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Influences on secured lending property valuations in the UK

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Abstract

A significant part of bank lending in the UK is secured on commercial property and valuations play an important part in this process. They are an integral part of risk management within the banking sector. It is therefore important that valuations are independent and objective and are used properly to ensure that secured lending is soundly based from the perspective of both lender and borrower. The purpose of this research is to examine objectivity and transparency in the valuation process for bank lending and to identify any influences which may undermine the process. A detailed analysis of 31 valuation negligence cases has been followed by two focus groups of lenders and valuers and also questionnaire surveys of commercial lenders and valuers.

Many stakeholders exist, for example lenders, borrowers and brokers, who are able to influence the process in various ways. The strongest evidence of overt influence in the process comes from the method of valuer selection with borrowers and brokers seen to be heavily involved. There is some also some evidence of influence during the draft valuation process. A significant minority of valuers feel that inappropriate pressure is applied by borrowers and brokers yet there is no apparent part of the process that leads to this.

The panel system employed by lenders is found to be a significant part of the system and merits further examination. The pressure felt by valuers needs more investigation along with the question of if and how the process could dispel such feelings. This is seen as particularly important in the context of bank regulation.

1. Introduction

A significant part of bank lending in the UK is underpinned by commercial property as security for loans. According to DTZ (2004), commercial real estate debt now accounts for 13.6% of commercial loan books and 7.5% of the total loan books of the banks.

Valuations play an important part in this lending process. They underpin individual lending decisions and are also an integral part of capital adequacy systems which attempt to manage the risks taken by lenders. Capital adequacy is the system by which it is determined how much capital a bank is required to hold. It is important to banks as capital is expensive to maintain. The amount required is related to the value of the bank's assets which, in the case of secured loans, is the value of the loans. The current approach to capital adequacy in the UK is based on the 1988 Capital Accord produced by Basel (1988) and the relevant EU Directives. Under the Accord, an institution is required to hold less capital to support assets with low credit risk weights than assets with higher risk weights. Currently, lending on commercial property carries a 100% weighting as it has historically been seen as high risk.

A second Capital Accord and associated EU directives, recommending new capital requirements, are expected to be in place by the end of 2006. This new framework is designed to encourage banks to be more analytical about the risks they routinely carry, and to allow lower risk weightings when evidence shows that they are adopting sound risk management policies.

Under Basel's new standardized approach, an 'exceptional treatment' is introduced to allow some commercial secured lending to qualify for a 50% weighting provided it meets rigid criteria, one of which is prescriptive valuation rules. To qualify, the loan to value ratio must be the lower of 50% of Market Value (MV) or 60% of Mortgage Lending Value (MLV); the qualities of competence and independence for valuers are also stipulated. These requirements clearly have implications for valuation practice.

There is an alternative to the standardized approach in the new Accord, as credit institutions have the option to adjust their own funds to actual risks by a new internal ratings based approach. This method allows for the capital requirements to be raised or lowered by a substantial amount depending, in part, upon the systems used to assess risk. As part of these systems, the quality of valuation procedures in secured lending could be influential.

Due to the reliance placed on valuations in both individual decision making and in capital adequacy requirements, there is a need for objective, accurate valuations procured through a transparent process. Any undue influences within the process which affect the operation of the system or the outcome need to be identified and procedures put in place to rectify any deficiencies.

In the UK, valuations for loan purposes are usually carried out by members of a self-regulating professional body, the Royal Institution for Chartered Surveyors (RICS), which is the provider of both mandatory and other practice statements, guidance notes and information papers. It also has policing powers under a disciplinary code. The RICS valuation practice manual attempts to formalise the whole valuation process; from appointment of the valuer through bases of valuation to reporting standards, although not methods.

The study by Baum *et al* (2000) on the property investment performance measurement valuation process in the UK led to the RICS setting up the Carsberg Working Party (RICS, 2002) to consider the influence issues raised. Although there were some specific recommendations regarding secured lending, most of the Working Party's recommendations related to performance measurement valuations. The current research programme was commenced to extend the investigations from periodic to one-off valuations such as lending valuations. The overall aim of this particular paper is to examine objectivity and transparency in the bank lending valuation process in the UK and to identify any influences which may undermine the process.

2. Literature review

Influence on valuations can arise from overt external pressure, such as from a client or another stakeholder in the transaction. Alternatively it may arise from bias due to the valuer's concerns regarding a relationship with the client or stakeholder. Such bias may be unconscious or conscious on the part of the valuer. A third form of influence is also behavioural, but it is not related to clients and does not involve moral hazards, it may, however, have an impact on the outcome of a valuation. The first two types of influence are the most relevant to this study and the literature is reviewed below. The third form of influence is important but is beyond the remit of this particular work.

Influence of clients and stakeholders

3rd party involvement in selection of the valuer

In the context of a secured lending transaction, the primary purpose of a valuation is to provide the lender with at least part of the essential material on which to base an informed lending decision. It might be thought, therefore, that a lender (as the party most at risk from an inaccurate valuation) would routinely seek both to select the valuer and to control the terms of the valuer's appointment. In such circumstances the lender and valuer would be linked by a contract for professional services and their mutual rights and obligations could be clearly defined.

However, it is apparent that, in practice, this approach is not always adopted. In particular, lenders may rely on valuations commissioned and/or paid for by borrowers. Crosby *et al* (1998a) found that some lenders routinely permit the borrower to be involved in selecting the valuer. In such circumstances there is inevitably a possibility that the resulting valuation may be influenced by the borrower to the detriment of the lender

Overt influence

The problem of client influence has been the subject of studies in several countries. Kinnard, et al (1997) in the US found that valuers would change their valuations when requested by clients. Smolen and Hambleton (1997) found that valuers were sometimes pressured to alter valuations, and that banks were the main category of clients that were applying such pressure. Levy and Shuck (1999) also found that large fund manager clients influenced the valuation outcome in periodic valuations in New Zealand.

In the UK, Baum et al (2000) found evidence of client influence affecting the production of periodic fund valuations within the property investment market. Subsequently, as already noted, the RICS Valuation Faculty set up a Working Party under Sir Brian Carsberg, to consider whether various aspects of the provision of valuations gave cause for concern and to make recommendations as to how any such concerns should be allayed. The Carsberg Report (RICS, 2002) recognised that some interaction between clients and valuers is essential to the production of high quality valuations, not least because clients are likely to have information crucial to the valuation that they are best placed to provide. Nevertheless, the Committee was clearly concerned about the risks of client influence on valuations, and made recommendations for changes to RICS guidance to ensure transparency. The Report concluded that the secured lending context provided both the motives and the opportunities for attempts to influence valuations, and recommended that the RICS should undertake an investigation of this area of valuation practice.

