In this article we make ten key predictions, as we attempt to map out how claims against surveyors will develop over the course of the next few years.

A RECESSION

As sure as eggs is eggs, the number of claims against surveyors will sky rocket following a recession.

Whilst the last three months of 2016 saw GDP growth of 0.7%, the UK’s apparent resilience in the wake of the Brexit vote has started to wane. The first quarter of 2017 saw growth of only 0.3%. On 11 May 2017, the Bank of England cut its economic growth forecast for 2017 from 2% to 1.9%. It advised that even this revised prediction relied on “smooth” Brexit negotiations.

The one discernible economic cost of Brexit uncertainty is the slump of the pound. Prices are rising and inflation is expected to squeeze household incomes in 2017. The combined impact of lower real wages, increasing mortgage repayments and a lower probability that losses suffered by lenders will be covered by the value of repossessed properties on resale is a major cause for concern for those involved in valuing properties.

We have had a Japanese-style recession, 10 years of low interest rates, low returns and low investment. Article 50 has been triggered. Uncertainty over Brexit negotiations and the UK’s future relationship with Europe is likely to have a dampening effect on growth for the next two to three years.

According to the Royal Institution of Chartered Surveyors June 2017 UK Residential Market Survey, sales price growth has lost momentum (particularly in London and the South), the number of sales has faltered and the property supply shortage has “hit a new low.”
It remains to be seen whether Brexit interrupts the conventional boom and bust cycle and brings forward the next surge of claims against surveyors.

HOUSE PRICE REDUCTIONS
There are other potential drivers for reducing property prices. For example:

- The Chancellor’s 2015 decision to cut mortgage interest tax relief on buy-to-let investment properties, will stymy attempts to make a profit from rental properties (particularly by higher rate tax payers). It may also, if interest rate increases make other investment options more attractive, lead to reduced demand and a resultant slow in price increases.

- The current government’s commitment to invest an extra £1.4 billion in its Affordable Homes Programme, which, if successful, might go some way to redressing the currently massive differential between the supply and demand for residential properties.

- Increased base rates. The Bank of England predicts that inflation, which it anticipates will be 2.8% in 2017, is set to outpace earnings growth (predicted to be 2%) for the first time since 2014. If the Bank of England becomes concerned about inflation, it will likely increase interest rates to reduce the rate of economic growth. Doing this discourages borrowing and increases interest payments on loans, including variable mortgages.

- Currently, the mortgage market review (MMR) continues to slow the pace of sales. The MMR bans self-certification mortgages and tightens the checks and balances on interest-only loans, affordability assessment and qualifications of sales staff.

When property prices fall, lenders inevitably look to their professional advisers if properties are repossessed and their value does not cover the amount of the outstanding advance.

INCREASED APPETITE FOR COMPLAINTS
Since October 2014, surveyors have been required to sign up to one of three compulsory redress schemes:

- The Property Ombudsman
- Ombudsman Services: Property
- The Property Redress Scheme

An increased awareness of consumer rights has led to a year-on-year increase in customer complaints in recent years. The Property Ombudsman dealt with 7.5% more complaints in 2016 than in the previous year, and saw a staggering 27% increase in the number of enquiries in the first Quarter of 2017 (which may be explained in part by there being an unexpected lower number of enquiries in 2016 when compared to 2015). Awards The Property Ombudsman made in 2016 increased from 2015 by 51% to £1.2 million.

According to the Ombudsman Services: Property Annual Report for 2016, the main area of complaint against surveyors remains a failure to report defects. Poor customer service and communication remain the main source of complaints.

OVER-RELIANCE ON AUTOMATED VALUATION MODEL (AVM) VALUATIONS
Using mathematical modelling combined with a database of historic valuations, AVMs calculate a property’s value at a specific point in time by analysing comparable values. Some lenders are considering relying solely on AVMs for remortgages. This is understandable in the light of current industry shortage of qualified surveyors, combined with constant pressure on fees.

The role of IT companies will undoubtedly increase, but AVMs are only as good as the data on which they rely. For example, Quest produces AVMs based not just on registered sale prices, but also on previous agency listings and surveyors’ records. In a falsely inflated market (for example, Houses in Multiple Occupations in Leeds, when Morris Properties Limited was in operation), the comparables on which an AVM relies may be inaccurate.

Fraudsters are targeting areas where lenders rely on AVMs and desktop reports. For example, identity fraudsters might target a property with a low mortgage and apply for a further significant advance, which would be made without expert human input.

As Catherine Burtinshaw of Esurv suggests:

“...The extensive skillset of a qualified surveyor cannot be replicated by a computer which number-crunches statistics to produce an AVM. And, with a greater onus on lenders to ensure that fraudulent loan applications are effectively identified and declined, it is those that rely on AVMs who could, when bringing negligence claims against professional service providers, be subject to a higher proportion of contributory negligence themselves.”
OTHER TECHNOLOGY-RELATED ISSUES

Surveyors rely heavily on electronic systems. The impact on a business should those systems be interrupted or interfered with is potentially huge. Data breaches are becoming more commonplace in the UK. This is a massive concern for surveyors, who hold large volumes of electronic data.

Surveyors are leading the way in the use of drones/UAVs to perform their services. The underlying legal framework for operation of UAVs is complex. Operators usually need Civil Aviation Authority permission for commercial operations. There are also issues with permission from property owners, managers or local authorities.

