Commercial property loan valuations in the UK : the changing landscape of practice and liability.

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Abstract

This paper is the first of two 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.

This paper identifies the market background to commercial property lending and discusses the implications of the falls in value for lenders and valuers. These include two major strands; first, the outcome of discussions between the representative bodies of these two groups and, second, the increasing litigation caused by lenders suing valuers for professional negligence.

The discussions between representative groups have driven a debate on the valuation process leading to a number of reports and guidance notes. This paper discusses the outcomes paying particular attention to the basis of valuation for loan purposes and the provision of additional information in valuation reports.

This paper also reviews the legal framework which influences the relationship between the lenders and valuers and discusses the duty of care. The role of instructions in the valuation process, the significance of the identity of the person to be advised and the possibility of a conflict of interest arising are all considered. The paper also addresses the issue of the standards required of a commercial loan valuer, including how this is interpreted by the courts and the legal status of professional guidance notes.

The paper concludes by identifying potential areas for dispute within the loan valuation process and raising a number of research questions concerning the operation of this process which are addressed in a following paper.

Commercial property loan valuations in the UK : the changing landscape of practice and liability.

1. Introduction.

This paper constitutes the first of two setting out the results of a collaborative research study undertaken between Oxford Brookes University and the University of Reading in the UK. The study originated from the individual and separate work of members of the research team into, firstly, legal liability issues concerning the professions and secondly, the commercial property valuation process in the fallen UK property markets of the 1990s.

There have been a number of repercussions from the fall in property values since 1990. Firstly, valuers were concerned at the ability of simplistic valuation methodologies to cope with changed circumstances. This led to increasing dialogue between academics and leading practitioners and the development of a literature on the subject of over-rented properties and lease incentives. Secondly, there was increased litigation against valuers (anecdotal comment suggested that in 1993 over 70% of all claims in the construction industry related to valuations and the level of outstanding claims was double the level of premiums) and the concern about valuations was fuelled by high profile valuation ‘discrepancies’ such as the Queens Moat Hotel case. This all led to the view amongst some valuers and clients that the valuation process in general and loan valuations in particular were in need of a major overhaul.

This research has been undertaken within this context and began by identifying the background to the fall in commercial property values and the response of client lenders and valuers to these falls. It also investigated the development of legal liability issues with particular reference to the valuation profession. This background is set out in Section 2 of this paper. The objective of this part of the research was to identify the specific research questions which required further investigation to draw any conclusions on the legal liability implications of any changes to the valuation process. This first paper sets out the results of this process concluding in Section 3 with a refined set of issues and questions.

A following paper sets out the basis of the survey work designed to answer these questions and reports on and interprets the findings. As the research work developed, preliminary findings were reported at the Cambridge/Wharton joint conference in March 1996, at the European Real Estate Society meeting in Belfast, June 1996, and at the RICS research conference in Bristol in September 1996 (Crosby, et.al., 1996a, 1996b, 1996c)

The overall aim of both papers is to isolate the major legal liability implications of changes to the commercial property loan valuation process caused by the recession in the property market and to make recommendations to valuers and their professional institutions to improve the quality of the process and the result.

2. Background to the research.

2.1 Market background

During the 1960s, 1970s and 1980s, the UK commercial property market experienced growth in nominal terms in both capital and rental values and across all three main sectors of retail, office and industrial property. In 1989/1990, the commercial property market went into recession and rental and capital values in many sectors and locations are still below their 1989/90 levels (Figure 1).

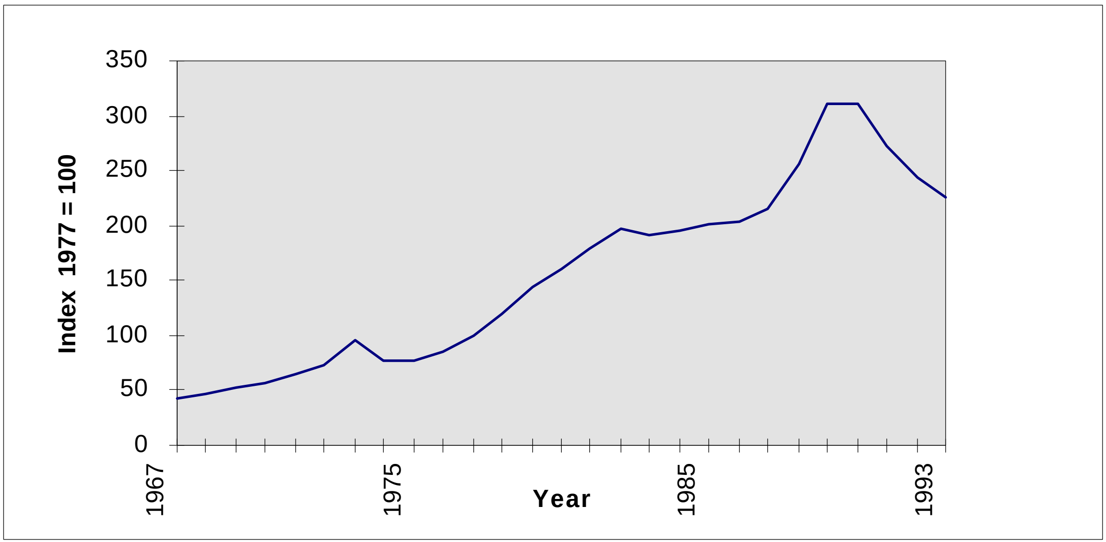

Figure 1 : JLW All Property Capital Value Index 1967-1993 in Nominal Terms

Source : JLW (1996)

There was also a temporary fall in values in the 1970s caused by a number of factors including a secondary banking crisis (Key, et.al., 1994). Capital values fell in 1974 but had regained their 1973 levels by 1977. This was well within a normal rent review cycle, which had only just reduced to around 5 years from a normal period of 7 and 14 years at the end of the previous decade. Although this recession appeared to be less severe than the most recent one, in real terms, the JLW capital value index has never regained its 1973 level. It was the high levels of inflation in the 1970s that disguised the severity of the 1970s property crash (see Figure 2.).