A particular aspect of the study by Baum et al (2000) concerned the valuation production process. They found ample evidence to support their conclusion that clients were able to, and did, influence valuations through a process of discussion and possible moderation before the formal submission of the report. This process frequently involved a meeting at which draft valuations would be submitted and discussed and at which, it was found, valuers could be subjected to pressure from clients to change those valuations. Levy and Schuck (1999) found the same process of draft valuation meetings operating in New Zealand.

Bias

One area of behavioural research which is central to the bank lending process concerns the provision of price information to the valuer before the valuation is undertaken. Gronow *et al* (1996) recommended that valuers should not be provided with the purchase price as it affected their opinion of value. Gallimore (1996) did not find that valuers with purchase price knowledge came to their opinion earlier in the process than those who did not know the purchase price, but this does not exclude the possibility that the provision of this information changed the approach and/or the outcome. Havard (2001) experimented on a group of appraisal students and found that purchase price knowledge did bias the result towards the price, as did the way in which the comparables were presented to the students. Other related research on this area includes studies of asking price affecting the outcome of a negotiation of price (Black and Diaz, 1996).

Intuitively, as the definition of MV is the exchange price, it would not be surprising if valuers changed the nature of the question, when valuing for loan purposes, to an attempt to confirm price rather than carry out a valuation strictly in accordance with the Market Value basis of valuation. The valuation accuracy and variation literature (see, for example, Matysiak and Wang (1995) in the UK; Fisher *et al*, (1999) in the US) could validate this approach, as market value can be taken from a point in a distribution of possible outcomes and valuers are only identifying whether price is within the distribution. Where influence or pressure is brought to bear on the valuer by clients or stakeholders in the valuation, valuation variation can be used as part of the pressure, especially if the desired change is argued to be within the accepted distribution of values. [Both legally as it is within the margin of error and conceptually as there is no such thing as a ‘correct’ valuation, only a distribution of possible outcomes].

Gallimore and Wolverton (2000) investigated the effect of knowledge of prospective purchase price on a group of mortgage valuers in the UK. They found that a significant minority of valuers did modify the valuation objective to price confirmation rather than market value. However, they suggested that the decision to change to price confirmation is not always due to overt pressure from the client but can also be self-induced. The valuer may simply assume that the client’s objective is to achieve a valuation equal to the purchase price to expedite the transaction and react accordingly.

There are other studies that have shown how business concerns can affect the valuer. Hansz (2004) presented mortgage valuers with different scenarios and found that higher valuations were being provided by valuers who were given information suggesting that their valuation had implications for future business from the client. Gwin and Maxam (2002) provided a theoretical justification for the proposition that rewarding valuers with future work can lead a valuer to overstate the value of a property if so required by the lender.

There is also a literature on behavioural influences on valuers, which are not client based and do not involve moral hazards but which may have an impact on the outcome of a valuation. For example, experiments have been undertaken on the selection and presentation of comparables and the ordering of events within the actual production of the valuation compared to a normative model (Diaz *et al*, 2002; Havard, 2001). As already noted, these are outside the scope of this particular study however Black *et al* (2000) reviewed much of this behavioural research and suggested further avenues for research in this field.

3. Research questions and methods

The discussion above raises a number of issues to be addressed. Whilst the project from which this paper is drawn is wide ranging, this paper is concentrating on an examination of the valuation process for commercial secured lending in order to determine the potential areas of influence that may provide threats to transparency and objectivity.

These specific questions are addressed under the following headings:

- Selection of the valuer
- Information as influence
- Influence on outcomes

The full research programme includes three different analyses:

- An analysis of decided lender-valuer negligence cases
- Focus groups of lenders and valuers
- Questionnaire surveys of lenders and valuers

These were conducted sequentially with the earlier analyses providing the framework for the later work. The findings of the analysis of cases and the focus groups and the initial findings of the questionnaire surveys are reported in the next section of this paper.

Case analysis

The analysis of decided valuation negligence cases encompassed 31 involving secured lending on commercial (i.e. non-residential) property from *Singer & Friedlander v John D Wood* (1977) onwards; this is believed to cover all the decided cases. The only cases excluded from the analysis were those that were not concerned with valuation issues, but were about issues such as time limits or the apportioning of damages; in these cases no background information on the valuation process was recorded. The database of cases included both reported and unreported cases, and the documentation available ranged from full transcripts to limited case summaries.

The cases of alleged valuer negligence, brought by lenders or borrowers, provide a written source of practical issues that cause legal problems. Even where it is not part of the litigation, the valuation process is often recorded in detail, thus providing an insight into this process in the secured lending context. Such cases may not provide a picture that is typical of secured lending valuation processes, but analysis of these cases adds to our knowledge and understanding of the process and may help to identify where problems of influence typically arise.

Each case was analysed under the headings of the individual research questions identified above. This involved tracking and recording the valuation process as far as it could be ascertained from the case documentation. The circumstances were summarised and tabulated under each heading, along with any other relevant issue raised in the cases.

Focus groups

Two discussion groups were organised in the spring of 2003, one group for commercial valuers and one for commercial lenders. Each comprised six participants. Both groups were presented with the same list of topics, which was based on the research questions arising from the literature as developed in the case analysis. This formed the framework for the discussions, which lasted two hours. The commercial valuers were all chosen from the London offices of major surveying firms, as they would give an insight into secured lending on high value properties in the important London market. The commercial lenders were all chosen from the head offices of major UK lending institutions, as their experience covered a wide range of property types and locations.

The written records of the focus group discussions were analysed to ascertain whether the major issues had been identified in the research questions and whether any new issues had been identified. The analysis also provided data on particular questions as well as determining the scope, structure and terminology of the questionnaire surveys.

Questionnaire surveys

The questionnaires to commercial property lenders and valuers were carried out during the latter part of 2003. The questions and percentage responses to the relevant questions for this paper concerning influence are set out in full in Appendix One.

<u>Lenders</u>

362 questionnaires were sent to head offices and local branches of organisations that provide loans secured on commercial property in the UK. Firstly, all major lenders included in the Property Finance Sourcebook were included (83 destinations) and a sample of other commercial lenders was added within the context of a regional matrix (the Standard Government Office Regions of England Wales and Scotland) and, within each of these regions, a sample of operators located in Metropolitan Districts, Mixed Urban/Rural Districts and Industrial Districts. This included banks, building societies and other specialist lenders. A total of 79 useable responses have been received giving a response rate of 22%.

The nature of the respondents

Table 1 shows that the majority of respondents come from banks, around half are from the head quarters of the lending institution and the majority are UK based rather than lenders with overseas head quarters. Most do not have a professional property qualification (those that do are members of the Royal Institution of Chartered Surveyors).

Table 1 : Respondents and their Organisation

Type of Lender	Banks	82%
	Bldg Societies	14%
	Other	4%
UK Office	UK H/Q	49%
	UK Branch	43%
	Other	8%
Location of Head Quarters	UK H/Q	71%
	Non-UK H/Q	29%
Professional Property Qualification	Yes	13%
	No	87%

Amount of lending

64 respondents (81%), provided the amount of lending undertaken by the respondent's organisation in the previous 12 months and the total of this was over £14 billion and the number of transactions nearly 4,800 (from 63 respondents). The average amount of lending for each respondent was £220 million with an average of 76 transactions. However there a few very large lenders amongst the respondents skewing these figures and the median value of lending was £45 million with the median number of transactions being 30.