PROPERTY TRENDS

According to the Royal Institute of British Architects, current property trends include:

- “One-off” houses
- Adapting homes for the elderly and/or disabled
- Sustainable housing

The specialised nature of these properties makes them difficult to value. To coin Lucretius, “one man’s meat is another man’s poison”. Having recently confirmed that a surveyor is unlikely to be able to rely on a margin of error defence where a valuation is more than 15% “out,” (Barclays Bank Plc v TSB & V Ltd [2016]) this may be an area of risk for surveyors.

VALUING STARTER HOMES

The government has committed £1.2 billion to developing sites for starter homes across England. The homes will be built exclusively for young first-time buyers and sold at a discount of at least 20% on the market value.

Starter homes are inherently problematic for lenders. They are sold at less than market value, involve the development of brownfield sites in less attractive locations and are subject to resale covenants. The current proposal is that starter homes must be sold with a 20% discount on market value for up to 15 years, which will apply when properties are taken into possession. If mortgagees lose money, they are bound to look to their advisors for recompense.

For surveyors, there are a number of complex valuation issues:

- Starter homes are not going to be sold in a true open market. They are only available to first time buyers under 40. The resale covenants will have an adverse effect on the market value of a property.
- The availability of comparable properties will give rise to problems in establishing open market value. Isolated developments on brown field sites will be difficult to value. Even if comparables are available, the sale restrictions imposed by the scheme and registered as land charges will make valuation more difficult.
- In its response to the Department for Communities and Local Government Consultation Paper, the Council of Mortgage Lenders flagged concerns that the introduction of the scheme might negatively impact the value of non-scheme properties in an area. In those circumstances, it will be difficult to establish true market value.

MEZZANINE AND BRIDGING FINANCE

When the market reaches a certain level (as it has recently), high risk forms of lending become more prevalent. They include mezzanine and bridging finance.

Mezzanine funding covers the gap between the “senior” debt (the primary source of funding, usually a loan from a mainstream lender) and the actual cost of a development. Mezzanine funding allows a developer to bridge a funding shortfall without using any of its own money. Developers will also use bridging finance to secure a development site with potential before anyone else buys it.

Both these forms of finance are expensive with interest rates well above the normal.

Developers can be confident that they will recover the additional cost (and more) if prices continue to rise. Likewise with bridging finance, a developer will know that he can refinance with a mainstream lender.

However, when the tide goes out the risks become apparent. Margins are so tight that even the slightest delay in selling the end product of a development can be disastrous. The developer cannot afford the interest on two loans.

Mainstream funders are not so willing to offer finance on development sites. The borrower defaults and both the bridger and mezzanine funder are left exposed.

The mezzanine funder has no cushion. Their debt is second ranking and the first to be affected by any
fall in the market. The same issue applies to bridging finance. The bridgers are left with a debt usually with a high loan-to-value secured against an impaired asset.

Where lenders incur losses, they inevitably examine the advice which they received at the height of the market and are the first to consider action against valuers.

However, Daniel Prince of Hamilton Underwriting Limited says:

“On the plus side, bridging loans are often short and valuers are therefore exposed only for a short period of time. However, with a housing market that is slowing for higher value properties, developers with limited assets potentially face having to pay several months of mortgage that they may not have been expecting. This may prove a stretch too far leading to default or an under-priced sale. Both of these options could lead to a potential notification against the valuer. Worryingly for insurers is that we often see these higher risks jobs undertaken by smaller firms.”

VALUING LEASE EXTENSIONS

Many flats built and sold since the Second World War were sold on 99 year leases. As a lease becomes shorter, it obviously gradually loses value. Buyers are generally less interested in purchasing properties which are subject to leases with an unexpired term of less than 85 years. Mortgages do not lend against leasehold properties with lease terms of less than 60 years, and some are reluctant at less than 70 years.

The Leasehold Reform, Housing and Urban Development Act 1993 (as amended) provides leaseholders with the right to extend their lease by a further 90 years and reduce the ground rent to a peppercorn rent, subject to meeting qualifying criteria.

Before starting the process for a statutory lease extension, leaseholders require a lease extension valuation report. The surveyor will advise on the cost of the lease extension and, often, deal with negotiations on behalf of either the freeholder or the leaseholder. If a deal cannot be struck, the matter will usually be referred to the First-Tier Tribunal (Property Chamber) for assessment.

The premium to be paid to the freeholder has two parts:

- The reduction in the value of the freeholder’s interest as a result of the extension (the loss of income from ground rent for the rest of the term and the loss due to waiting a further 90 years for the reversion).
- Where the lease has less than 80 years left to run, 50% of the “marriage value” (the increase in the value of the property arising from granting the new lease). As the term of the lease gets shorter, the premium payable to the freeholder for the extension increases.

Lease extension valuations are complex, involving calculation of yields and with limited comparables because of the “sliding scale” nature of the value of a lease.

Leasehold extension valuations are becoming more commonplace as many of the first 99 year leases come to an end, or at least reach a point where lenders are no longer prepared to lend against them.

That increase will inevitably lead to an increase in claims against surveyors, either where “bad bargains” are struck on the advice of the surveyor or when the Tribunal has become involved and costs of negotiations have been wasted by the surveyor’s unrealistic assessment of value.

VALUING HIGH-RISE FLATS

The 14 June 2017 fire at Grenfell Tower was a national tragedy, with much more important consequences than those discussed in this article.

Whilst many questions remain unanswered, what is clear following the fire is that many will be reluctant to live in high-rise developments, particularly ex-local authority properties where indications are that fire safety measures are not always appropriate. Those who have valued high-rise properties pre-Grenfell might find themselves the target for claims for alleged over-valuation when the value of these properties inevitably drops due to lack of demand.

With our team planning ahead for what the future may bring, please contact any of the following individuals, should you require our assistance.
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