

**LENDERS' LOSSES:
WHAT IS THE RESPONSIBILITY OF THE VALUER?**

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As everyone knows, the collapse of the Irish property market over the last few years has gone hand in hand with the near collapse of the banks. Developers have defaulted on their loans and the larger loans have been acquired (less a substantial haircut) by NAMA. The value of the underlying security held by the lender has invariably fallen sharply and is now often well below the amount of the outstanding loan. If or when the lender realises the security, it suffers a loss.

The same thing has happened in the residential lending market albeit repossessions have been delayed by the moratorium agreed between the lenders and the Government.

If the property on which the loan was secured was over valued, the lender may seek to recover its losses from the valuer. The lender will argue that it made the loan in reliance on the valuation. It will say that it would not have made the loan at all if it had been advised of the real value. The lender will therefore attribute all its losses on the transaction to the overvaluation.

If the property market had not fallen, the overvaluation may not have mattered. The lender may still have had sufficient security, especially if the market had gone on rising.

This gives rise to the question, can the lender recover from the valuer losses that were due to the fall in the property market?

The Scope of the Valuer's Duty

Before I consider that question, I would like to remind you of the nature of the valuer's duty. A valuer, in common with other professionals, is required to exercise reasonable care and skill in carrying out his work. The degree of care and skill required of him is that which is ordinarily exercised by members of the profession.

Not every error will amount to a breach of duty and the courts accept that valuation is not an exact science. In *Baxter –v- Gapp*¹, Lord Goddard said:

“Valuation is very much a matter of opinion. We are all liable to make mistakes and a valuer is certainly not to be found guilty of negligence merely because his valuation turns out to be wrong..”

There is a fair bit of case law on when an over valuation will be found to be negligent. In *Singer & Friedlander v John D Wood & Co*² Watkin J said:

“Pinpoint accuracy in the result is not, therefore, to be expected by he who requests the valuation. There is, as I have said, a permissible margin of error, the 'bracket' as I have called it. What can properly be expected from a competent valuer using reasonable care and skill is that his valuation falls within this bracket.”

In a 2010 case against CB Richard Ellis³, the judge took the view (which should probably be regarded as no more than a rule of thumb) that the permissible band or bracket on standard residential property was plus or minus 5%; for more unusual properties was plus or minus 10% and for properties with exceptional features was plus or minus 15% or more. Only if the valuation fell outside those bands might it be considered to be negligent.

The court in that case also considered whether it should be concerned only with the *outcome*, ie the final valuation figure(s), or whether it is the *process*, ie the valuation methodology which is more important. The defendant was in fact held not liable when it arrived at the right result but for the wrong reasons.

SAAMCO

To return to the question of whether a lender may recover from a valuer losses that were due to the fall in the property market, this issue was considered in a seminal decision of the House of Lords which arose out of the fall in the UK property market in the early 1990s. The case was *South Australia Asset Management Corporation -v- York Montague Ltd*⁴ which is often referred to as SAAMCO.

¹ [1938] 4 All ER 457

² [1977] 2 EGLR 84

³ K/S Lincoln & Others –v- C B Richard Ellis Hotels Ltd [2010] EWHC 1156 (TCC)

⁴ [1997] AC 191

In SAAMCO there were in fact three separate appeals involving different parties which were heard together as they raised similar issues of principle. In each case, a lender had made a loan on the strength of a valuation which turned out to have been a negligent over valuation. In each case, the borrower defaulted, the lender realised the security and sold it at a loss. In each case the loss suffered by the lender was greater than it would otherwise have been because of the fall in the property market.

The Court of Appeal had decided that in a case where the lender would not have lent but for the negligent valuation (a so-called 'no-transaction' case), the lender was entitled to recover the difference between the sum which it lent (plus interest) and the sum which it recovered when the property was sold. The valuer was therefore liable for all of the loss attributable to the fall in the market.

It was argued on behalf of the valuers that it was unfair that the valuer should be saddled with the whole risk of the transaction including the risk of a subsequent fall in the value of the property. The valuer did not "*undertake the role of a prophet*".

Lord Hoffmann in his judgment analysed the nature of the duty owed by the valuer. Ordinarily, the valuer undertook to provide *information*, the information in question typically being an estimate of the price which the property might reasonably be expected to fetch if sold on the open market at the date of the valuation. The information was to form part of the material on which the lender was to decide whether and if so how much it would lend. If the information was wrong, the valuer should not be held responsible for all the consequences of the lending decision but only for the consequences of the information being wrong.

Lord Hoffman distinguished between a person under a duty to *provide information* for the purpose of enabling someone else to decide upon a course of action and a person under a duty to *advise* someone as to what course of action he should take. If the duty was to advise, the adviser must take reasonable care to consider all of the potential consequences of that course of action. If negligent, he will be responsible for all of the foreseeable consequences of that course of action having been taken.