<u>Valuers</u>

569 questionnaires were sent to UK firms. These firms were chosen as all firms who advertised themselves as undertaking commercial valuations within the RICS Directory of Firms. A total of 152 useable responses have been received giving a response rate of 27%.

The nature of the respondents

Partners or directors of the firm account for around 85% of respondents and the rest are heads of department, consultants or surveyors ands valuers. Every single respondent bar one who did not respond is professionally qualified with the RICS qualification.

Amount of lending valuation work

133 (88%) respondents answered the question concerning the amount of commercial lending valuation work done out of the office in the last 12 months and the total was over £17.2 billion, an average of nearly £130 million for each respondent firm. A larger number of respondents (145, 95%) answered on the number of valuations carried out and this amounted to over 22,400, an average of over 150 each. However, as with the lenders, these means are skewed by a small number of very large operators and the median value of work done is £15 million and the median number of valuations is 50 per year

4. Research findings

Selection of the valuer

A leading commercial valuer, one of the members of the valuers' focus group, described the "ideal scenario" as one where the lender both instructs and pays the valuer directly, and where the only valuation report is one addressed directly to the lender. However, it is clear that this "ideal scenario" is very far from the norm.

Negligence cases

Analysis of the negligence case database reveals that third parties were involved in the selection and/or appointment of the valuer in 24 out of the 31 cases which concerned commercial property (and in 2 of the other 7 cases it was impossible to state whether or not there was third party involvement). In 19 of the cases where a third party was involved, this was the borrower; in 5 it was a broker.

In some of these cases, the third party involvement went no further than recommending a valuer, who was then appointed by the lender. However, some are more extreme, in that the lender never issued direct instructions to the valuer at all. Indeed, in one case (*Allied Trust Bank Ltd v Edward Symmons & Partners* (1994)) it was clear that the lender had no direct contact with the valuer at any time, and had issued no instructions as to the basis of the valuation. This case was one of several in which the valuer clearly had a pre-existing relationship with the borrower, having done previous valuations for the borrower which were shown to different lenders.

Focus groups

The valuers' focus group acknowledged the need for valuers to maintain a sufficient degree of independence to safeguard professional credibility, but claimed that a substantial amount of valuation work was dependent on pre-existing relationships with borrowers and/or brokers. The point was made that, in large commercial transactions, it would be quite common for a valuer to have done substantial preliminary paid work (perhaps including a desktop valuation) for the borrower, and for the borrower to want that valuer to carry out the full valuation for the lender. It was suggested that lenders were highly likely to accept an existing valuation from a valuer introduced by a borrower if that valuer was on the lender's panel (i.e. the lender's list of approved valuers). It was also suggested that even an existing valuation from a non-panel valuer might well be acceptable.

While the valuers' focus group saw little cause for concern in the involvement of borrowers in valuer selection, brokers were seen in a very different light, at least by those who handled loans in excess of £1 million. Brokers operating below that figure were regarded in a better light, and it was said that lenders generally liked to deal with them in preference to the often inexperienced borrowers. The main criticism of the relatively small group of high-value brokers lay in their practice of requesting desktop valuations from several firms as a means of selecting valuers. If valuers are competing for instructions by reference to the amount of the valuation they may then be pressurised to confirm a prior valuation and so this could be a means by which the final outcome of the valuation is influenced. However, it was acknowledged that these brokers were in a very powerful position, since they controlled a large slice of the lending market - indeed, some lenders were said to be almost entirely dependent on them for their lending business.

Interestingly, the lenders' focus group expressed far less concern generally about third party involvement in the selection of valuers, one member saying that the lender's credit department would always be instructed that the valuation in such circumstances was not to be regarded as independent. This group also claimed that their own organisations would always insist on giving direct instructions to the valuer, even one originally selected by the borrower.

Questionnaires

Lender survey

The role of the borrower and broker in the selection process was examined by asking how often borrowers or brokers select the valuer and also by a set of scenarios which address either the bringing of completed valuations to the lender or requests to appoint particular valuers.

The majority of respondents said that the valuer is seldom (46%) or never (27%) chosen by the borrower or broker whilst 14% said it occurred half of the time. Only 2 lenders (3%) gave always as a response and 11% said it happened usually. The circumstances when this could occur are heavily dependent on whether the valuer is on the lender's panel.

Figure 1 illustrates the marked difference between the responses of lenders to accepting a completed valuation from the borrower depending on whether the valuer is or is not on the panel of the lender. The same pattern of response is seen when a broker presents the valuation, the lower % responses are due to the increased level of respondents saying that it doesn't occur or giving no response.

Figure 2 illustrates the number of lenders who will appoint a valuer when asked to do so by either borrower or broker. Again the same distinction between the panel and non-panel valuer is illustrated.

