apparent reasoning was that the lenders were comfortable with those valuers with whom they were familiar. One lender intimated that it would consider using a valuer not on its panel if requested by the borrower, adding that -

> "If the borrower insists, then we may allow them to choose the valuer if we know the (valuation) firm concerned. We will usually have a 'check-valuation' done if we are at all concerned".

The four lenders who suggested that they might allow the borrower to select the valuer also stated that this occurrence was rare. In two of these cases, it was intended to give the borrower a choice of valuers so that they could approach a small number of panel valuers to negotiate the best fee.

The lender study indicates that 33% of lenders allow the borrower to be involved in the formal selection of a valuer, and 44% of lenders stated that the borrower was occasionally allowed to contact the valuer to negotiate fees. In itself, allowing the borrower to negotiate fees with the valuer is only a cause for concern if the fee negotiations have an impact upon the selection of the valuer. The responses of four lenders imply that there are situations where the borrower can influence the selection of the valuer. For three of the lenders, the borrower routinely has an impact upon the choice of valuer.

The valuer survey supports the contention that borrowers, prior to receiving formal instructions, have an influence upon the selection procedure. Twelve London (80%) and seven provincial (58%) valuers replied that borrowers usually or occasionally established

valuation fees, with seven London (47%) and five provincial (42%) valuers stating that occasionally initial contact was by the borrower, not the lender. Although the number of valuers who will accept formal instructions from borrowers is less, four valuers stated that they do allow it at least occasionally.

It is not surprising that borrowers wish to be involved. Borrowers have a substantial interest in the findings of the valuation report, since the report's findings will usually be an influential factor on the lender's decision to offer a loan. An adverse report could materially affect the amount the lender is prepared to advance and, in some cases, may cause the lender to withdraw altogether. In addition, the lender survey revealed that it is the borrower who ultimately pays for the valuation service.

Payment of valuation fees is a contentious issue. The valuers almost invariably report to lenders, but lenders require that the valuation fees are paid using borrowers' funds. Whilst contractually the valuer has no relationship with the borrower, it is obvious that the borrower has a strong interest in fees being as low as possible. 56% of lenders surveyed felt fees were unimportant to the lenders in their choice of valuer, although they generally accepted that they were important to their customers.

The payment of valuation fees by the bank, using borrowers' money, has a further drawback for the borrower. Since valuation fees include Value Added Tax which banks are not eligible to recoup, the borrower is forced to pay the fees and the tax, through the bank. If the bank pays the fees on the borrower's behalf, borrowers will also find themselves unable to reclaim their Value Added Tax.

Over half of the lenders surveyed (56%), said that they sometimes allow the borrower to pay the valuer direct, thereby allowing the borrower to reclaim the Value Added Tax. Although this practice may be beneficial for client relationships, it is perhaps legally doubtful. It calls into question the validity of the contractual relationship between the

lender and valuer. In addition, as one lender who avoids this situation commented, it appears to be an attempt to avoid payment of Value Added Tax.

2.1.3. Commencing the valuation

The valuer study suggests that it is rare, but not unknown for valuers to accept instructions for loan valuations from any party other than the lender. Since initial contact was not uncommon from a third party, it is necessary to examine the way in which initial contacts are translated into formal instructions.

The study suggests that, in the majority of cases, valuers are initially contacted to assess fees, availability and provide a 'ball-park' valuation. If these are acceptable, formal written instructions follow. The RICS in VGN12 (RICS, 1992) advised the valuation profession not to commence valuations before receipt of formal written instructions; however, the subsequent Mallinson report accepted that "commercial necessities may dictate that work must start before formal instructions can be prepared". To account for this factor, Mallinson proposed that:

> "12.6 A valuer should not submit his valuation, either orally or in writing, until he and his client have initialled a formal 'Memorandum of Instructions' which contains the key elements upon which the valuation will be based."
>
> (Mallinson, 1994)

In the lender survey, all nine respondents stated that they would expect the valuer to commence a valuation immediately following verbal instructions. In the valuer survey, 73% of London valuers and 75% of provincial valuers said that they would commence a valuation immediately following oral instructions. However, the overriding impression

was that, except in extreme cases, valuers were unwilling to commit significant time to a valuation before receipt of written instructions.

