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TECHNICAL BULLETIN

FOR RESIDENTIAL SURVEYORS

THE ABUSE OF LEASEHOLD INTERESTS

CONTINUING PROFESSIONAL DEVELOPMENT 60 Minutes

GROUND RENTS: THE CALM BEFORE THE STORM?

PITCHED FIBRE DRAINS PART 2

VALUING DEVELOPMENT SITES: LESSONS LEARNED

TIUTA INTERNATIONAL V DE VILLIERS SURVEYORS [2017] UKSC 77

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BlueBox partners
promoting Surveyor excellence

THE TECHNICAL BULLETIN

FOR RESIDENTIAL SURVEYORS

Welcome to the Technical Bulletin for Residential Surveyors. This Bulletin is designed for residential practitioners who are members of RICS and/or the Sava Scheme.

Produced jointly by BlueBox partners and Sava here you will find technical articles, updates on convention changes and best practice. We hope you will find this useful in your day-to-day work and we welcome any feedback you may have and suggestions for future publications.

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CONTENTS

04
THE ABUSE OF LEASEHOLD INTERESTS
CHRIS RISPIN

07
GROUND RENTS: THE CALM BEFORE THE STORM?
DUNCAN GREENWOOD

11
PITCHED FIBRE DRAINS PART 2
PHIL PARNHAM

17
VALUING DEVELOPMENT SITES: LESSONS LEARNED
CHRIS RISPIN

20
TIUTA INTERNATIONAL V DE VILLIERS SURVEYORS [2017] UKSC 77
DUNCAN GREENWOOD
CHARLIE BENDING

23
WHAT IS YOUR POSITION IF YOUR CUSTOMER CANCELS THE HOME CONDITION/ BUYERS SURVEY?
NIK CARLE

THE ABUSE OF LEASEHOLD INTERESTS

WHAT SHOULD A VALUER CONSIDER?

CHRIS RISPIN MANAGING DIRECTOR, BLUEBOX PARTNERS

Leasehold remains the number one concern for homeowners in the UK. Recent research by DAC Beachcroft (international firm of lawyers specialising in advising the insurance industry) summarised the government's thinking on leasehold interests following their recent consultation.

Although the findings of the consultation could mean that leasehold issues will be addressed for future market activity, there seems very little that can be done by people holding an existing leasehold property. Their only avenue remains seeking legal advice on whether they were badly advised at the start of the process.

While any rise in claims could stimulate work for those specialising in the valuation of leasehold interests in determining losses arising from an onerous lease term, this won't resolve anything for the customer.

Valuations and true market value

When there are issues such as progressive movement or contaminated ground, the current response is to establish the facts before providing a valuation. This involves engaging an expert to investigate and determine whether any remedial action is required, who is responsible and at what cost. This is then used to assess the true market value.

So, where does this leave someone who owns a property with a perceived (or actual) onerous term and wants to sell or re-mortgage? The RICS have been silent on this so far, leaving valuers to decide how to advise their client. Which points should a valuer consider?

Points to consider

1. Reaching a point of certainty

As with any valuation, it is important to get to a point of certainty. This applies as much to lease terms that could affect value and saleability as it does to structural or site-related concerns.

If the process currently used for serious defects was applied to a lease with unknown terms, it would be immediately important to establish the facts before giving a value. Access to the terms of the lease should be standard practice at the time of the valuation. However, this is rarely the case and the lease terms are often left until shortly before exchange, resulting in timing issues. For new build properties these details should be disclosed along with the DIF (Disclosure of Incentive Form).

Need for change

Case study

To highlight the need for change, here is a short case study regarding a purchaser who was in a chain of three. They were due to exchange contracts shortly. On the day of exchange, the purchaser found out that the 'first-time buyers' were actually the owners of a property but looking to let it out, so were unable to exchange.

This information had not been established by the conveyancers or estate agents at the outset, resulting in unnecessary delays and stress. This sort of incident is an obvious reason for the rise in online agents who are transparent in what they do and do not offer. This is far from an isolated incident in the housing transaction process.

While those in the residential property industry continue to sell cut down 'valuation surveys' and legal processes at unrealistically low prices, then situations like this will arise and frustrate the process.

In a properly conducted valuation, the valuer could receive a summary of the lease to scrutinise and incorporate it into the overall analysis. Determining whether the lease could affect the valuation at the outset would mitigate problems such as those described above.

2. Impact of ground rent

In a case with escalating ground rent, it should be for the valuer to determine the likely impact of this in the future. Escalation of the ground rent in accordance with RPI (Retail Price Index) may be reasonable, although it's impossible to predict the average market in 50 years' time.