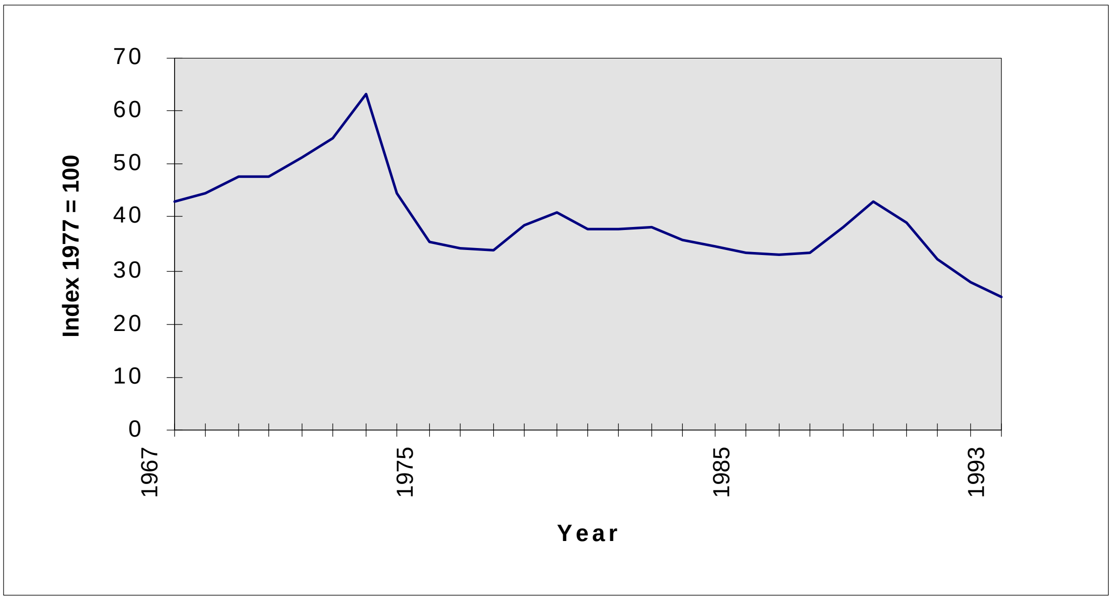

Figure 2 : JLW All Property Capital Value Index 1967-1993 Adjusted for Inflation

Source : JLW (1996)

The banks have been a significant factor in funding property investment. Prior to the 1970s crash, outstanding bank debt to property companies as a percentage of all commercial loans rose from around 5% in 1971 to over 10% in 1974. Although they reduced their exposure to the property sector in the wake of the 1970s crisis (back to around 5% of all commercial loans in the early 1980s), the banks returned to the sector during the 1980s and lent heavily. By 1991, bank lending was back to a level of 12% of all commercial loans (DTZ, 1995).

Figure 3. illustrates banks' total outstanding debt to property companies between 1970 and 1996.

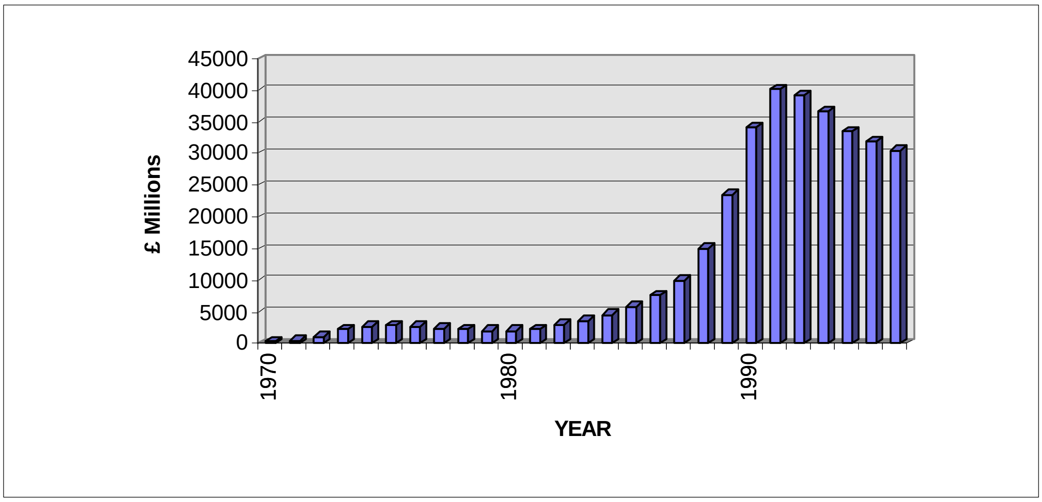

Figure 3 : Bank Lending to Property Cos - Outstanding Debt 1970 to 1996

Source : DTZ Debenham Thorpe

Figure 3. illustrates the fourfold increase in outstanding debt between 1985 and 1990. Underpinning many of these loans were the valuations provided by valuers between the mid 1970s and 1989/90, when property values were rising.