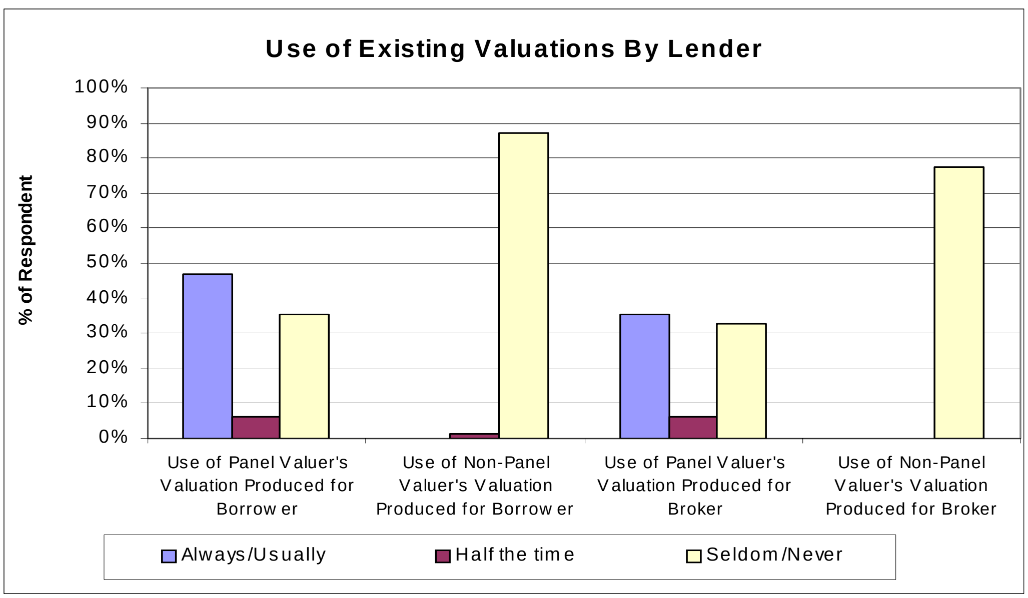

Figure 1: Use of existing valuations by lenders

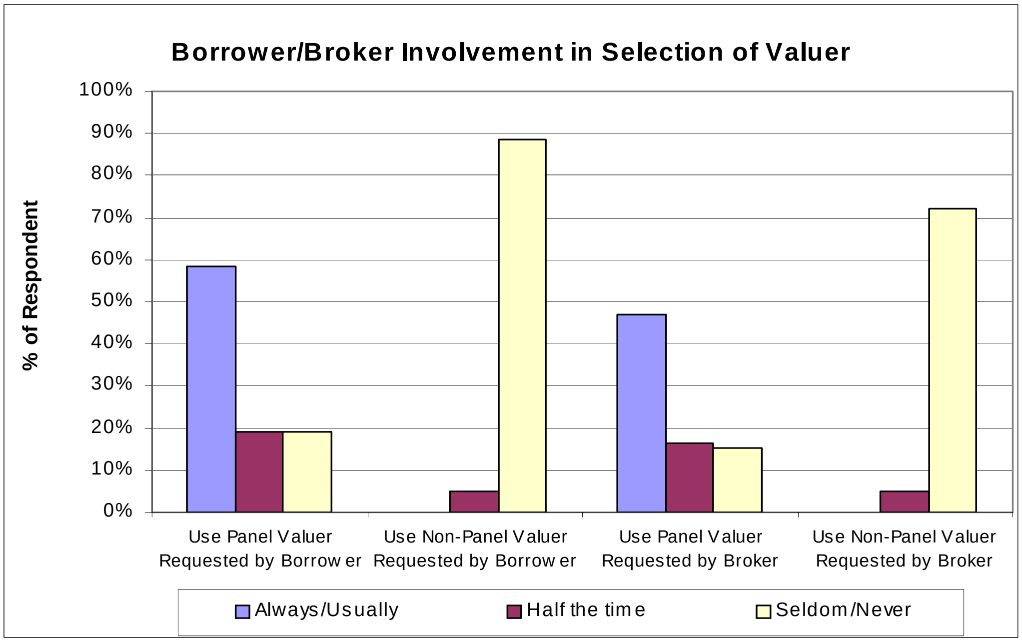

Figure 2: Selection of valuer by borrowers and brokers

Valuer survey

The responses of the valuers reveal a higher level of involvement by borrowers and brokers in the selection process than was indicated by the lenders. Valuers were asked about who formally appoints them and also about the amount of work that is introduced to them by borrowers and brokers. The responses indicate that although the majority of valuations result from formal instructions by the lender, the borrower and/or the broker have an influence on that selection. The formal appointment of the valuer is made by the lender in an average of 80% of cases, by the borrower in 11%, the broker in 3% and both borrower and broker in the remaining 7% of cases. However, respondents suggested that an average 32% of instructions were first introduced to the valuer by the borrower and 6% by brokers.

In order to investigate the involvement of borrowers and brokers in the valuer selection process, questions were asked concerning the respondents' views on the probable outcome of a set of scenarios similar to those put to the lenders. The responses are illustrated in Figures 3 and 4.

40% of valuers said that the scenarios concerning brokers did not occur. Taking this into account, it is equally likely that the lender will accede to a borrower's request as to that of a broker. However the lender is more likely to instruct a panel valuer than to accept an already prepared valuation from one. If the valuer is not on the lender's panel then requests to instruct or use certain valuers are unlikely to be granted whether from a borrower or broker.

These responses from the valuers indicate a greater likelihood of valuations and recommendations being taken up by the lenders than was indicated by the lenders themselves. However, both surveys show that the panel is a vital component of the bank lending valuation process; the influence a borrower or broker can have over selection of the valuer is controlled by the panel system with lenders quite happy to oblige but only if the valuer is on the panel and has therefore already been approved by the lender.