While a valuer can't predict the future, they can point out potential concerns and make reasonable, documented assumptions based on their market knowledge. It is then for the lender and buyer to decide whether to take that risk.

If there has been previous market activity based on similar terms, this could indicate the degree of risk, but this should not be tempered by knee-jerk reactions of some lenders who have put up the shutters to such risk.

Where more onerous terms are identified, and that will affect saleability both now and in future years, such cases should be referred back to solicitors to negotiate with the landlord for a variation in the lease terms. This isn't an easy solution and it's hoped that it will be addressed by the government's proposals.

Is it possible that, given repeated referrals, Landlords will see the error of the situation (particularly if the property becomes un-mortgageable), and acquiesce to revised terms? It does depend on those involved in the decision-making process making clear that unacceptable lease provisions will not be tolerated.

What can owners do?

Owners hoping to re-mortgage having found the value of their property has been adversely affected by the lease terms have little choice but to seek legal advice on whether this loss was foreseeable at the time of the original purchase.

If the potential for such a loss has been missed by one of the parties involved in the transaction, they may have failed in their duty of care. Valuers in such a situation should address the situation, ideally with the support of the original lender and conveyancer. This would be the fairest approach for the customer.

Many situations have a logical process that can achieve a fair solution to all involved but this often doesn't fit our super-fast 'get an answer instantly' world. Nevertheless, professionals should resist attempts to cut corners that could lead to them being labelled as the scape-goat.

GROUND RENTS: THE CALM BEFORE THE STORM?

LOOKING AT THE FUTURE OF GROUND RENTS

DUNCAN GREENWOOD PARTNER, DAC BEACHCROFT

The topic of ground rents has had a huge amount of attention over the last 12 months, culminating in the government's consultation paper on leasehold reform launched in July 2017. Reports of block notifications abound across the property professional sector, but are these likely to produce large scale exposures for professionals and their PI (professional indemnity) insurers?

The issue

Historically, ground rents in long leasehold titles were fixed at extremely modest levels, ranging between peppercorn (£1) and £50 per annum. Often, these were not even collected by freeholders due to their low values.
During the last decade, however, new types of ground rent clause began to appear in long leasehold titles of new build residential properties. Not only were higher starting figures introduced (often between £250 and £500 per annum), but they also became the subject of review every 10 or 25 years.

Many of these clauses doubled the ground rent on each review, resulting in shocking growth throughout the overall term of the lease, which is frequently between 125 and 999 years.

As an example, take a £250,000 house purchase with an initial ground rent of £500 per annum and a 'doubling' review cycle every 10 years over the 125-year term. What appears to be relatively modest ground rent liability at the outset will soon become significant. By the 50th anniversary, the annual ground rent liability will be £16,000 and by the 100th anniversary an eye-watering £512,000.

The realisation

So, why has this become an issue now, given that initially it appeared that it will take a number of years before the ground rents begin to spiral?

Following the leasehold reform legislation was announced, the right to acquire the freehold interest and/or seek to extend the term of the original lease comes after two years' ownership. This right was often used as a selling point to those considering leasehold purchase, particularly where houses (rather than flats and apartments) were involved. The press frequently reports that house purchasers are told they could acquire the freehold for a relatively modest price of around £3,000 to £4,000 after this two-year qualifying period.
However, when the qualifying period ended, homeowners wanting to exercise this right discovered that the cost could be very different to that initially suggested. Media reports started to surface with anecdotal stories of homeowners being quoted figures of anywhere between £25,000 and £75,000 - a far cry from the pre-purchase indications.

Why is this? Although the basis of assessment under the legislation is far from simple, the process considers the investment value of the right to receive ground rent over the term. Rapid ground rent growth significantly increases that investment value while diminishing the leasehold value in equal measure.

The consequences

As news of this problem spread, the lending industry became extremely cautious about accepting leasehold titles of this type as security, due to the obvious dangers posed to a property's value over the term of the mortgage. This, in turn, caused numbers of 'subject to contract' sales to fail, leaving many people with unsaleable properties.

By May 2017, Nationwide Building Society changed its policy to deem all leasehold titles unacceptable, unless the ground rent throughout the term of the lease was reasonable. The bank specified a maximum not exceeding 0.1% of the property's value. Many other lenders have followed Nationwide's lead. A further complication is a rather unintended one. The Housing Act 1988 says that long leases over 21 years, where annual ground rents exceed £1k in London and £250 elsewhere, are assured tenancies. This applies to a very large number of instances. As currently provided for in the Act, rent arrears (including ground rent) provide a mandatory ground for possession.