As indicated previously, the commercial property market went into recession around the end of 1989. Sale prices and therefore valuations of property assets fell substantially. For example, one of the more extreme cases was the Central London office market, where rents peaked at £65-£70 per square foot in 1989 and the average capitalisation rate was 5% (Hillier Parker, 1990). By 1993, the rental value had fallen to around £30-£35 per square foot and this represented a headline rent, not a real rental value. A two year rent free period would be required to obtain a letting at the headline rent. The average capitalisation rate had risen to 7.5%. (Hillier Parker, 1993). If the property was vacant, a further void period would be built into the valuation (Crosby and Murdoch, 1994). The net effect is that a tenanted property, bought for £1,300 per square foot in 1989, vacated by the tenant in 1993, could have been valued at around £350 per square foot at that time, a fall of 73%.

Some of these falls would be offset by the operation of upwards only review clauses. In 1993, 60% of the property held in the Investment Property Databank was let on leases with more than 15 years unexpired (Investment Property Forum, 1993) and 48% of office tenancies, 39% of retail and 54% of industrial tenancies were let at rents in excess of rental values (over-rented). The City of London office market had 58% of properties over-rented by an average of 70% (IPD, 1994). Assuming the Central London office block illustrated above was let on a lease with upwards only rent reviews, had 15 years unexpired in 1993 and was 70% over-rented, its valuation per square foot would be approximately £600 to £650, a fall of only 50% from the peak 1989 value (see Baum and Crosby (1995) for an explanation of UK valuation techniques in a fallen market).

As the whole of the economy was also in recession, company bankruptcies increased substantially (see Figure 4.) and the property assets, on which much lending had been secured, needed to be sold (or at least taken account of in the banks' deliberations regarding the minimisation of their losses).

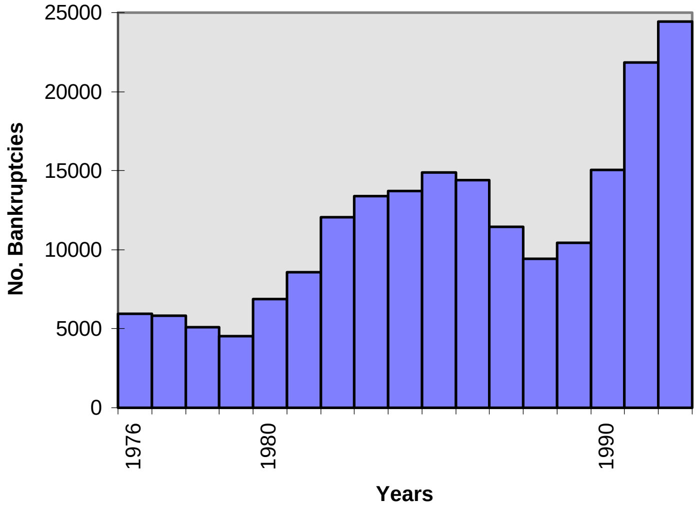

Figure 4 : Company Bankruptcies in England and Wales - 1976 to 1992

Source : Central Statistical Office

To summarise, the combined effect of general and property market recession and the level of bank lending secured on property assets created a situation where the banks were exposed to an increasing level of bad debts not covered by the security underpinning those loans.

Two major issues concerning this particular research are raised by the market background. The first is the role of the valuers in the bank lending process. The second is the attitude of the banks to the losses incurred as a result of the fall in property prices with reference to the valuers and their valuations. Even though in real terms the property market recession in the mid 1970s was actually more severe than the most recent case, inflation protected the value of the loan security. But if it is assumed that UK economic policies will continue to focus on the maintenance of low inflation, and cyclical movements in property markets continue, falls in nominal property market values are likely to occur with increasing regularity in the future. Therefore lessons need to be learnt from the current experience to reduce the possibility of extensive litigation against valuers in the future.

2.2 Institutional responses

In the wake of both 1970s and 1990s property crashes, two main themes are apparent. The first is an increase in the litigation by banks against valuers and the second is an institutional response from the valuation profession.

After the 1970s crash, two highly influential cases concerning negligent valuations were decided. Singer and Friedlander v John D Wood [1977] 243 EG 212 and Corisand Investments v Druce and Co [1978] 248 EG 315, 407, 504 placed apparently very onerous obligations upon loan valuers. In Corisand, Gibson J thought that a valuer for loan purposes "can reasonably be required to consider what the position may well be in circumstances of forced sale within six to twelve months of his valuation." In Singer and Friedlander, Watkins J suggested that the duty was to value to within a tolerance "generally ten per cent either side of the figure which can be said to be the right figure."

These cases raise a number of issues. For example, the inappropriate use of the term "forced sale" by Gibson, J. in this context (a forced sale is one where the marketing period is restricted, not where the vendor needs to sell but has a full marketing period in which to obtain market value). However, the major issue is the "margin of error". The celebrated dictum in Singer and Friedlander continues to inform judges' attitudes as recently as the cases of First National and Commercial Bank Plc v Andrew S Taylor (Commercial) Ltd [1995] EGCS 200, Craneheath Securities v York Montague [1996] 7 EG 141 and

Birmingham Midshires Building Society v Richard Pamplin and Co [1996] EGCS 3. It is worth noting that Judge Ian Hunter QC added what may come to be regarded as a modern gloss on this concept in Mortgage Expres Ltd v Joliffe and Flint unreported in December 1995. In referring to the permissible margin of error in Watkin J's judgement he stated that he would prefer not to refer to the bracket as encompassing a degree of error since to be in error, albeit even marginally in error, presupposes that there is a correct value. The only correct value is what the property actually sells for in an active market .... I would ..... prefer to say that the bracket is a means of identifying the margin within which experienced and competent valuers may reasonably differ in their opinion of the property's value. Having identified the outer limits of the margin, the correct value for this purpose is the median figure." Whether this gloss rehabilitates the controversial bracket or merely prolongs its life remains to be seen. It still contains evidence of misunderstanding of elements of the valuation process by judges.

