Practice&Law

A MARGINAL VICTORY ON VALUATION NEGLIGENCE

Negligence Frances Richardson and Katie Bradford analyse the current law on permissible margins of error in valuations

Recent case law has confirmed that a challenge to a valuation must climb two steps to succeed. First, that the figure falls outside the permissible margin of error. Second, that the valuation process was incompetent. A negligence claim will fail if the valuation is within the margin of error, and one recent decision has re-opened the debate as to how wide that margin is.

Margins of error

Valuations cannot be carried out with pinpoint accuracy. Different competent valuers will come up with figures within a range, sometimes clustered together, sometimes far apart. While the court process requires a "true figure" to be established, the courts have long accepted that there is a permissible margin of error either side of that figure. Historically this was seen as 10% either side of the "true market value", a margin that was increasingly seen as an established convention. However, it can be reviewed on a case-by-case basis. The court will rely on expert evidence as to how much variation is acceptable in the particular circumstances of the case.

Back in 1977, in *Singer & Friedlander Ltd* v *John D Wood & Co* [1977] 2 EGLR 84, Watkins J said:

> "The permissible margin of error is said by Mr Dean, and agreed by Mr Ross, to be generally 10% either side of a figure which can be said to be the right figure… which at the time of valuation is a figure which a competent, careful and experienced valuer arrives at after making all the necessary enquiries and paying proper regard to the then state of the market. In exceptional circumstances the permissible margin, they say, could be extended to about 15%, or a little more, either way."

REX FEATURES

When will the court accept that a wider margin is reasonable? One obvious reason is where there are many variables in the valuation. In *Goldstein* v *Levy Gee (a firm)* [2003] EWHC 1574 (Ch); [2003] PLSCS 154, Lewison J dealt with that by drilling down and establishing a separate bracket for each component of the valuation. For example, one bracket for rent and another bracket for yield. When all the variables are fed in, it creates an overall bracket. The result of that approach is a wider bracket.

Lewison J said in *Levy Gee*:

"Mr Howe submits that the way to do this is to take all the figures at the lowest end of the spectrum followed by all the figures at the highest end of the spectrum. Although one may instinctively feel that this stacks the figures in the way most favourable to the valuer, it seems to me that the logic cannot be faulted."

Another justification for a wider bracket may be the market. It is often argued that a valuer must stand back from the valuation figure established through rigorous analysis, and do a sense check. If the overall figure feels wrong in the market, the valuer can be justified in tweaking to reflect a moving market. And a sense check

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may be even more important where there is a slow market, with little direct comparable evidence.

In theory, an investment property should be easier to value (and imply a tighter margin of error) than a speculative development. A mixed development might justify a wider margin. Driving against this, valuation techniques for substantial properties are now very sophisticated. New methodology may be said to have led to requirements for greater accuracy. These improved techniques may narrow the range of the bracket.

Outcome or process driven?

On a negligence claim, historically, the court has focused on the end result: the figure rather than the process. An incompetent process may fortuitously lead to a figure within the margin of error – the valuation will not be held to be negligent. This principle has been upheld by the Court of Appeal so can only be challenged in the Supreme Court. Loss is a necessary element in a claim for negligence – no loss, no claim. The courts have accepted that an incompetent valuation within the permissible margin of error does not cause the claimant loss – even though 10% or more distance from the "true" value can be a very substantial sum.

THE PERMISSIBLE MARGIN OF ERROR

- Generally 10-15% either side of "true market value"; may be as low as 5% in well traded properties
- In *Titan*, the judge discussed applying a 20% margin but ultimately concluded that the bracket there was 15%
- The margin to be applied will depend on:
  - complexity of the valuation
  - availability of comparables
  - market volatility

It is impossible to look at the outcome without examining the process needed to get there

In *Mount Banking Corporation Ltd* v *Brian Cooper & Co* [1992] 2 EGLR 142, RM Stewart QC, sitting as a deputy High Court judge, said:

> "If the valuation that has been reached cannot be impugned as a total, then, however erroneous the method or its application by which the valuation has been reached, no loss has been sustained."