In keeping with the Mallinson recommendation, 93% of London valuers and 83% of provincial valuers would not release the valuation report before receiving instructions. However, three valuers (11%) confirmed that they occasionally completed and submitted a valuation without receiving formal written instructions. Their reasoning appeared to be that they already knew the client and the client's requirements. Nevertheless, it is a practice which Mallinson and the RICS Red Book (RICS, 1995) suggest should be avoided. Without formal instructions, there is the possibility that the valuation, while undoubtedly produced in good faith, could fail to address the client's needs. In a worst case scenario, the valuation could prove misleading to the client, and result in litigation. Valuers should consider that, although they owe a duty to their clients, they also have a responsibility to their firm and the credibility of their profession. In view of the clear and unequivocal nature of RICS guidance on this subject, it is likely that the courts would view this practice unfavourably in the event of litigation.

2.1.4. Instruction format

Instructions provide the valuer with a record of the requirements of the client. In the survey, both valuers and lenders frequently mentioned that the quality of instruction letters have improved immeasurably in recent years. Concern was expressed by a few valuers that a number of lenders' instructions had become far too verbose and often requested information that was wholly inappropriate. Indeed, one lender provided a sample instruction letter comprising seven A4 pages and a further eight page appendix. However, the improvement in the standard of instruction letters should be commended, as it can only improve the understanding between valuers and their clients. Indeed, if an instruction letter is believed to contain inappropriate requests, the valuer should communicate this to the client. 'Slavish adherence' to misconceived instructions would be

no more tenable in a professional than ‘slavish adherence’ to institutional guidance or any other stipulation.

The London valuer study found that 93% of instructions were received on standard forms produced by the lender, whilst five firms (33%) stated that 100% of their instructions were received in this way. Amongst provincial valuers, 92% of instructions were on lender’s forms, with five firms (42%) obtaining 100% of their instructions in this way. (reported in Crosby, et.al., 1995). In the lender study, 78% of respondents always used standard form letters of instruction, although these forms were usually tailored to reflect any unusual requirements. One lender (11%) appreciated the advantages of standard forms and was in the process of developing one. The remaining lender felt that standard forms were wholly inappropriate. Nevertheless, the study strongly suggests that the issuing of standard letters of instruction has become an increasingly common procedure.

Whilst the valuer survey found that the vast majority of instruction letters originate from the lender, the larger valuation firms were often consulted by lenders about the form and content of these letters. Encouragingly, 56% of lenders discuss all aspects of the valuation with the valuer, suggesting that content of formal instructions usually results from discussions. One lender reported that it sends a draft instruction letter, which is then re-written between the parties to produce the formal instructions.

2.1.5. Procedures for confirming formal instructions

Although receipt of formal instructions should be sufficient for the valuer to commence the valuation, the study found that valuers commonly confirmed receipt of formal instructions subject to their ‘standard conditions and terms of engagement’. This practice was mentioned by a number of valuers and confirmed by the lenders. However, lenders commented that the legal wording was difficult to comprehend and did not clearly communicate what the implications of the conditions were.

The Mallinson Report recommended that the valuer should ensure that the Valuation Report and its limitations are understood by the client and that the valuer should provide all information relevant to the clients' needs, whether asked for or not. The extent to which the adoption of 'standard conditions and terms of engagement' could actually result in clients receiving valuations which are inappropriate to their needs is unclear. One lender suggested that these conditions tended to obscure, or 'scotch over what they have not seen with standard words'. Another lender routinely sends such conditions to its solicitor, causing often considerable delay in the valuation process. In view of the required rapidity in producing a valuation and report, this delay is rarely viewed favourably. Perhaps of most concern is the observation of a third lender who stated:

> "We use valuers as our eyes and ears, we don't actually see the property. P.I. led caveats and conditions of engagement are annoying, we often don't read them and don't really understand them anyway"

2.1.6. Amending formal instructions

The final stage in the instruction process arises when formal written instructions are amended because the instructions are either inappropriate or incomplete. Only four London valuers (27%) always confirm oral amendments to instructions before releasing the report. One usually did and another occasionally did. However, five London valuers (33%) never confirmed oral amendments. Of the remaining two, one valuer said written instructions were not amended, while the other gave no reply. Of the provincial valuers, it was found that only two usually confirmed verbal amendments, whilst the remaining ten valuers (67%) responded that either oral amendments were confirmed or oral amendments did not occur.

All the lenders surveyed suggested that they would expect valuers to advise them if they felt that the instructions provided were inappropriate to the clients' needs. All the provincial valuers stated that they would always advise the lender of any inappropriate instructions. The replies from the London study were less clear, with ten valuers (67%) stating that they would always advise in this situation, one valuer (7%) answered 'usually' and three (20%) answered 'occasionally'. With hindsight, it could be suggested that the question, as put, could have been misinterpreted by the respondents in the mistaken belief that the question was seeking to ascertain how often it was necessary to advise lenders that their instructions were inappropriate. However, the valuer who stated that he would usually advise in such situations commented that, if it was not a serious problem, he would probably go ahead anyway. A second valuer suggested that "the level of fees are insufficient to allow us to 'mollycoddle' the client"

The remaining valuer remarked that he would never advise a client whose instructions were inappropriate to the situation, but would instead deviate from the formal instructions to provide a more appropriate service.

2.2 The basis of loan valuations

In the valuer survey, the 27 interviewees were asked which basis was most commonly used. Twenty five (93%) indicated OMV, one (4%) indicated OMV and ERP together, while only one valuer (4%) indicated that ERP was most commonly used. Only one valuer did not prefer OMV as the first choice of basis, suggesting that it was the client's decision, not the valuer's. Five valuers (19%) suggested that requests for ERP were reducing, although one interviewee (4%) said they were increasing. Four interviewees (15%) suggested that the banks did not understand the bases and three (11%) went further and suggested the banks thought they knew what they were getting, but they were wrong.

When the valuers were asked for comments on why the banks asked for ERP, ten out of the fifteen London valuers (67%) expressed serious doubts about its validity, as did one (8%) of the provincial valuers. A further one London valuer (7%) and two provincial valuers (18%) were not themselves clear regarding the ERP/OMV definition difference. Six (40%) of the London valuers and one (8%) of the provincial valuers thought that the banks did not understand ERP (or suggested that the banks thought they understood ERP, but really did not). Four (15%) valuers were of the opinion that the banks asked for ERP simply because of a head office decision that they should do so.

The survey reveals an interesting situation. Around 40% of valuers surveyed (including 67% of the London valuers) provide valuations on a basis which they do not believe delivers to the client what the client needs. Over 25% of valuers did not believe that the banks understood ERP.

The lender survey indicated that lenders generally dictate bases with only 1 (11%) indicating that they allowed the valuer to do so, and that only occasionally. All 9 of them use OMV and 8 (89%) use ERP, although 2 of these ask for it occasionally. Only two lenders actually preferred ERP to OMV.

These findings are at slight odds with a previous survey of banks by DTZ (1995) which suggests that they welcomed the valuation profession's responses and over half of them supported the new basis of valuation of ERP, although a third of respondents were sceptical about its effectiveness. The DTZ findings show more lender support for ERP at that time. This may show a changing attitude towards ERP, as lenders realise its limitations, set out in the previous paper.

Three valuers (11%) suggested that OMV supported by a market commentary was a better solution to the banks' problems. Additional information in valuation reports was a

major theme in the Mallinson Report and VGN 12 set out a schedule of information which should be included in reports. This list and the findings of previous work on valuation reporting across a variety of valuation purposes (Crosby, et.al., 1995) provided a focus for the survey questions on the information content of reports.