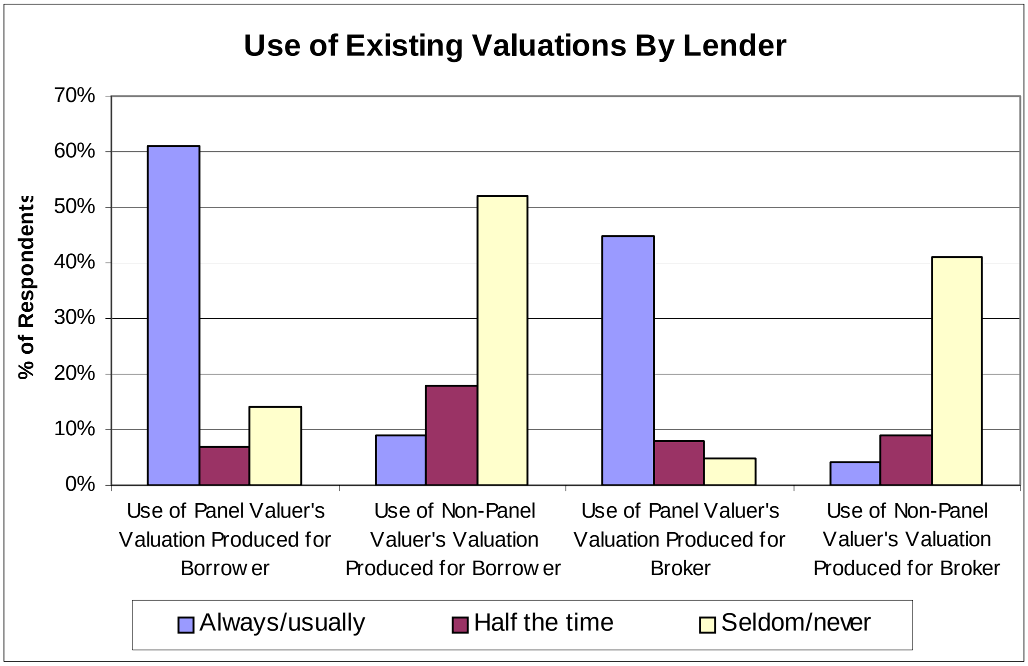

Figure 3: Use of existing valuations by lenders

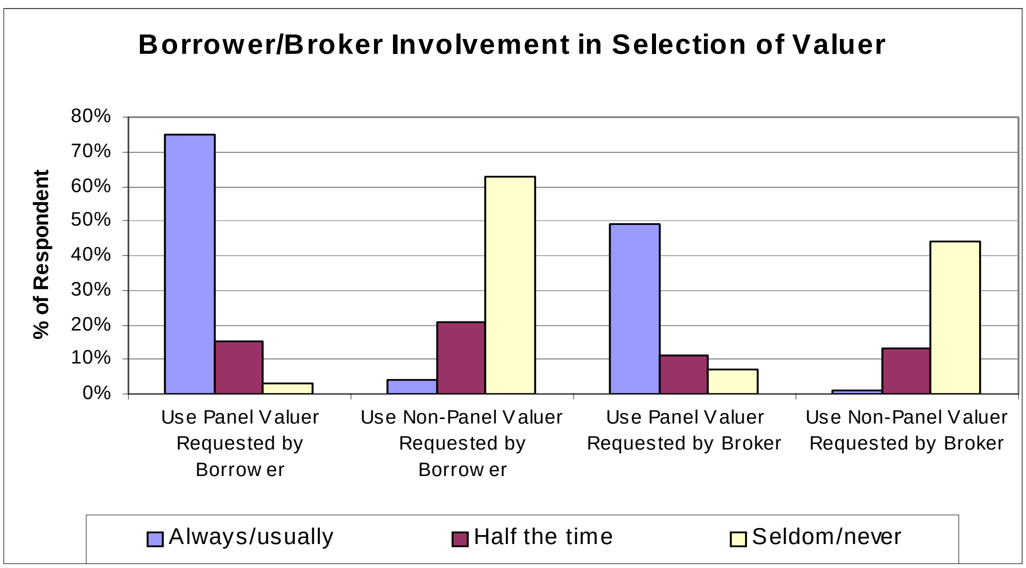

Figure 4: Borrower/Broker Involvement in the Selection of the Valuer

Information as influence

<u>Negligence cases</u>

The role of the purchase price in the lending valuation has been an issue in five of the negligence cases. However, the major issue to arise from the cases is not over-reliance on the purchase price but rather under-reliance on it. There is no doubt that judges feel that the purchase price is a very important piece of information within the valuation process and should be taken into account. In *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* (1994), one issue was that the valuations of certain properties were wildly out of line with the prices at which they had just been acquired. The judge suggested that a valuer who fails either to take a recent transaction price into account or to explain a marked discrepancy between that price and the valuation, is almost certainly guilty of negligence. In this case and in *Nyckeln Finance Co. Ltd v Stumpbrook Continuation Ltd* (1994), the judge also held the lenders guilty of contributory negligence in failing to seek an explanation for the discrepancy.

In both *Interallianz Finanz AG v Independent Insurance Co Ltd* (1997) and *Barclays Bank plc v William H Brown Ltd* (1996), valuers were criticised by judges for not finding out about the purchase price. In *Arab Bank plc v John D Wood (Commercial) Ltd* (1998) the judge said that a purchase price should be ignored if there were good reasons for it being out of line with the market. In general, however, judges clearly believe that the purchase price is an integral part of the information base; they imply that testing the market value against the purchase price should be part of the process.

<u>Focus groups</u>

The valuers' focus group discussed the role of the purchase price in detail and identified the situation where the purchase price changes through the transaction period, sometimes as a result of the lending valuation being used in further negotiations with the vendor. The valuers were also content with the idea of facilitating the transaction by taking note of the purchase price, and of using the distribution of values to justify reasonable movements in the purchase price from an initial assessment of value. However, it was clear that some lenders did not give the valuer the purchase price in order to get an unbiased view of market value and the valuers further suggested that the purchase price information sometimes came to them at a later stage of the process.

<u>Questionnaires</u>

Lenders' survey

Lenders were asked about the information that they give to valuers at the beginning of the process. The majority of lenders inform valuers of the identity of the borrower (87% always or usually) and also provide the purchase price where a transaction is occurring (76% always or usually). However, the amount of the loan and other terms of the loan such as duration are revealed less often (around 65% always or usually).

Valuers' survey

A similar set of questions were put to the valuers. The respondents said that they are virtually always aware of the identity of the borrower and where there is a market transaction in operation, 71% say they are always or usually given the proposed purchase price. However, just under half of respondents are usually or always given details of the amount of the proposed loan and even less (35%) say they are usually or always given other details of the loan such as duration.

Influence on outcomes

<u>Negligence cases and focus groups</u>

There is little hard evidence, from either the negligence case database or the focus groups, of clients influencing the final valuation figure. Only in two cases have discussions between the valuer and another party led to changes being made to the report in its final form. In *Speshal Investments Ltd v Corby Howard Cane Partnership (t/a HBSV) (2003)* the party involved was the lender. However in *Western Trust & Savings Ltd v Strutt & Parker* (1998) the valuer, who had been instructed by the borrower, had sent a draft valuation to the borrower and then altered it before sending the final version to the lender.

The valuers' focus group, while acknowledging that sending a draft valuation to the client was common practice, claimed that resulting discussions were almost invariably about technical issues and (sometimes) their presentation, not about the valuation figure itself. However, there was evidence that they were prepared to move valuations in the same way as they were willing to confirm purchase prices; that is, to use the distribution of values to get to a valuation figure which allowed the borrower to obtain the amount required. There is therefore no doubt that the process of discussion between stakeholders and clients during the valuation process and the nature of valuation distributions does allow for valuation outcomes to be negotiated within certain parameters.

<u>Questionnaires</u>

Lenders' survey

There were almost equal numbers of lenders that always or usually discussed the valuation figure with the valuer in draft form (40%) as there were that seldom or never did (48%). There was a similar picture for the other elements of the valuation. However only 4% of lenders suggest the valuation figure usually changes and 81% suggest it seldom or never changes.

Valuers' survey

The valuers were more inclined to say that they seldom or never discussed the figure (44%) or other aspects of the valuation (42%) with the lender, with 26% and 29% respectively saying they always or usually discussed these issues. They denied that the valuation changed: 94% said the valuation figured changed seldom or never.

The valuers were even less likely to discuss the valuation figure or other aspects of the valuation with the borrower, 77% and 65% respectively saying it seldom or never happened. The valuers were again adamant that any discussions with the borrower did not affect the valuation, with 94% saying it seldom or never happened, with those that said it never happened being higher than with the lenders at 37% compared with 18%.

There were some interesting differences between the responses concerning borrowers and brokers. Despite a higher non-response rate, a higher proportion of respondents (10% compared to 3%) usually discuss the valuation figure with the broker but also a higher proportion never discuss it (34% compared to 28%). However, a lower proportion always or usually discusses other aspects of the valuation with the broker (7% compared with 11%). Any resultant changes are similarly rare

Opinions on influence

Lenders' survey

The lenders were presented with a series of statements on influences with which they were asked to agree or disagree (or neither agree nor disagree). The results are shown in Figure 5. There is a large measure of disagreement with the statements that borrowers or brokers have too much influence on the selection or choice of the valuer to be used and around 70% disagree that borrowers and brokers have too much influence on the valuation outcome. The highest level of agreement comes with the statement that brokers have too much influence on the selection of valuers but this is only 24% of respondents with 19% agreeing borrowers have too much influence on selection. Only between 10% and 15% of respondents think borrowers or brokers have too much influence on the outcome. However, the fact that they are perceived to have any influence at all may be adjudged to be a significant problem.