In *Merivale Moore plc and another* v *Strutt & Parker (a firm)* [1999] 2 EGLR 171, in the Court of Appeal, Buxton LJ said that the first question was "whether the valuation, as a figure, falls outside the range permitted to a non-negligent valuer". He continued:

> "A valuation that falls outside the permissible margin of error calls into question the valuer's competence and the care with which he carried out his task. But not only if, but only if, the valuation falls outside that permissible margin does that enquiry arise."

So, if a valuation figure falls within the range of permissible figures even by accident or incompetence in the process, then the High Court and the Court of Appeal would be bound to hold that the valuer was not negligent. Even if there were clear mistakes in the valuation, a dissatisfied client will not win only by proving that the valuer did something wrong.

A different approach has peeped through to challenge the end figure approach. In the case of *Lion Nathan Ltd and others* v *C-C Bottlers Ltd and others* [1996] 1 WLR 1438, Lord Hoffman said:

> "Whether a forecast was negligent or not depends on whether reasonable care was taken in preparing it. It is impossible to say in the abstract that a forecast of a given figure would not have been negligent. It might have been or it might not have been, depending on how it was done."

This looked at process not result. However, there are two complications in relation to applying this reasoning more broadly. First, it did not concern a negligent property valuation but a warranty given by the vendor of a business. Second, and more importantly, it is a decision of the Privy Council on appeal from the Court of Appeal of New Zealand, so it is not binding in English law and can only be considered as persuasive authority. Both the High Court and Court of Appeal are still bound to follow the principle established by the Court of Appeal in *Merivale Moore* and to test the result against the permissible margin of error.

But process is the second hurdle for a claimant. In the recent High Court case of *Titan Europe 2006-3 plc* v *Colliers International UK plc* [2014] EWHC 3106 (Comm); [2014] PLSCS 262, Blair J followed this result-driven principle. He also looked at the methodology in detail. To find the "true market value" of the property and the appropriate bracket (ie outcome-driven), the judge considered the valuations which competent valuers would put forward. This led him to look closely at the different methodologies proposed to him by the expert valuation witnesses.

The facts of the case were that in 2006 Colliers valued a group of warehouses in Germany for Credit Suisse at €135m. Relying on that valuation, Credit Suisse lent the sum of €110m to the property owner. The owner later defaulted on the loan. The lenders issued proceedings in 2012 against Colliers alleging it had negligently overvalued the property. The property was being marketed for €22.5m at the time of the trial. It was accepted this was not a straightforward property portfolio to value and there were differences of opinion between the experts as to the correct methodology to employ.

Even though the judgment went badly for Colliers, *Titan* reinforced, and arguably even extended, the valuer-friendly state of the law. The judge determined the "true market value" of the property in 2006 had been €103m. The margin of error that the judge considered to reflect the complexity of the valuation was 20%, although he concluded that the bracket here was likely to be 15%. However, he did not need to rule on how wide the bracket was as, even with a range of 20% (as put forward by Colliers' expert), the valuation of €135m fell outside it.

The judgment confirmed the ruling of Lewison J in *Levy Gee* that even if the valuation fell outside this bracket, it still might not be negligent if the valuer had been careful and competent in their methodology. However, valuers should not become complacent as, even on this basis, Colliers was found negligent. Colliers' valuation failed to give sufficient weight to the fact that the property was likely to attract poor demand because it was very large, old and built to the specific needs of the tenant, and there was a real risk that the tenant might vacate.

Titan illustrates that, while commentators often polarise the law in this area as process-driven or outcome-driven, it is, in reality, impossible to look at the outcome (or rather what the outcome should have been) without examining the process needed to get there.

Blair J in *Titan*, while analysing in detail the methodologies proposed by the expert witnesses, did not make detailed comments on the inadequacies in process of Colliers' actual valuation. Despite its valuation being outside the bracket (even if stretched to 20%), if Colliers acted reasonably and competently in its process, the valuation itself would not necessarily be negligent. The judgment has been appealed, with a hearing in the Court of Appeal scheduled for October 2015. This may result in a different decision applying the current law. However, unless that decision is appealed to the Supreme Court, it is not likely to change the approach in this area. Most readers will sleep easier for that.

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