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CASE STUDY

*After the Fall ...*

*Valuers' Liability in a Falling Market*

*In June 2007 the Bank lent £3.2 million secured on a property which was valued at £4 million. The borrower defaulted on the loan and the LPA receiver appointed by the Bank has just sold the property for £2 million. The Banks' recovery after the LPA's receiver's costs and expenses is £1.8 million, so the bank has suffered a £1.4 million loss. An expert has advised that the original valuer used inappropriate comparables in the valuation which resulted in the wrong yield and rental value being applied. The true value of the property in June 2007 was £2.5 million The Bank wishes to sue the original valuer. How will damages be assessed?*

*Will the calculations be different if the true value of the property in June 2007 was £3 million?*

### Introduction

1. The current recession signals a decline in the property market all too familiar to those of us who were practising (or suffering) in the early 1990s. Worsening financial circumstances lead to an increase in defaults on mortgage repayments in turn leading to an increase in repossessions. The mortgagee attempting to realise its security is finding that the realisable value is no longer sufficient to discharge the loan plus expenses: so-called negative equity. The lender wants to recover the shortfall and starts to explore potential sources of recovery of greater financial strength than the hapless borrower.

2. Enter the valuer who initially advised on the market value of the property in question. If he or she can be shown to have valued negligently, by having suggested a higher market value than in fact was the case, then recovery of the shortfall may be possible. But how is it to be assessed in a falling market? In particular can the negligent valuer be made responsible for the fact that the bank has lost not just the difference between the market value at the time of the purchase and its true value then, but also the drop in value in the intervening period between purchase and re-sale by the bank?
3. The last recession saw many such cases, and their prevalence, and the questions they raised, led to a spate of proceedings culminating in the decision of the House of Lords in *South Australian Asset Management Corporation v York Montague* [1997] AC 191 (“SAAMCO”). Lord Hoffman, giving the leading judgment, set out the principles to apply to the measure of damages recoverable. It is to these principles that reference must be made in order to answer the questions posed above.

### **Analysis**

4. In summary, the negligent valuer is liable for the loss that was a foreseeable consequence of the valuation being wrong, not for all the loss that was a foreseeable consequence of the course of action decided on by the bank in reliance on the inaccurate valuation. Lord Hoffmann said, at 214:

“I think that one can to some extent generalise the principle upon which this response depends. It is that a person under a duty to take reasonable care to provide information on which someone else will decide upon a course of action is, if negligent, not generally regarded as responsible for all the consequences of that course of action. He is responsible only for the consequences of the information being wrong. A duty of care which imposes upon the informant responsibility for losses which would have occurred even if the information which he gave had been correct is not in my view fair and reasonable as between the parties.

...

If his duty is only to supply information, he must take reasonable care to ensure that the information is correct and, if he is negligent,

will be responsible for all the foreseeable consequences of the information being wrong.”

5. In analysing how this statement of principle is to be applied to the facts of any given case there is a distinction to be drawn between cases where the lending bank would not have lent at all had it known the true value of the property (so called “no transaction” cases) and cases where the lending bank would have lent had it known the true value of the property but would have lent a lower sum (so called “successful transaction” cases).
6. Assuming first that this is a “no transaction” case, in that the Bank would not have lent at all had it known the true value of the property, the Bank has suffered a loss of £1.4 million, that sum being the difference between the sum it lent and the proceeds of sale from the property. This will be the measure of damages, subject to a cap. The Bank cannot recover more than the difference between the valuer’s negligent valuation and the true value of the property, that is, the shortfall in the Bank’s security. This is the result of SAAMCO; if the Bank were to recover more than the shortfall in its security, not only would it be recovering the loss resulting from the valuation being wrong but it would also be recovering the loss resulting from its course of action taken in reliance on that information being wrong. The result is that the valuer is responsible for the loss caused by its valuation being wrong but not for the loss caused by the fall in the property market.
7. If the property was in fact worth £2.5 million, then the cap is £1.5 million, that sum being the difference between the negligent valuation (£4 million) and the true valuation (£2.5 million). As the actual loss is less than this cap, it will be recoverable in full.
8. If the property was in fact worth £3 million, then the cap is £1 million, that sum being the difference between the negligent valuation (£4 million) and the true valuation (£3 million). The damages recoverable in respect of the Bank’s loss of £1.4 million will therefore be limited to £1 million.

9. Assuming this is a “successful transaction” case, in that the Bank would have lent had it known the true value, the Bank’s loss of £1.4 million will be subject to a different cap, this time the difference between the amount lent and the amount the Bank would have lent if it had an accurate valuation. This also follows from SAAMCO – the loss suffered by the Bank caused by the valuation being incorrect will not exceed this difference. Any further loss will have been caused by other factors, such as a fall in the property market.
  
10. So if the property was in fact worth £2.5 million, and the Bank would have lent, say, £1.5 million had it know the true value of the property, the Bank will recover its full loss of £1.4 million because the cap is £1.7 million (that is, the difference between the sum lent (£3.2 million) and the sum that would have been lent had the Bank known the true value (£1.5 million).
  
11. By contrast, if the property was in fact worth £3 million, and the Bank would have lent, say, £2 million had it know the true value of the property, the Bank will recover just £1.2 million. Its loss of £1.4 million is subject to the cap of £1.2 million, namely the difference between the sum lent (£3.2 million) and the sum that would have been lent had the Bank known the true value (£2 million).
  
12. It can be seen from this example that in successful transaction cases a preliminary step to assessing the level of recoverable damages will be to establish the level at which a bank would have lent had it known the true value of the relevant property, thus adding a layer of complexity and potential dispute to recovery.