As a result of the 1970s property crash and the increasing concern regarding valuations (Greenwell and Co, 1976), the valuers' professional institutions in the UK, particularly the Royal Institution of Chartered Surveyors (RICS), initiated research into valuation methods, culminating in two research reports (Trott, 1980; Trott, 1986) and developed guidance notes (Red Book) on practices and procedures in the valuation process (RICS, 1976). Although the guidance notes were developed for a very restricted number of valuations which would be available in the public domain, and might be acted upon by third parties, their influence was far wider and clients increasingly asked for valuations in accordance with the Red Book (Mallinson, 1994). The Red Book was developed and expanded throughout the 1980s (RICS, 1980; 1986) and further guidance more applicable to the loan valuation process was also produced, termed the White Book (RICS, 1992)

After the 1990 crash, the same two responses were apparent. An increase in litigation was accompanied by a number of initiatives from the RICS. The major difference is that the British Bankers Association (BBA) has played a more influential part in the institutional responses.

In 1994, two events occurred. A Valuation Guidance Note (VGN 12) was agreed between the RICS and the BBA for insertion into the White Book. This guidance note introduced a new definition or basis of valuation, Estimated Realisation Price (ERP), to be used solely for loan valuation purposes and suggested the type of information which should be included in a loan valuation report. In addition, a property banker was invited to be a member of the RICS Mallinson Committee, set up to consider the wide range of issues concerning property valuation procedures, practices and methods, while paying particular attention to the views of clients.

The Mallinson Report (Mallinson, 1994) was the catalyst for a new version of the Red Book, merging and expanding upon the existing Red and White Books (RICS, 1995). Subsequently, the RICS and the BBA produced a booklet outlining the appraisal and valuation service banks should receive from valuers, aimed at informing non-property bank staff (RICS/BBA, 1996).

Although this guidance to the loan valuer contains information across the whole of the valuation process, the new basis of valuation suggested in VGN 12 has been the focus of most discussion (see, for example, Law and Gershinson, 1995). Prior to the current recession, the basis of valuation set out in institutional guidance notes was Open Market

Value (OMV). OMV is an attempt to estimate what the exchange price would be where a transaction has not actually taken place on the subject property.

Unfortunately, the identification of a single snapshot in time exchange price valuation, in a market which takes time to transact, requires some detailed interpretation; hence the RICS Red Book definitions which have evolved over time and continue to do so in the latest edition (RICS, 1995). The Red Book claims that OMV is now indistinguishable from the international definition of Market Value. The latest definition of OMV is:

> the best price obtainable in a transaction completed on the valuation date (in previous definitions the words 'reasonably expected' appeared after 'best price') based upon the following assumptions:

(i) a willing seller (a hypothetical owner who is neither eager nor reluctant i.e. not forced but not at a price which suits only him/her).

(ii) prior to the valuation, a reasonable period to market the property and complete all the necessary legal formalities was available.

(iii) during this period, the state of the market was the same as at the date of valuation.

(iv) any bid from a special purchaser is excluded.

(vi) all parties acted knowledgeably, prudently and without compulsion. This last assumption has been added by the new Red Book.

The state of the market assumptions make the definition of OMV a well defined *unrealisable* number. This is because a transaction on any comparable property being completed at the date of the valuation would have been placed on a market which would have been in a different state from now (unless a truly static market had existed over the marketing period). The definition assumes that the market at commencement of the sale is in the same state as at completion.

However, the assumption of a sale completed (rather than started) at the valuation date has to be correct to take into account comparable evidence, even if it theoretically requires valuers to make adjustments to completed transactions placed on a market which was in a different state from that which exists at the valuation date. The reality is that valuers will adopt evidence of present and past market activity, as well as recently agreed but not yet completed sales, to form their opinion of value, paying little attention to the precise content of the definition.

In the wake of the property market recession, the banks did not interpret market valuations as being estimates of exchange price at the valuation date, they interpreted them as backward looking. They also believed that they required a forward looking valuation and, via a joint British Bankers Association/RICS working party, the new definition of estimated realisation price (ERP) was published in White Book VGN 12..

Most of VGN 12 has been incorporated into the new Red Book and ERP remains as an alternative to OMV for commercial property loan valuations. If an ERP is given, it must be accompanied by an estimate of OMV.

The Mallinson Committee endorsed ERP, although a minority on that Committee argued strongly against the majority view on bases in general and ERP in particular.

ERP is identical to OMV in that it represents an exchange price in the market place, but it differs on a number of points, two of which are fundamental. 'Reasonably expected' is retained in the ERP definition but the two fundamental points are:

(i) the marketing period commences on the date of valuation, with the sale completed after a reasonable marketing period to be specified by the valuer.

(ii) the market is dynamic and is not assumed to be static over the marketing period.

The valuation is now a 'real' price. The Red Book confirms that the intention of the valuation is to inform the client of the price the property would fetch if the agent was instructed today. An alternative view (for new loans) would be the price the property would fetch if a lender loaned this morning and foreclosed this afternoon.

It is debatable whether this actual realisable number is beneficial to lenders. It is, in fact, easy to illustrate that, far from solving problems, it would have created a much greater problem for the banks if it had been standard practice in the 1980s.

It has already been suggested that banks lend in the boom and foreclose in recessions. The real issue is the difference between ERP and OMV in rising and falling markets.