Political reaction

On 21 July 2017, the government issued Consultation Paper Tackling unfair practices in the leasehold market. The eight-week period for stakeholder response has now closed and the results are under consideration.

The paper noted that there were four million leasehold properties in England in 2014-15 and, of these, 1.2 million were leasehold houses. In 2016, around 10,000 new build leasehold houses were sold, out of around 57,000 sales of leasehold houses in England.

Serious consideration is likely to be given to outlawing the creation of new build leasehold houses and limiting the level of starting ground rents and future escalations on all new residential leases. If this happens it will close the door on future problems but won't help the many homeowners who currently find themselves with rapidly escalating ground rent clauses.

Even the government seems to accept that retrospective action will be difficult; although one question in the consultation papers did invite responses to *"How could the government support existing leaseholders with onerous ground rents?"*. In reality, an industry solution appears more likely but even this will not be easy.

The difficulties arise because the management of freehold reversionary interests is not seen as a core part of a house builders' business. This has led to the interests being typically sold to third party investors who specialise in releasing the value in the ground rents.

In light of the escalating ground rents and their impact on the value of the freehold reversion, this has become big business. The Secretariat of the All Party Parliamentary Group for leasehold reform estimated in late 2016 that UK house builders were generating between £300-£500 million a year from these sales.

Industry response

The consultation paper singled out one major house builder for creating a fund to support its customers, noting that *"parts of the industry are taking action to support leaseholders with onerous extant ground rents. In April 2017 Taylor Wimpey announced it would set aside £130 million for a Ground Rent Review Assistance Scheme for its customers facing doubling ground rent terms. We welcome this and are keen for others to follow suit"*.

Media reports suggest that this scheme, while most welcome, is limited to those customers who remain the owners i.e. those who bought a new build property and have not since sold it on. It is envisaged these people will be compensated through the voluntary scheme. It is understood that most third-party freeholder reversion investors have been brought on board and will permit rectification. It does not, however, appear to assist those who have bought 'second hand'.

In August 2017, another major house builder announced that it would buy back a large number of freehold reversions from one third party investor in order to rectify the ground rent provisions and limit future escalation to reasonable levels. The levels are likely to be RPI/inflation linked. Similar steps have been announced by at least one third party investor. What the other major players decide to do remains to be seen.

Professional targets

Unsurprisingly, claims firms have started to advertise heavily as they look to sign up home owners who own property on leases with escalating ground rent clauses. The clear aim is to bring claims against the professionals who advised them at the time of purchase. It is also possible, in any case of mortgage default, that lenders will seek to claim if the realisation of their security is affected by the nature of the ground rent clause in the lease.

Solicitors will inevitably be first in the firing line, but lawyers are not themselves valuers. While a failure to mention a

rapidly escalating ground rent clause will be a difficult position to defend, mere mention of its terms without advice as to its potential implications (from both a leasehold reform perspective and a future security/investment standpoint) is a different matter.
What about mortgage valuation and homebuyer surveyors? Often, the lease itself is not made available to the surveyor and reports reference this, aside from reference to the term of years left to run, with *"it is assumed it contains no onerous conditions"*.

A ground rent clause which doubles every 10, 15 or even 20 years may well be regarded as 'onerous', but the question is whether the surveying profession will be able to hide behind the assumption. The awareness of those actively engaged in the valuation of new and recently new properties with regard to the widespread use by house builders of escalating ground rent clauses over the last decade or so will affect what happens next.

Estate agents should also be aware of the issue. They must ensure that, when dealing with the marketing of an estate house built since the new millennium, the ground rent clause is checked to determine whether or not it is reasonable or not. The Consumer Protection from Unfair Trading Regulations 2008, which replaced the Property Misdescriptions Act, outlaws not only misleading and untruthful statements but, more significantly, 'material omissions'. These refer to omitting to mention a known negative, that would likely influence a purchaser's decision-making process.

Limitation may be a factor and will need to be considered in all cases where the lease purchase occurred more than six years ago. However, the latent damage provisions may be deployed to resist any argument that a claim is time barred, dependent on the circumstances.

What next?

Only time will tell whether what is perceived by many as a 'housing scandal' will prove to be a major headache for property professionals and their PI insurers. Claims seem inevitable and clear strategies for dealing with what will be a fast-moving landscape are essential.