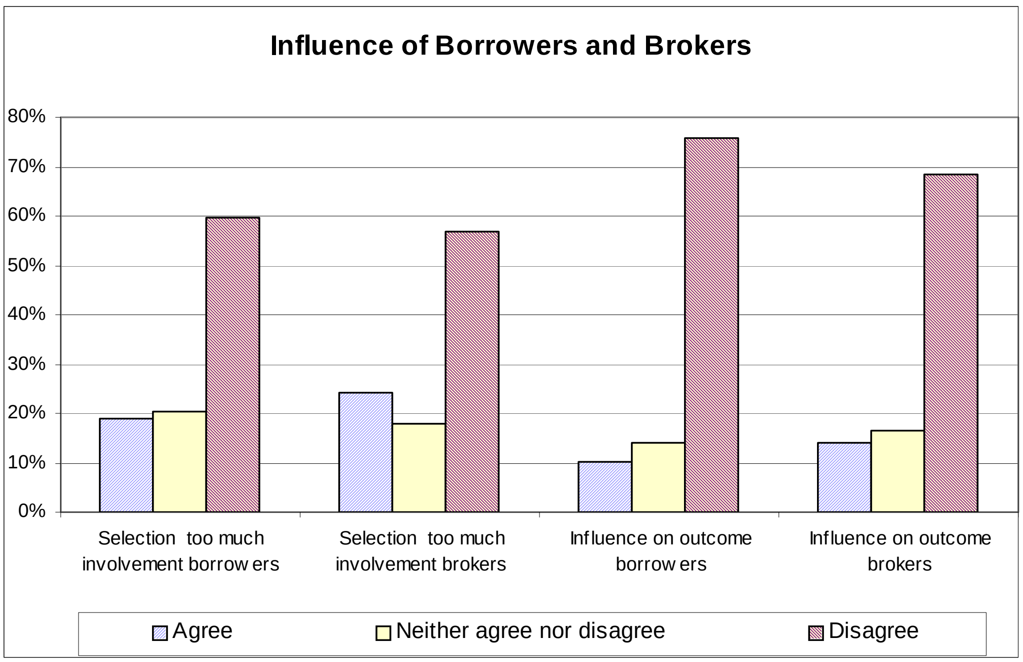

Figure 5 : Influence of borrowers and brokers according to lenders

Valuers' survey

Figure 6 illustrates the valuers' responses to three issues of whether borrowers and brokers have too much involvement in the selection of the valuer and whether lenders, borrowers and brokers have too much influence on the valuation outcome and apply inappropriate pressure on the valuers. The issues are ordered from the left to show those which elicited the most agreement. Influence on outcome is rejected for all three groups. There is some agreement that borrowers and brokers have too much involvement in selection. However, the most agreement comes for the proposition that borrowers and brokers apply inappropriate pressure on valuers.

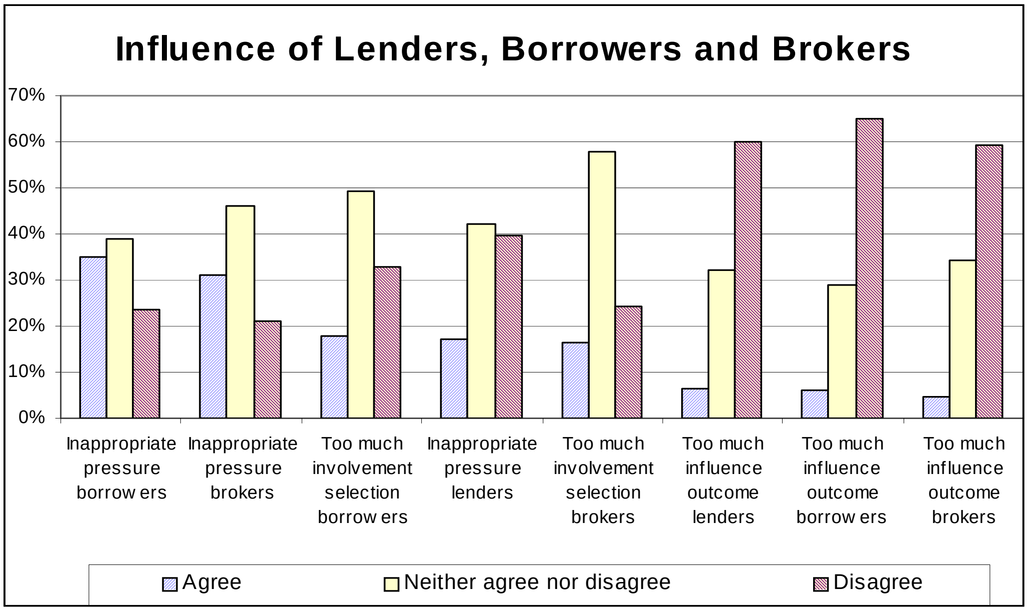

Figure 6: Influence of borrowers. brokers and lenders according to valuers

4. Discussion

The analysis of the negligence cases shows far greater involvement by borrowers and brokers in the selection process than is indicated by the questionnaires. So this may be a feature of disputed valuations distinguishing them from the norm. Whilst it is not possible to ascertain whether this aspect contributes to the fate of the valuation, it does raise questions about whether such involvement has direct consequences within the process and ultimately on the outcome. Any influence on the outcome is denied by both valuers and lenders, however the valuers do reveal that borrowers and brokers apply inappropriate pressure. It may be hypothesized that the involvement of borrowers and brokers in selecting valuers leads to inappropriate pressure on the valuers by these parties.

The admission by valuers in the questionnaires to inappropriate pressure from borrowers, brokers and, to a lesser extent, lenders, in itself merits further investigation. The valuers' focus group did highlight the pressure that they felt from brokers; the members of the group were all valuers from firms doing a large amount of secured lending valuations and it may be that this type of firm is subject to pressures that are not felt in smaller firms. Therefore the proposition that valuers in large firms are subject to more pressure from the various parties than those in smaller firms needs testing.

Pressure on valuers may be applied in many ways, not necessarily through overt discussion of the valuation. However it could be expected that there would be a relationship between the discussion of the valuation (both the figure and other aspects) and reported pressure. If there is no relationship between these issues then the pressure may be much more subtle.

In order to test these relationships between the involvement of borrowers and brokers in selection, discussions of draft valuations, firm size and perceived inappropriate pressure, the valuers' questionnaire responses were further analysed using Chi-squared tests.

The results of these tests are set out at Appendix Two and summarised below.

There is no statistical association between the amount of business introduced to the valuer by the borrower and the valuer's opinion on whether borrowers apply inappropriate pressure. This does not entirely rule out a relationship as it may be that, in responding to the question on pressure, valuers have in mind a minority of cases. However it does suggest that borrowers do not have to be involved in selection to apply pressure.

At first sight there is a strong association between the amount of business introduced by brokers and the valuer's opinion on whether brokers apply inappropriate pressure. However the result is influenced by the valuers who get no work from borrowers and who, understandably, neither agree nor disagree with the assertion. Once those valuers who get no work from brokers are excluded the p value is 0.058.