ERP is a forecast of what the price might be when a transaction is completed in the future. Therefore, in a rising market, ERP is higher than OMV. This interpretation is confirmed by the RICS's own notes to accompany their Red Book official Continuing Professional Education lecture tour in the Autumn of 1995. The banks may have used ERP to lend even more heavily than they did in the competitive lending market of the 1980s. Conversely, in falling markets, ERP will be lower than OMV, not much comfort for a lender foreclosing on the loan and not usually the point at which a formal valuation is required (more likely to be informal advice as to possible sale price, information which agents have been providing in the past without recourse to new definitions).

However, there is now a requirement in the new Red Book that ERP is always supported by OMV. The lenders, faced with a higher ERP in a rising market, might choose the lower figure on which to base the loan. However, competition to write more business in a bull market may have the opposite effect. This always supposes that valuers will be ready and willing to quantify this difference.

Another major element of VGN 12 has been previously identified as the information content of valuation reports. Previous survey work (Crosby, et.al., 1995) indicates that clients, while generally satisfied with valuation reports and valuations, believe that there is not enough interpretative market information provided to put the valuation figure into perspective. This survey work also indicates that lenders are the least satisfied client body in comparison with financial institutions and property companies and would like to see additional regulation of the valuation process. The reporting issue is developed in more detail in a following paper.

In response to the recession and the ensuing criticism of valuers, there has been a considerable professional institutional response. This has given valuers more guidance on the loan valuation process and may well encourage more consistent application. It has also laid a foundation for a more formal relationship between valuer and client. Before studying this relationship further, the legal liability framework is discussed.

2.3 The Legal Framework

The volatile property market and economic conditions of the late 1980s and early 1990s claimed victims both from the ranks of investors and lenders. A distinction, however, may be observed between these two classes. Whereas many of the former calculated, invested and lost on the basis of their own judgment (although some no doubt also took advice from various sources), lenders invariably obtained a valuation in the course of making the decision to lend. Thus, while some investors could claim that they had used professional advice in some way, many were left with no-one to blame but themselves. For the lenders, this was not so. The decision to make a loan resulting ultimately in a loss was the lending institution's, but it could at least allege that that decision had been based upon the valuation supplied to it. This possibility raises several legal issues, which have become of great significance during the past four years.

First, and most obviously, the lending institutions would virtually always have at hand a party, a commercial organisation, which could represent a source of recovery of the losses sustained. Valuers would make eligible targets for several reasons (Lavers, 1994) including their professional indemnity insurance, their relative financial soundness, their professionalism and their concern for confidence in their reputation. The consequence of this eligibility has been what can only be described as a wave of litigation, during the early 1990s, comprising claims by lending institutions against valuers. These cases will be referred to further below. These claims, however, are by no means a straight forward matter.

The second issue which is raised (the first of two which are central to this paper) is the nature of the legal duty owed to the lender. In many cases, it will be a simple matter of contract, because the lender has instructed the valuer, either under a contract for services, such as for a panel valuer, or under a contract of employment, where the valuer is employed in-house. However, the evidence provided by such cases as Allied Trust Bank Ltd v Edward Symmons and Partners [1994] 22 EG 116 and Craneheath Securities v York Montague [1996] 7 EG 141 is that lenders have continued to accept valuations which they did not commission. The legal significance of these practices is discussed in section 2.3.1 below.

There are other legal issues raised by the possibility of recovery by lenders against valuers, for example, the reality of reliance by lending institutions upon commercial loan valuations and the possibility of contributory negligence. These are outside the scope of this paper, but are the subject of further work currently under preparation.

The second central issue to this paper is the standard of care and skill required of a defendant valuer, whether sued in contract or tort, and specifically the role of institutional guidance in establishing that standard and whether or not it has been met. As the new Red Book becomes more detailed and relates to many more situations, it is more likely to be used as the authority in valuation cases. This may place greater responsibilities on the drafters and the users of the Red Book and require a much greater understanding of its use and possible abuse in legal liability cases.

Prima facie, this question of standard can be explained by a set of simple propositions. The plaintiff, to succeed in the claim, must establish breach of the duty of care owed. In a professional negligence case, that will mean falling below the minimum standard required by the law. This is ascertained by comparing the conduct of the defendant with that of a notional 'ordinary competent practitioner', faced with an identical situation. However, this notion, the Bolam standard, as it is sometimes called, after the case in which it was formulated: Bolam v Friern Hospital Management Committee [1957] 1 W.L.R. 582, is by no means so easy to define. In practice, of course, the respective parties will offer evidence as to the applicable standards. In Section 2.3.2. below the application of this standard in commercial loan valuation cases is discussed in more detail.

2.3.1 The contract-tort issue

Ostensibly, the legal nature of the valuer-lender relationship might be expected to be straightforward and entirely uncontroversial, namely a simple contract for professional services with the lender as purchaser and the valuer as supplier. However, evidence has been forthcoming that neither the relationship nor practice are always so straightforward.

From the older cases, which have been fully discussed (Murdoch, 1989; Lavers, 1988; Lavers and McFarquhar, 1988), it is apparent that situations have arisen where the valuer is instructed by the borrower and the report is shown to the lender, perhaps to more than one lender. Thus it may be possible for a valuer to owe a duty of care to a lender arising from the tort of negligence, rather than contract.