2.3 Information content in reports

Crosby et al (1995) examined the views of clients on the information content of property investment reports. A questionnaire survey in December 1994 elicited 80 responses (a 36% response rate) relating to an estimated £50 billion of commercial and industrial property and 15,000 properties. This is very similar to the make up of the Investment Property Databank.

There were four major client groupings; insurance companies, pension funds, property companies and banks. While 68% of responses came from a valuer within the client organisation, only 28% of the responses from banks came from valuers. In addition to the 18 banks who responded, there were three other non-valuer respondents from financial institutions whose main need for valuations was for loan security purposes, meaning that 26% of the responses related to this part of the valuation process.

The survey highlighted some consistent criticisms of the information content of reports. However, the survey showed that valuer's valuations are generally well regarded by clients. The main cause for concern as far as the lender clients are concerned is quality of reports.

The specific criticisms of reports relate to the information content. Table 1. identifies the main headings of information which appear in reports.

TABLE 1 : INFORMATION CONTENT IN VALUATION REPORTS

Information Type	Number of Respondents Indicating Information Provided		
	Yes	**No**	**No Response**
The Physical Location	61	3	16
The Building Design and Layout	52	10	18
The Building Measurements	57	7	16
The Tenancy Details	59	4	17
The Planning Situation	49	14	17
The Location in National and Regional Context	43	20	17
The State of the Lettings Market	37	23	20
The State of the Property Market	33	28	18
The State of the Wider Investment Market	22	40	18
The Valuation Method Used	43	19	18
The Comparable Information Used	39	22	19
The State of the Economy	22	39	19
Others	8	7	65

Source : Crosby, et al (1995) plus additional analysis of questionnaire data for this paper.

The descriptive elements, such as the location, the tenancy details and the building measurements, are most likely to appear in valuation reports. Comments on the building design and layout and the planning situation are also likely to appear. The more interpretative issues beyond property-related matters, which are least likely to be included in the report, are the state of the economy and the state of the wider investment market/s. The contents which are likely to appear in the majority of reports are a discussion of the location in its national and regional context, the valuation method and comparable information used, and the state of the property market.

Respondents were also asked to comment on whether they thought this balance of information was correct. Using the scale of 1 to 5 where 1 = too little, 3 = just the right amount and 5 = too much, the respondents scores were averaged and ranked in descending order. These are shown in Table 2.

TABLE 2. : RESPONDENTS' PERCEPTION OF BALANCE OF INFORMATION PROVIDED

Information Type	Lender Respondent Score	Average Score
The Physical Location	3.10	3.17
The Building Measurements	2.95	2.95
The Tenancy Details	2.20	2.72
The Building Design and Layout	2.38	2.62
The Planning Situation	2.40	2.53
The Location in National and Regional Context	2.11	2.50
The State of the Property Market	2.05	2.31
The Valuation Method Used	2.00	2.19
The State of the Economy	2.08	2.18
The State of the Lettings Market	1.95	2.16
The Comparable Information Used	2.22	2.02
The State of the Wider Investment Market	1.72	1.98

Source : Crosby et.al. (1995) plus additional analysis of questionnaire data for this paper.

Despite the response to previous questions indicating that respondents were generally happy with the quality of valuation reports, these rankings suggest some underlying problems. As only one element has scored over 3, there is a general perception that valuers provide too little information in reports. Respondents are generally happy with the provision of property-specific factual information, such as the location (where 74% of responses to this question indicated that valuers provided just the right amount of information), the building measurements (70%) and the tenancy details (72%).

Respondents indicated the requirement for more interpretative information on the property market. Of the respondents who answered this question, 43% thought valuers provided too little information on the location in its national and regional context, 42% too little on the planning situation and 54% thought too little on the state of the property market. Regarding valuation methods, 54% and 65% thought too little information was provided on valuation methods and comparables respectively. The lack of information on

the lettings market was more noticeable than for the property market as a whole, with 69% of responses to this question indicating too little information was provided.