The only statistical association regarding the size of the firm is with the opinions on brokers applying inappropriate pressure. However, larger firms are simply more opinionated than small ones as they agree **and** disagree with the statement more than would be expected by chance. More smaller firms responded neutrally to the statement than would be expected. However, as smaller firms have significantly less involvement with brokers than the large ones this is perhaps not surprising.

There is no association between the amount of discussions that valuers have with lenders, borrowers or brokers and their perception of inappropriate pressure from these parties. Again this does not entirely rule out a relationship, valuers may have in mind a minority of cases when responding to the question on pressure but it does suggest that pressure is being applied in other ways than through overt discussions

5. Conclusions

The overall aim of this paper was to examine the bank lending valuation process and to identify any threats to transparency and objectivity. The objectives of the paper were to examine a number of questions concerning the possibility of influence on the valuer from clients and other parties (borrowers, brokers and lenders) who have a stake in the outcome.

The issue of influence on the valuer is a major one for this research. Influence can be overt, in the form of pressure from other parties; it can also be covert and self-induced. The valuer can, with or without pressure from interested parties, decide to assess whether the price is within an acceptable margin of error, and may feel that confirmation of a reasonable price is the real task of the process. Whether this should indeed be the true basis of the task is a legitimate question for the bank lending valuation process.

The strongest evidence of overt influence on the process comes from the method of valuer selection. The ideal position, as discussed in the valuers' focus group, is for the valuer to be selected, paid by and report to the lender. The borrower and broker should play no part in this process, but evidence from both the cases and the focus groups is that they are heavily involved, especially in larger cases "over £1 million". The valuers' focus group acknowledged that they needed to maintain professional integrity, but were also aware of the importance of brokers and borrowers in initiating and securing loan business. They were clearly much more comfortable with borrower involvement than with broker involvement in their selection. This was at least partly because brokers tended to be extremely active in following a transaction through from beginning to end; they would sometimes put pressure on valuers not to inhibit the deal. Their major objective is to broker the deal and they have little interest in the longer term validity of the transaction.

The lenders survey implied that borrowers and brokers were not involved in selection to any great extent although the valuers surveyed suggested one third of their instructions involved borrowers. It is clear that great store is placed by the lenders on the panel system. Lenders are relatively amenable to selection by borrowers or brokers from their panel, particularly to borrowers who ask for a specific valuer. This suggests lenders have faith in their own vetting systems and in the integrity of valuers.

There has been much discussion in recent years concerning client influence on various aspects of the operation of the property market; in this context, a more appropriate terminology would be influence by interested parties or stakeholders in the transaction. Only in two negligence cases is there actual evidence of a draft valuation sent to a borrower being altered before a final version is sent to the lender. But the discussion with valuers suggests that some level of influence is applied by borrowers/brokers even when the instructing party is the lender.

The responses to the questionnaire statements on influence are revealing. Valuers say that borrowers and brokers attempt to influence them but that pressure is resisted and has no influence on the outcome. However, it would clearly be difficult for valuers to admit to bowing to such pressures. There is no apparent part of the valuation process that leads one third of valuers to feel that inappropriate pressure is being applied by borrowers and brokers. It may be that the pressure comes from the agency-client and other business pressures identified in the work of other researchers.

Two areas are highlighted for further investigation. The first is the panel system employed by lenders as a quality control mechanism and which underpins the whole process. There are questions raised both about the processes used by individual lenders for admitting valuers to their panels and also about how valuers ensure that they remain on the panel. The second area concerns the pressure coming from borrowers and brokers. This has not been linked to any specific part of the valuation process, however, the valuation process as it stands clearly does not dispel these feelings of being pressured. This begs the question of if and how it could. Exploring these two issues is particularly important in the context of the changing banking regulatory framework. Under the new EU/Basel capital adequacy rules, the independence of the valuer has a key role to play in reducing the capital that a lender has to hold. It is therefore important that the panel and valuation systems are seen to be transparent and to foster objectivity in the valuation outcome.

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Appendix One – Questions and Responses

Lender Survey

Table 1 : Selection of the Valuer – Involvement of Borrowers/Brokers

	Always	Usually	Half the time	Seldom	Never	NR
How often is the valuer chosen by a borrower or broker?	3%	11%	14%	46%	27%	0%

Table 2 : Selection of the Valuer – Use of Panel/Non-Panel Valuers and their Valuations

Please indicate how you respond in the following circumstances. If the situation never occurs, then please tick the 'Does not occur' box:	Always	Usually	Half the time	Seldom	Never	Does not occur	NR
If a borrower brings us a full valuation from a panel valuer we will use it	6%	41%	6%	19%	16%	11%	0%
If a borrower brings us a full valuation from a non-panel valuer we will use it	0%	0%	1%	37%	51%	10%	1%
If a borrower asks for a particular panel valuer, we will appoint that valuer	9%	49%	19%	15%	4%	4%	0%
d) If a borrower asks for a particular non-panel valuer, we will appoint that valuer	0%	0%	5%	38%	51%	5%	1%
If a broker brings us a full valuation from a panel valuer we will use it	4%	32%	6%	14%	19%	25%	0%
If a broker brings us a full valuation from a non-panel valuer we will use it	0%	0%	0%	28%	49%	22%	1%
If a broker asks for a particular panel valuer, we will appoint that valuer	4%	43%	16%	9%	6%	22%	0%
If a broker asks for a particular non-panel valuer, we will appoint that valuer	0%	0%	5%	28%	44%	22%	6%

Table 3 : Information Flow at Beginning of the Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We inform the valuer of the amount of the proposed loan	41%	24%	9%	16%	10%	0%
We inform the valuer of the other terms of the loan (such as duration)	35%	29%	5%	16%	14%	0%
We inform the valuer of the identity of the borrower	63%	24%	3%	6%	4%	0%
Where property has just been, or is being purchased, we inform the valuer of the agreed price	43%	33%	6%	10%	8%	0%

Table 4 : Information Flow Between Lender and Valuer During the Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We discuss the valuation figure with the valuer whilst the valuation is in draft form	10%	30%	22%	34%	4%	0%
We discuss aspects of the valuation, other than the figure, with the valuer whilst the valuation is in draft form	10%	25%	25%	34%	5%	0%
Where we have discussions on the draft valuation with the valuer, the valuation figure changes as a result	0%	4%	14%	65%	16%	1%

Table 5 : Opinions of Lenders

	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	NR
Borrowers have too much involvement in the choice of valuers	0%	19%	20%	43%	16%	1%
Brokers have too much involvement in the choice of valuers	3%	22%	18%	37%	20%	1%
Valuers undertake valuations without declaring conflicts of interest	0%	16%	13%	46%	25%	0%
The extent of valuers' conflict of interests is a problem to lenders	4%	19%	28%	42%	6%	1%
Borrowers have too much influence on the valuation outcome	0%	10%	14%	53%	23%	0%
Brokers have too much influence on the valuation outcome	1%	13%	16%	43%	25%	1%