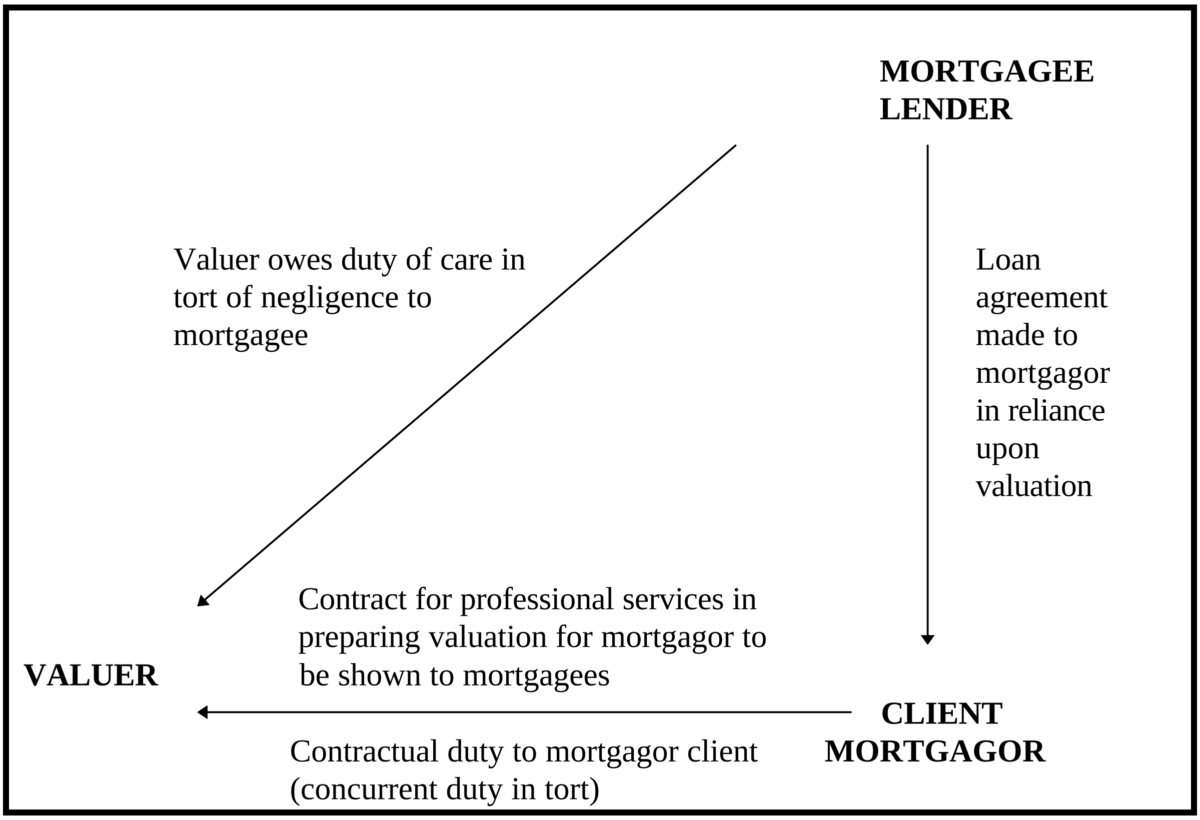

Figure 5 : The Valuer's Duty of Care

This certainly occurred in the classic cases of Singer and Friedlander v John D Wood [1977] 243 EG 212 and Corisand Investments v Druce and Co [1978] 248 EG 315, 407, 504 during the previous wave of negligence cases which followed the property market fall in the mid 1970s. There is evidence in the cases that it might still occur. In Allied Trust Bank Ltd. v Edward Symmons and Partners [1994] 22 EG 116, the sequence of events is very clear from the case report: "(the borrower) applied to the bank for finance and supplied them with a valuation report ("the report") which he had obtained from Edward Symmons and Partners, a firm of surveyors and valuers ... who are the defendants."

The recently decided Court of Appeal case of Craneheath Securities v York Montague [1996] 7 EG 141 also revealed a less than straightforward network of obligations. There, the valuers, York Montague, prepared a valuation for the Danish bank Kreditforeningen

Danmark on September 26th 1989, which was sent to Craneheath Securities in early December, being re-addressed in their favour. Setting aside the questions raised by reliance upon a valuation which was over two months old at a time of considerable market movement, the inference which can be drawn is again that the lender relying on the report was not the valuer's client in the contractual sense.

At one level, it might be argued that no particular significance attaches to the question as to whether the valuer's duty to the lender is in contract or tort, or, given that concurrent liability is possible, in both. The court in BNP Mortgages v Goadsby and Harding Ltd. [1994] 42 EG 150 said simply "the duty in tort or contract is the same". To assume that it thus makes no difference is, it is submitted, a mistake. The existence of evidence in reported cases that loan valuations are carried out for borrower clients and then shown to lenders, raises at least three major issues.

(a) The role of instructions in the valuation process?

By definition, in such a case, the lenders do not instruct the valuer to carry out the valuation, although it is possible sometimes that likely general requirements will be known, either to the borrower or valuer. Normally, in professional work, the boundaries and contents of instructions are crucial in defining the services to be performed. Given that valuers are likely to have such forms imposed upon them (rather than their own) it is unclear why, or whether, banks really wish to carry out transactions in this way. Clearly they regard control over the process as desirable, if not essential. The Mallinson Report endorses the view that instructions are crucial in a number of ways. Page 45 begins with an unattributed quotation to the effect that

“The preparation of a valuation requires precise instructions from the client.” It continues: “Using a valuation without knowledge of the instructions which led to it is potentially dangerous.”

(b) The significance of the identity of the person to be advised.