Bottom of the rankings was information on the state of the wider investment markets. Respondents obviously believe that valuation reports should include a discussion of other investment markets, although this information is only provided in some one-third of valuation reports.

The lenders were the least satisfied group of clients. They scored the valuers lower than the survey respondents as a whole on every single category except two. They were particularly concerned about the lack of information on markets and the state of the economy. They were less concerned with the provision of comparable information and they also felt that the provision of factual information was better than the more contextual information.

The lenders, unlike the other respondents, would be prepared to pay more for better quality (75% against a survey average of only 40%) but over 80% are keen to see even more industry regulation of the valuation process (against a survey average of only 55%).

This research raises questions of whether the valuers are able to respond to this request for additional information. The additional information is less property specific and more contextual. It would help to lessen the problem with the basis of valuation identified in the previous paper where the single snapshot in time gives no indication of the capability of the asset value to cover the loan at a future date.

During the interview survey carried out for this research, the valuers' response to these calls for additional information was examined. Twenty six interviewees (96%) confirmed that they 'always' gave factual information on the location, descriptions of the property and its condition. The other interviewee responded with 'usually' to all of these

categories. Contextual information on the state of the current market was ‘always’ reported by twenty four interviewees (89%) with the other three reporting ‘usually’. Information on future trends was reported to be ‘always’ provided by sixteen interviewees (59%) while another nine (33%) suggested that they ‘usually’ gave it. Only two valuers (7%) suggested that they only ‘occasionally’ gave it. However, these answers were qualified. A number commented that their view of the future communicated in reports was very limited or vague and/or they would only give it if asked.

Valuation methods were ‘always’ or ‘usually’ set out in reports by twenty interviewees (74%) and availability of comparables was discussed in reports always or usually by twenty four valuers (89%).

The interviewees tend to confirm the overall picture gained from the previous survey of clients regarding valuation reports. Valuers are less willing to give contextual information than they are factual property information. A number of comments are framed with the view that the valuers only volunteer information if pressed.

The interview survey of lenders gives added weight to the findings. Two (22%) of the nine banks stated that the market commentary was more use than the valuation figure, but all nine wanted the valuation expressed as a single figure. Regarding the content of reports, 6 (67%) specified the content of reports, with 4 (44%) having standard forms. Over half (55%) thought that valuers’ reports were comprehensive, but 4 (44%) suggested they were sometimes too verbose and unfocused. The interviewees confirmed that, where additional information was required, it included market commentaries, comparables and DCF based ‘checks’. They also suggested that PI-led caveats should be reduced and simplified.

3. Interpretation of Findings

3.1 The selection and instruction of valuers

The procedures adopted by both borrowers and lenders at the instruction stage of commercial loan valuations reveal two potential problems for the valuer/lender relationship. The first is the possible conflict between the interests of the lender and the borrower. The second problem relates to the client's requirements and whether the valuer is in a position to identify and deliver the client's needs correctly.

3.1.1. Source of Instructions : Borrower/Lender

The research findings suggest that there is the distinct possibility of a conflict of interest arising if a valuer accepts instructions from a borrower client. The purpose of a valuation report for loan purposes is to provide the lender with sufficient information to make an informed lending decision. A borrower may wish to have a valuer make a market assessment of the value of his property either for internal accounts purposes or as a sale/purchase valuation, but these are not to be confused with a valuation for loan purposes. The objective of a borrower in procuring a loan valuation is presumably to borrow as much money as desired on the security of the property. This is obviously radically different from the lender's requirement, which is to determine the value of the security against which any lending decision will be made. The valuer has a legal obligation to take care of the interests of any third party who can reasonably be expected to rely upon his valuation. If a valuation commissioned by a borrower is relied upon by a lender, the valuer will be held to have a legal obligation to protect the interests of both the client (the borrower) and the lender. Whilst it could be argued that valuers undertake

their valuations objectively, it is clear that situations where the interests of a client may conflict with a legal obligation to a third party should be avoided. It is clearly not in the best interests of the valuer to accept instructions in this fashion, not least because the valuer has no way of knowing the requirements of the third party involved. A number of major cases are proof that the practice of a borrower commissioning a report and then 'hawking it around lenders in search of the best deal' was not uncommon during the 1970s. The valuer and lender surveys, backed up by evidence from more recent cases, suggests that this unfortunate practice continued throughout the 1980s and survives, albeit not extensively, to the present day.