The first port of call should be an invitation to the freeholder to rectify the clause to one which is acceptable to both homeowner and lender (if any) alike. After that, it remains to be seen what the government can achieve retrospectively, whether through legislation or industry liaison.

It is clear, that those who were forced to abort sales will probably bring consequential loss claims. If a decision was taken to sell at a discount, these could result in losses in excess of simple wasted costs.

Ultimately the real 'cost' may be the time spent administering large numbers of notifications and potential claims which, individually, are of limited real value. A very different picture could emerge if the industry resists government pressure and fails to follow the lead set by the few to date.

PITCHED FIBRE DRAINS
PART 2

HOW AND WHEN TO REPORT RICS'S PITCHED FIBRE DRAIN PRODUCTS

PHIL PARNHAM DIRECTOR, BLUEBOX PARTNERS

Introduction

Phil Parnham, director of BlueBox Partners, follows on from the pitch fibre drain article in Issue 27 of the Technical Bulletin with this feature focusing on how the same issues should be reported in RICS's Home Survey products. Our previous feature on pitch fibre drains focused on reporting within Sava's Home Condition Survey format. To get a complete picture, we recommend you download both issues.

RICS Home Surveys standards

The duties of practitioners regarding underground drains are described in the relevant practice notes, including:

- RICS HomeBuyer Report (Survey only), Professional Statement (PS), 1st edition 2016
- RICS Building survey, 1st edition Practice Note (PN), 2012.
- Surveys of Residential Property, Professional Guidance, 3rd edition, May 2016 reissue.

RICS have changed the name of their standards over the last few years, and the first two publications listed above are mandatory for members who are providing RICS licensed Home Survey products for their clients.

The third document represents best practice guidelines endorsed by the RICS but is not mandatory. It is aimed at RICS members who provide their own survey products outside of the licensed Home Surveys brand.

Review of duties in level two and level three products

Please note, 'level two'; denotes HomeBuyer Report (HBR) with and without a valuation or equivalents and 'level three' to Building Surveys (BS) or equivalents.

Inspection of drainage systems – level two products

The PS and GN are broadly similar. For example, under G6 (Drainage) of the HBR PS, it states:

> *"Chambers (except in the case of flats) are visually inspected from ground level where it is safe and reasonable for the surveyor to lift the cover(s)"*

Our interpretation of this includes:

- Don't lift chamber covers in public spaces and/or common areas in flats. Only lift in areas exclusively used by the subject property.
- Don't lift 'heavy' chamber covers. Examples include thick cast iron lids, those inset with brick paving's, concrete and other heavy materials.
- Only spend a 'reasonable' amount of time and effort trying to lift chamber covers using standard equipment (e.g. chambers keys, large screwdriver/crowbar). As the HBR is an 'economic' product, you shouldn't spend too long removing plant growth/grit and dirt from the chamber lid/frame junction. Do NOT unscrew any covers/lids.
- Although the phrase 'inspected from ground level' suggests a straightforward visual inspection, if pitched fibre drains are suspected or identified, then you should spend a little more time trying to look up and down the drain as described in Issue 27.

The next relevant phrase from the PS is:
"Neither the drains nor drainage systems are tested (G6, page 54)."

This defines the difference between levels two and three. At level two, you should **NOT** make any special effort to observe the drains being used. You should note what you see when you lift the cover but not flush toilets or run water taps. If the drains are running when you are looking then that is a bonus but taking a more active role crosses the line between level two and three.

Under 'other issues' in G6, the issues of pitch fibre pipes are specifically mentioned:

"'Pitch fibre drainage pipes identified in inspection chambers".

Although this does not extend the visual inspection, it emphasises that pitch fibre drains are an issue that should be acknowledged by practitioners. This enhances our duty of care and creates a 'trail of suspicion' to follow if pitched fibre pipes are noted or suspected.

Inspection of drainage systems – level three products

Again, the PS and GN are broadly similar. Under G6 (drainage) of the BS PN (page 63), it states:
"The surveyor opens all reasonably accessible, lightweight inspection chamber covers within the curtilage of the property. The assumed routes of the drain runs and their general condition are reported based on a visual inspection. Where a water supply is available and turned on, the surveyor may also run water through the system as part of the inspection.