It is certainly possible for the identity to be disclosed to the valuer at the time of valuation, but equally certain that in some cases this does not happen, for example the <u>Allied Trust Bank</u> and <u>Craneheath Securities</u> cases mentioned above. The Mallinson Report (Mallinson, 1994, 11) contains the trenchant statement that “it is the professional duty of a valuer to understand not only the purpose for which his client seeks a valuation but his ability to understand and benefit from the advice given.” This is under the heading ‘Know Your Client’ and the conclusion is that “a valuer should be required to carry through a ‘know your client’ process analogous to the requirements placed upon financial advisors under the Financial Services Act.” A valuer could technically fulfil this requirement if instructed by a borrower client, while the valuation would still have been completed in ignorance of the identity and requirements of the person who would actually be relying upon the report. Perhaps the closest the Mallinson Report came to recognising this fact is in the statement that “it has not been unusual for ‘a valuation’ to be obtained for one purpose and used for another.” (Mallinson, 1994, 44). It is submitted that the Mallinson Committee meant that the valuer should know who is to make use of the report. Knowing the client borrower in a situation like this would be largely irrelevant if the valuer was in ignorance of the lender who was to rely on it.

(c) The possibility of a conflict of interest.

The Mallinson Report lays great emphasis on the need for the valuer to consult the interests of the client. Where that is not the person who will actually rely upon the valuation report, the valuer may be said to have two duties, one in contract and one in tort, to parties on opposite sides in two commercial transactions, namely a loan agreement and a mortgage. Mortgagor clients' 'interest' is presumably to borrow as much money as they want on the security of the property. Frequently, their other wish would be to encourage the lender to lend at, and beyond, the limits of prudent lending.

Yet the valuer also owes a duty to take care for the interests of the lender. The difficulty of discharging this duty while in ignorance of that lender has already been remarked upon above. It may, however, be discharged at the expense of the valuer's client, the mortgagor, in giving sufficient warning or negative information to dissuade the lender from making the loan. If the purpose of the loan is to purchase the property, or to finance the running of a business, the effect of the valuation maybe to 'kill the transaction'. It may be actively harmful to the mortgagor client's interests. While it may be contended that the valuation is simply objective, it would be naive to ignore the possibility of valuers feeling under an obligation to clients who instruct them and pay their fees and whose success is dependent upon their valuation figure and report. Lest it be thought impossible for a professional person to succumb to such pressure, reference may be made to the case of Mortgage Express Ltd. v Bowerman and Partners [1995] EGCS 129, where the Court of Appeal had to consider the failure of a solicitor acting for both mortgagor and mortgagee to protect the mortgagee’s interests by reporting to them apparent doubts about the adequacy of the value of the security.

As modern reported cases continue to provide evidence that valuers accept instructions from borrowers and lenders act upon valuations which they have not commissioned (and reported cases constitute the ‘tip of the iceberg’), the extent to which these practices actually exist is a legitimate area of further study.

2.3.2 The standard required of the commercial loan valuer

The way in which the courts determine whether the defendant's work meets the standard required by the law to avoid a finding of negligence is to hear expert evidence as to what the 'ordinary competent practitioner' would have done. However, it cannot be assumed that there is a single answer which all practitioners, or even all competence practitioners would give in every case. The general approach taken was set out by the court in the architect's case of Nye Saunders v Alan E Bristow [1987] 37 Build L.R. 93. Where there is a conflict of opinion as to whether the standard has been discharged, the courts will treat the matter "upon the basis of considering whether there was evidence that at the time a responsible body of architects would have taken the view that the way in which the subject of inquiry had carried out his duties was an appropriate way of carrying out the duty, and would not hold him guilty of negligence merely because there was a competent body of competent professional opinion which held that he was at fault".

This might be regarded as reassuring to practitioners, in that it seems to embody a degree of understanding on the part of the judiciary that there is some scope for legitimate disagreement as to the conduct of valuations.

This general reassurance should not be allowed to obscure a very specific difficulty which both courts and valuers have in making judgements as to the adequacy of a practitioner's work. This difficulty concerns the role of guidance notes. The leading text book in this area (Murdoch and Murrells, 1995), states correctly that "such documents are frequently relied on by the courts as evidence of the kind of procedure which, if not adopted, may justify a finding of negligence against a practitioner". The question remains, though, as to whether valuers in particular are therefore entitled to conclude that adherence to professional guidance will afford them protection and, conversely, whether departure from it will always be hazardous and inadvisable.

The authors regard this as one of the fundamental issues encountered in this research for two reasons. First, the courts seem to be showing greater interest in professional guidance than previously, with explicit reference to it in a number of cases. Second, the discussion regarding bases of valuation for loan purposes may reveal an interesting, but potentially very disturbing, disparity between institutional guidance and the attitude of valuers.

An awareness and appreciation of any guidance given by a professional body or institution must be relevant in the overall assessment of whether a defendants has acted competently. Ignorance of such guidance, or failure to have regard to it, would certainly not be regarded as consistent with the standard of the ordinary competent practitioner. This is not the same thing as a requirement on a practitioner of 'slavish adherence' to the guidance. The approach of the courts falls short of that proposition both in valuation cases and in those involving other professions. In the New Zealand case of Bevan Instruments Ltd v Blackhall and Struthers (No 2) [1973] 2 NZLR 45, the court had to consider the effect of an engineer's departure from a code of practice in design work. Beattie J began his judgment with the proposition that "Bearing in mind the function of codes, a design which departs substantially from them is prima facie a faulty design". This was then qualified with the words "unless it can be demonstrated that it conforms to accepted engineering practice by rational analysis". The judge concluded that he could "not go so far as to say however that the mere circumstance that a client is unaware that the designer is working outside a code can of itself categorise a designer's actions as negligent". This is consistent with the judgment of Sir Michael Ogden QC in the case of PK Finans International (UK) Ltd v Andrew Downs and Co. Ltd. [1992] 24 EG 138 that "mere failure to comply with these guidance notes does not necessarily constitute negligence. I am not prepared to find Mr Appleton guilty of negligence because of this omission....."