The valuer survey suggests that a large majority of valuations for loan purposes are initiated by instructions from the lender. In the current climate, it appears that both valuers and lenders recognise the importance of formal instructions. It was regularly suggested that procedures underlying formal instructions are much more stringent than was the case at the height of the boom. However the fact that a minority of valuers do still accept instructions from borrowers should be cause for concern.

3.1.2. <u>Knowing the client</u>

The stated objective of the RICS in publishing guidance notes is to ensure that valuers are able to provide clients with the service they require. The necessity for a valuer to 'Know the Client', now incorporated in the RICS guidelines, has arisen through the deliberations of the Mallinson Report. The Report recognised that misunderstandings between valuers and their clients occasionally occurred and the Report's recommendations can be viewed as an attempt to remedy the situation.

Two recommendations in particular address this issue:

“9.4 It should be clearly understood that a valuer has a general obligation to supply with the valuation, whether invited or not , such additional information as he has reason to believe his client will need to understand, use and benefit from the valuation”

“11.1 Valuers produce their figures and reports for an enormous range of clients, from those who already have a great understanding of property, to those wholly unfamiliar with property, the property market and the terms and concepts used by valuers. We consider that it is the professional duty of a valuer to understand not only the purpose for which his client seeks the valuation, but also his ability to understand and benefit from the advice given, and to have at least some understanding of the importance of the advice to the client.”

(Mallinson, 1994)

If valuers are to provide the service envisaged by Mallinson, they must establish not only what the client requires but also who the client is and who, apart from the client, is likely to rely upon the report.

The preparation of a valuation report requires precise instructions from the client detailing the purpose and scope of the service required. The study reveals that the procedures adopted by valuers and their clients in the production and verification of instructions are far from ideal. Mallinson advised that written instructions should be in the valuers' possession before the valuation is undertaken. Mallinson made it clear that proper instructions are vital if misunderstandings between the client and the valuer are to be avoided.

> “The absence of proper instructions can lead to client dissatisfaction (he does not get what he wants), and worse, to the valuation misleading him, or others who read it” 12.1.

However, whilst it is clear from the survey that both valuers and clients understand the importance of written instructions, receipt of those instructions before commencing the valuation is far from universal practice. Indeed, a significant minority had occasion to release the valuation report without formally receiving and verifying instructions. In addition, further evidence from the study suggests that, whereas releasing a report without receipt of formal instructions was uncommon, failing to confirm subsequent amendments to those instructions was not.

It seems likely that, in the absence of formal written instructions, it would be difficult for the valuer to understand fully the needs of the client. Since the valuer is under an obligation to serve those needs, it is doubtful whether a valuer, lacking formal written instructions, can provide clients with the service they require and expect.

Finally, failure to provide written records of any amendments to formal instructions must be viewed as unacceptable. In the event of litigation, it is vital that the valuer can show that the service provided is not only suitable for the client’s needs, but is also the service the client requested.