In the SAAMCO case itself, the lender advanced £11m on a property valued at £15m. The judge found that the actual value at the date of the valuation was only £5m. The property was later sold by

the lender for £2,477,000. The loss was quantified at £9,753,927 being the difference between the amount of the advance plus interest and the proceeds of sale, less 25% for the lender's contributory negligence. The consequence of the valuation being wrong was that the lender had £10m less security than it thought. If it had had that margin, it would have suffered no loss. The whole loss was therefore within the scope of the valuer's duty and recoverable.

In the second appeal (*United Bank of Kuwait –v- Prudential Property Services*), the lender had advanced £1.75m on the security of a property valued at £2.5m. The correct value was found to be between £1.8 and £1.85m and it was later sold by the lender for £950,000. The lender's loss including interest was quantified by the judge at £1,309,876. Applying the principle that I have described, Lord Hoffmann on appeal decided that the damages should be limited to the consequences of the valuation being wrong which were that the lender had £700,000 (or £650,000) less security than it thought. The damages were therefore reduced to that sum being the difference between the valuation and the correct value.

In the third appeal (*Nykredit Mortgage Bank –v- Edward Erdman Group*), the lender advanced £2.45m on the security of a property valued at £3.5m. The correct value was found to be £2m or at most £2.375m and it was later sold by the lender for £345,000. The lender's loss including interest was quantified by the judge at £3,058,555. On appeal, as in *United Bank of Kuwait*, the damages were reduced to the difference between the amount of the valuation and the correct value.

In a further appeal by *Nykredit* in relation to the calculation of interest, the House of Lords developed the approach into a two stage test. The first step was to establish the 'basic loss' of the lender. The second step was to see whether that basic loss exceeds the amount of the over valuation. If it does, the lender's recovery is limited to the amount of the over valuation. That limitation is sometimes referred to as the 'SAAMCO Cap'.

The principles set out in SAAMCO appear straightforward but their application has caused some practical difficulty. I am going to consider just one of the difficulties which is as to the calculation of contributory negligence on the part of the lender.

Platform Home Loans Ltd –v- Oyston Shipways Ltd⁵

It is not uncommon for the damages to be awarded against a negligent valuer to be reduced for contributory negligence on the part of the lender. For example, it may have failed to apply its own lending criteria or it may have had information that should have caused it to query the valuer's valuation.

In *Platform Homes*, the lender's lending policy was to restrict non-status loans to a loan to value ratio of 70%. The property was valued at £1.5m and on the strength of the valuation, the lender lent £1,050,000. The judge found that the valuation was negligent and should have been £1m. The borrower defaulted and the property was sold for £435,000. After taking account of interest, the lender's basic loss was found to be £611,748. As the basic loss exceeded the amount of the over valuation, the lender's recovery before consideration of contributory negligence was limited to the amount of the over valuation (£500,000).

The lender was found contributorily negligent in two respects. Firstly, the borrower had failed to answer a question on the application form as to the purchase price of the property. It had in fact been bought two years previously in a dilapidated state for only £375,000. The lender did not follow up on the omission. If it had done so, it might well have queried the amount of the valuation.

Secondly, the judge found that the lending policy was in any event unreasonably incautious for high value properties and the loan to value ratio should have been set at a lower level. Taking both of these factors together, the judge found that the lender was contributorily negligent to the extent of 20%.

The issue on appeal to the House of Lords was whether the 20% deduction was to be applied to the lender's basic loss or whether it was to be applied to the amount of the over valuation. If it was applied to the former, the net damages would have been £489,398 (£611,748 less 20%). If it was applied to the latter, the net damages would have been £400,000 (£500,000 less 20%).

⁵ [1999] UKHL 10

The House of Lords reasoned that the lender's loss had been caused partly by the over valuation and partly by the lender's own imprudence. The only logical approach was to make the deduction for contributory negligence from the amount of the lender's loss: the basic loss. There was no logical reason to apply it to the amount of the valuation.

Application to Ireland

The cases that I have referred to so far have all been English cases. That is because there have been no significant reported cases on valuer's negligence in Ireland.

However, SAAMCO was briefly considered by the Irish High Court in another context in *ACC Bank plc –v- Fairlee Properties Ltd*⁶. In *Fairlee*, Finlay Geoghegan J indicated her view that the principles set out by Lord Hoffmann in SAAMCO were consistent with decisions of the Irish Supreme Court and therefore it seems likely that the Irish courts will follow SAAMCO when an appropriate case comes before them.

It is perhaps surprising that more claims have not been brought against Irish valuers in recent times. If or when lenders take a more aggressive approach to recovering their losses, valuers and their insurers may take some small comfort that the full consequences of the property slump are unlikely to be visited upon them.

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⁶ [2009] IEHC 45