Valuer survey

Table 1 : Selection of the Valuer

	Always	Usually	Half the time	Seldom	Never	Does not occur	NR
If a borrower gives the lender a full valuation from me, and I am on the lender's panel, it will be used	14%	47%	7%	12%	2%	14%	4%
If a borrower gives the lender a full valuation from me, and I am not on the lender's panel, it will be used	0%	9%	18%	43%	9%	16%	3%
If a borrower asks for me, and I am on the panel, the lender will appoint me	14%	61%	15%	3%	0%	5%	3%
If a borrower asks for me, and I am not on the panel, the lender will appoint me	1%	3%	21%	56%	7%	10%	3%
If a broker gives the lender a full valuation from me, and I am on the lender's panel, it will be used	7%	38%	8%	4%	1%	39%	3%
If a broker gives the lender a full valuation from me, and I am not on the lender's panel, it will be used	1%	3%	9%	35%	6%	43%	3%
If a broker asks for me, and I am on the panel, the lender will appoint me	8%	41%	11%	7%	0%	31%	3%
If a broker asks for me, and I am not on the panel, the lender will appoint me	0%	1%	13%	39%	5%	39%	3%

Table 2 : Information Flow at Beginning of Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We are informed of the amount of the proposed loan	3%	46%	28%	22%	2%	0%
We are informed of the other terms of the loan (such as duration)	2%	33%	35%	28%	3%	0%
We are informed of the identity of the borrower	53%	47%	0%	0%	0%	0%
Where property has just been, or is being purchased, we are informed of the agreed price	9%	62%	20%	8%	1%	0%

Table 3 : Information Flow Between Valuer and Lender During the Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We discuss the valuation figure with the lender whilst the valuation is in draft form.	3%	23%	30%	39%	5%	0%
We discuss aspects of the valuation, other than the figure, with the lender whilst the valuation is in draft form.	3%	26%	28%	39%	3%	0%
Where we have discussions with the lender on the draft valuation the valuation figure changes as a result.	0%	1%	5%	76%	18%	1%

Table 4 : Information Flow Between Valuer and Borrower During the Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We discuss the valuation figure with the borrower whilst the valuation is in draft form	1%	2%	18%	49%	28%	1%
We discuss aspects of the valuation, other than the figure, with the borrower whilst the valuation is in draft form	1%	10%	24%	49%	15%	1%
Where we have discussions with the borrower on the draft valuation, the valuation figure changes as a result	0%	1%	3%	57%	37%	2%

Table 5 : Information Flow Between Valuer and Broker During the Valuation

	Always	Usually	Half the time	Seldom	Never	NR
We discuss the valuation figure with the broker whilst the valuation is in draft form	0%	10%	7%	32%	34%	17%
We discuss aspects of the valuation, other than the figure, with the broker whilst the valuation is in draft form	0%	7%	8%	34%	33%	18%
Where we have discussions with the broker on the draft valuation, the valuation figure changes as a result	0%	1%	1%	37%	44%	17%

Table 6 : Opinions of Valuers

	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree	NR
Borrowers have too much involvement in the choice of valuers	5%	13%	49%	28%	5%	0%
Brokers have too much involvement in the choice of valuers	4%	13%	58%	22%	2%	1%
Borrowers have too much influence on the valuation outcome	2%	4%	29%	47%	18%	0%
Brokers have too much influence on the valuation outcome	2%	3%	34%	40%	19%	2%
Lenders have too much influence on the valuation outcome	1%	6%	32%	55%	5%	1%
Borrowers apply inappropriate pressure on valuers	6%	29%	39%	22%	1%	3%
Brokers apply inappropriate pressure on valuers	6%	25%	46%	19%	2%	2%
Lenders apply inappropriate pressure on valuers	3%	14%	42%	36%	3%	1%

Appendix Two: Cross-tabulations and Chi squared test results

	Discussing the valuation figure			
Lenders applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	Total
Disagree	28	15	17	60
Neither Agree nor Disagree	26	21	17	64
Agree	11	10	5	26
Total	65	46	39	150
		Chi Squared test p value		0.72
	Discussing other issues with the valuation			
Lenders applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	
Disagree	24	18	18	60
Neither Agree nor Disagree	27	19	18	64
Agree	12	6	8	26
Total	63	43	44	150
		Chi Squared test p value		0.97
	Discussing the valuation figure			
Borrower applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	
Disagree	29	5	1	35
Neither Agree nor Disagree	47	10	2	59
Agree	39	12	2	53
Total	115	27	5	147
		Chi Squared test p value		0.88
	Discussing other issues with the valuation			
Borrower applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	
Disagree	25	5	4	34
Neither Agree nor Disagree	39	15	5	59
Agree	31	15	7	53
Total	95	35	16	146
		Chi Squared test p value		0.55
	Discussing the valuation figure			
Broker applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	
Disagree	23	3	6	32
Neither Agree nor Disagree	45	4	21	70
Agree	32	3	12	47
Total	100	10	39	149
		Chi Squared test p value		0.79

	Discussing other issues with the valuation			
Broker applying inappropriate pressure	Never/Seldom	Half the Time	Always/Usually	
Disagree	23	3	6	32
Neither Agree nor Disagree	46	4	20	70
Agree	32	5	10	47
Total	101	12	36	149
		Chi Squared test p value		0.70

	Amount of business introduced by Borrowers				
Borrower applying inappropriate pressure	Less than 10%	10% to 20%	21% to 50%	Over 50%	Total
Disagree	9	15	5	6	35
Neither Agree nor Disagree	14	14	14	10	52
Agree	12	16	7	17	52
Total	35	45	26	33	139
		Chi Squared test p value			0.26
	Amount of business introduced by Brokers				
Broker applying inappropriate pressure		0%	Less than 10%	10%+	
Disagree		6	15	8	29
Neither Agree nor Disagree		29	19	10	58
Agree		10	11	18	39
Total		45	45	36	126
		Chi Squared test p value			0.003**

	Number of valuations per respondent firm			
Broker applying inappropriate pressure	Up to 30	31 to 100	Over 100	Total
Disagree	9	10	13	32
Neither Agree nor Disagree	27	28	11	66
Agree	15	12	18	45
Total	51	50	42	143
	Chi Squared test p value			0.042*
Borrower applying inappropriate pressure	Up to 30	31 to 100	Over 100	Total
Disagree	9	13	13	35
Neither Agree nor Disagree	20	24	12	56
Agree	22	12	16	50
Total	51	49	41	141
	Chi Squared test p value			0.15
Lender applying inappropriate pressure	Up to 30	31 to 100	Over 100	Total
Disagree	17	22	19	58
Neither Agree nor Disagree	23	24	15	62
Agree	11	4	8	23
Total	51	50	42	143
	Chi Squared test p value			0.28