3.2 Bases of valuation

In view of the nature of the valuer’s legal liability and specifically the duty of care as discussed in the previous paper, the conclusion following on from this part of the research is inexorable. If valuers believe that ERP is unsuited to their clients' needs, or that they will not understand it, they have a duty to consult further with the clients and to establish an appropriate solution. The Red Book requires the supply of an OMV basis to accompany ERP (with the odd

exception set out in the new RICS/BBA guidance to bankers of a lender's report form which does not require it). The supply of both OMV and ERP, accompanied by a reasoned explanation of the perceived limitations of ERP or advantages of OMV as a basis for valuation, would appear to be such a solution. Valuers who are accepting and fulfilling instructions which they believe are inappropriate to the clients' needs are running a risk. They are ignoring Mallinson's advice that "if a client requests a basis of valuation which, in the valuer's view, is inappropriate for the purpose of the valuation, he must tell the client of his opinion and offer him additionally a figure on the more appropriate basis". In the view of the authors, they are also ignoring the law's expectation that a professional will be a reflective practitioner, who is familiar with all relevant guidance and takes it seriously, but who ultimately exercises intelligent judgement in using it or declining to do so. This is absolutely consistent with the expectation of the professional body of its members:

> "We are of the opinion that, because of the many purposes for which valuations are required, there is no standard approach which should be adopted by the profession .... The bases must be designed to meet the clients' needs".
>
> (Mallinson, 1994)

Indications at the beginning of 1996 (discussions by one of the authors with RICS committee members) are that some of the main proponents of ERP have realised that its introduction may have been counter-productive. This could well lead to a gentle demise of ERP, starting with reducing usage in practice and culminating in its non- appearance in a subsequent edition of the Red Book. In the meantime, valuers who are asked for ERP, but believe it inappropriate, may be under a duty of care to declare their doubts and not take the line of least resistance, which is merely to give the client what is asked for, without question.

This research has not addressed the wider question of whether a single snapshot in time pricing valuation is the right question for the banks to ask. The lack of 'shelf life' has not been solved by ERP, because its view into the future is dangerously short, but it has focused attention on the identification of future trends. Given that the ideal advice for lenders would be a forecast of the timing and the extent of the deepest recession in the property market over the term of the loan and the obvious difficulties of long term forecasting of any market, let alone at the property specific level, there is a pressing need for a debate on the provision and analysis of information to be provided within reports.

3.3 Information content in reports

The survey confirmed the conclusions of previous work to the effect that banks believed that they are now receiving better reports due to the more detailed instructions and improved communication between client and valuer concerning each other's needs. DTZ (1995) commented that the property crash of the 1990s focused the banks' attention away from the snapshot in time valuation towards assessments of current and future market trends. This confirms the approach of the RICS and the BBA, who stress the information content within valuation reports, even though there still tends to be a concentration on property-specific matters within all of these publications (RICS, 1994; RICS, 1995; RICS/BBA, 1996). But it also questions the need for the new basis of valuation, i.e. ERP. ERP appears to have been the product of a misunderstanding of the precise nature of the limitations of any exchange price valuation on the part of the banks and a reluctance of the valuers to refuse the bankers' demands.

The nature of valuation reporting in the future perhaps has the widest implications for valuers. In the past, valuers in the UK have been able to communicate with clients at a minimalist and factual level. The survey work points to a fundamental change in the

expectations of clients. They are no longer prepared to accept a valuation figure which is not put into its proper market context.

In order to do this, clients require more interpretative information and the survey findings suggest that a number of valuers agree that this is what they need. Believing that clients should have certain information and interpretation but failing to provide it is at least inconsistent with the concept of professionalism and, arguably, with the professional's legal obligations. Apart from VGN 12, guidance notes have tended to focus on factual material when discussing reporting. However, as clients are demanding more information on market trends, tenant strength, and valuation methodology and information, valuers and their professional institutions will be forced to consider how it might be provided and communicated.

4. Conclusions

The market conditions of the late 1980s and the early 1990s have had a significant effect on the relationship between the valuer and the lender. Following a boom in lending during the 1980s, with intense competition for new business, both lenders and valuers appear to have compromised good practice under the influence of commercial pressures. Professional negligence cases already heard in the wake of the 1990s recession have revealed examples of these compromises. In addition to poor valuation expertise, they also include items such as a lack of detailed formal instructions, in some cases delivered after the valuation report, and minimal information provision in support of the valuation figure.