Sir Michael's clear statement was that "these guidance notes are not regarded as a statute". Given that it has been established that non-compliance with codes, guidance or other institutional procedures is not automatically to be regarded as negligence, the converse question remains as to whether a professional defendant who has followed that code or guidance is immune from a finding of negligence. There is superficial support for this argument in the judgment of Judge Clarke QC in Allied Trust Bank Ltd v Edward Symmons [1994] 22 EG 116.

The summary of the judgment in the head-note simply says that "a valuer who followed the RICS Statement of Asset Valuation Practice No 1 (July 1992) could not justifiably be criticised where he lacked specific instructions to the contrary". This certainly would connote a general invitation to a professional to follow RICS guidance in absolute security. The judge's actual words, however, are a good deal more restricted: "a valuer who, lacking specific instructions to the contrary, adopted in respect of a wholly private transaction a method of valuation prescribed for valuations which were to be made public could not justifiably be criticised for having acted in accordance with the guidance provided by the SAVP."

This much more specific statement, it is submitted, cannot be used as authority for a wide proposition that adherence to the RICS SAVP or any other guidance or code is beyond criticism. If it could, it would flatly contradict the position in the law generally regarding the obligations of a professional practitioner. The authors of the leading text-book on Professional Negligence (Jackson and Powell, 1992) state quite simply that "A professional is not .... entitled slavishly to follow the provisions of a code of practice". They quote two examples from construction and engineering practice which leave little room for doubt as to the general attitude of the courts. In IBA v EMI and BICC [1980] 14 Build L.R. 1 Lord Fraser said that he had "reached the firm conclusion that BICC failed in their duty of care when they applied the code of practice that had been found appropriate" (emphasis supplied). Even more significant is the case of Holland Hannen and Cubitts (Northern) Ltd. v Welsh Health Technical Services Organisation [1985] 35 Build L.R. 1, where Robert Goff LJ held that "In considering that question he cannot simply rely on the codes of practice. It is plain from the evidence that the code of practice is no more than a guide for use by professional men, who have to exercise their own expertise". Sir Michael Ogden's reservations about the status of the RICS guidance notes are made very apparent in the PK Finans case: "I suspect that they are as much for the protection of surveyors as anything else, in that they set out various recommendations which, if followed, it is hoped will protect the surveyor from the unpleasantness of being sued".

From the cases and other sources referred to, it may be concluded that a valuer will not automatically be regarded as negligent in departing from RICS guidance. It is equally clear that following RICS guidance does not provide a magic protection against action by a client alleging negligence, although it may constitute evidence of competence. There are cases which suggest that professionals cannot escape from their responsibilities by 'going through the motions' or 'taking the line of least resistance'. For example, in CIL Securities Ltd v Briant Champion Long [1993] 42 EG 281, the defendant rent review surveyor was criticised by Judge John Mowbray for failing to offer advice on valuation methods to his client. In structural surveys, two cases (Lees v English and Partners [1977] 242 EG 293 and Eley v King and Chasemore [1989] 22 EG 109) indicate that the surveyor should do more than just state simple facts and is under a duty to interpret, draw conclusions and make recommendations. Architects are under a duty to clarify instructions with clients if they are unclear (Stormont Main Working Mens Club v J Roscoe Milne Partnership (1989) 13 Con LR 127) (Lavers, 1989). Perhaps the most similar profession in terms of the client/professional relationship is that of solicitors. In Mortgage Express Ltd v Bowerman and Partners [1995] EGCS 129, the solicitor was under a duty to inform clients of any doubts, in this case regarding the accuracy of the value of a property put up as security for a loan.

The unanimous message from all these cases is that professionals are under an obligation to act for the benefit of their clients and to query or seek clarification where instructions or expectations are unclear and where the clients interests are threatened thereby.

3. Conclusions and Areas for Further Study

The commercial property market recession at the end of the 1980s has focused the minds of valuers and clients involved in loan valuations. This has led to a variety of changes in the process by which valuations are commissioned and undertaken and the amount of guidance available to all parties. This discussion of the background to the loan valuation process and the principles of legal liability raises a number of questions concerning the relationship between valuer and client. The two main legal issues discussed in this paper are:

(i) The 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.

This raises questions regarding the process by which valuers are identified, selected and instructed for the purpose of carrying out loan valuations. Evidence within reported cases, and the various institutional responses to the recession in property markets, indicates that a study of this part of the valuation process is required.

(ii) The valuer's duty of care and the standards required of the valuer in carrying out that duty.

The valuer has a duty of care to offer advice, interpret information, draw conclusions and make recommendations. In assessing this duty of care, the courts would have regard to institutional guidance notes. However, slavish adherence to guidance notes when the professional believes that they give inappropriate advice will not form a credible defence in a case of negligence.

This raises questions concerning aspects of the process which valuers may feel are innappropriately dealt with within guidance notes. Following the publication of a number of institutional guidance notes culminating in the new Red Book, a variety

> of issues remain. The ones highlighted by this paper are the new basis of valuation of ERP supported within the Red Book and the information content of valuation reports.

In a second article, the authors report the findings of an interview survey of valuers and lenders in the UK, discuss the implications of the findings and draw conclusions regarding the legal liability issues in the loan valuation process.

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