A number of the problems have been addressed by both bankers and valuers through individual and joint institutional action and debate. This has led to more information on good practice and procedures which this and other research suggests will help avoid some of the problems of the past. For example, the discussions appear to have led to improved communication between both parties, greater understanding of each others' needs, greater

understanding of the limitations of the valuation figure and the subsequent need for supporting information in reports to put the valuation figure into context. Instructions are more detailed and valuation reports are believed to provide more and better information to clients.

This may mean that any future recession will not lead to another outbreak of valuation negligence litigation, at least not to the same extent as recently experienced. Better informed valuers and clients, using more detailed and well thought out guidance notes, should be more able to avoid potential liability. However, the increased quality of the guidance notes may be, ironically, one of the difficulties. As guidance becomes better and relates to more valuation situations, it becomes more influential. There is a danger that the new Red Book will be adhered to more slavishly than in the past. Where the Red Book gives inappropriate advice, 'slavish adherence' is a poor defence to a negligence claim and could even help create one. The onus is therefore on those who draft guidance notes to be aware of this danger and ensure the quality of the research and development work on the guidance notes, especially in explaining their limitations and the care which must be taken in their use.

There are a number of specific issues arising from this research where the results suggest that the valuation process needs to improve.

(i) There are still cases of borrowers choosing and even instructing valuers. This could lead to a potentially harmful conflict of interest, pulling the valuer's obligations in two directions.

(ii) There are still cases of valuers undertaking valuations before formal instructions are issued and even releasing the report before the formal instructions arrive.

(iii) The proliferation of bases of valuation in the new Red Book following the Mallinson Report and VGN 12 still includes ERP and ERRP. They appear to be not well regarded by valuers and even the lenders are mixed in their response to these bases.

(iv) The lack of contextual information in valuation reports. Despite improvements, valuers are still perceived to be light on information apart from property-specific factual information.

The third and fourth points illustrate one of the principal issues of this research: that those valuers who have adopted the approach of providing minimal information in the belief that it would help protect them against negligence claims will need to re-appraise their position. In the debate on both bases of valuation and the provision of more information to put the valuation into a market context, some valuers are not communicating their beliefs to clients.

Regarding bases, the need for a differently-timed exchange price valuation has been debated and found wanting and the movement away from its use has been suggested by the survey work. Despite this, it is still asked for by lenders and provided by valuers who feel it does not aid their client. It has been suggested by this research that the provision of information which the valuer knows or believes to be of no benefit to the client without comment to that effect may constitute a breach of duty.

Regarding valuation reporting, the survey work coupled to previous research in this area, suggests that clients' demands are for more contextual information to assist in the interpretation of the single snapshot in time valuation figure. This includes market trends, valuation methods and comparables and tenant covenant strength for investments. Professional guidance still tends to concentrate on property-specific factual information and gives no help on how this other information could be provided. In considering the valuer's legal duty of care, it must always be borne in mind that the standard required will be determined by 'the ordinary competent practitioner', a notion based on what is deemed current good practice in the profession. If, as appears to be the case from the study, it is generally accepted that provision of such information is necessary to the client, its conscious or even negligent non-provisionally be difficult to defend, even if no mandatory provision from RICS

guidance can be adduced to require it. Although it is possible that other valuers acting as expert witnesses may currently support non-provision as the actions of an ordinary competent practitioner, in the future they may not. While the survey work reveals some valuers who habitually give a minimalist response in providing only what is specifically requested by clients, it also includes others who support the movement towards increased information provision within a more pro-active and helpful approach enshrined within VGN 12 and Mallinson.

Professional guidance is moving towards greater disclosure of information and client demands are moving in the same direction. Even if professional guidance does not require a particular approach, this is not a defence against providing it if a competent practitioner believes it should be provided. The converse is also true, non provision of an element required by professional guidance is not necessarily proof of negligence. While there can be no doubt that adherence to the many excellent precepts of the Red Book will normally be both good practice and good risk-avoidance, it will be a doubtful shield for valuers who fail to provide assistance which they, and competent practitioners generally, know to be necessary to their clients.

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