Our interpretation is:
- Don't lift chamber covers in public and/or common areas of flats. Only lift those in areas exclusively used by the subject property. Also, don't lift heavy chamber lids.
- This is a level three service and client expectations and your duty of care are enhanced, therefore you should spend a 'reasonable' amount of time and effort trying to lift chamber covers using standard equipment. This usually includes removing some plant growth/grit and dirt from the chamber lid/frame junction, unscrewing any covers/lids where possible and moving lightweight objects/garden furniture to access the chambers.
- Also spend more time trying to look up and down the drain as described in Issue 27, particularly if pitch fibre pipes are noted or suspected.
- Although drain tests are not carried out, there is a clear expectation that toilets should be flushed and taps left running (as long as the water is on) as a standard part of the inspection. Not only does this

allow you to see if the drains are at least free-flowing but it could also establish the routes and layout of the drainage system.

- This is reinforced in the Surveys of Residential Property Guidance Note (page 14) where it states: "When the surveyor considers it appropriate to the assessment of the system, turning on water taps, filling and emptying sinks, baths, bidets and basins, and flushing toilets to observe the performance of visible pipework."

The BS Practice Note (p63) goes on to say: *"The surveyor must attempt to identify the means of foul and surface water disposal. There have been recent changes to legislation with which the surveyor should be familiar before undertaking the inspection."*

This covers issues such as misconnections of surface and foul water wastes and pipes, sustainable urban drainage systems, and responsibility for shared drains among others. Practitioners need a greater level of technical knowledge when providing level three services – it's important to be familiar with the relevant rules and regulations.
As with the level two products, pitched fibre pipes are specifically mentioned under 'other issues' in the BS PN.

Figure One: In this inspection chamber, the main channel is formed by a pitched fibre pipe. This is unusual pitch fibre normally changes to salt glazed channels within the chamber.

Reporting on pitched fibre drains

Reporting the restrictions on inspection

If inspection of the drainage system is restricted in some way, then you must tell the client. The HBR PS is clear about this (page 45):

"The surveyor should inform the client and the latter's advisers of any limitations to inspection of the property and give reasons for this in the text box at the top of the page – i.e. where an element(s) or part(s) of which would normally be inspected within the terms of conditions but could not due to various reasons (e.g. roof covered in snow, chimney stack hidden from view). If further comment is required, it can be included within the appropriate element text box."

For both the HBR and BS licensed reports then brief notes should be included in the 'limitations to inspection box' at the top of the first page of the services section (section G). This should be concise descriptive and clarify why you couldn't do the job the client expects. Here are a few examples:
I could not inspect the drainage system because…

- … the cast iron inspection chamber lid was rusted to the frame.
- … the inspection chamber lid was inset with brick pavings and was too heavy to lift safely.
- … a large soil filled planter was positioned directly over the inspection chamber and could not be moved safely.

If using your own level three format, there should be a similar section for this purpose.

As with all cases of restricted inspection, you should record the details in your site notes and photograph the feature. This will mitigate any potential misunderstanding when your client moves in.

Figure two: This half-hidden inspection chamber has a tight fitting concrete cover. Not only would the cover be too heavy to lift but it looks to be stuck fast in its frame. You should record this in your site notes, take a photo and tell your client in the report.

Figure three: Although this lightweight frame had a lot of debris between the cover and frame, we think you should take a little time to clear this so a full inspection can be carried out.

Limitations of inspection and the effect on condition rating

Broadly similar to the approach described in the last issue for HCS products, how to apply a condition rating to a partially inspected element is summarised here:

- **Partial inspection** – If you haven't been able to inspect all of the drainage system but you've seen enough to allow you to come to a general view, then allocate an appropriate condition rating but make sure your client understands it is based on a restricted inspection. A typical example would be where the lid of one inspection chamber is rusted shut but you've managed to remove the lids to the two other chambers in the property and you saw no worrying signs.

- **No inspection with no worrying signs** – Where no chamber covers could be lifted, but 'trails of suspicion' are noted, allocate a 'not inspected' condition rating. Report the inspection restriction and consider adding at the end of the drainage section in G6:
  "However, if you want to be sure about the true nature of the drainage, you should ask an appropriately qualified person to inspect the whole system".
  While this approach could be considered over-cautious, we think it is an appropriate approach. As the 'not inspected' decision will be partly speculative, it is helpful to bring this to your client's attention. If they want certainty, then they must arrange for further investigations.

- **Inspection with worrying signs** – If you can't lift any chamber covers but can see a 'trail of suspicion', then further inspection is required. In the Home Survey brand, this becomes an automatic condition rating three.

Typical examples would include foul water seeping around the edge of the chamber covers, tall trees/dense shrubs growing directly over the line of older drains or local knowledge that other houses on the estate have pitched fibre drains.

Reporting on restriction implications

While informing clients why something couldn't be done is important, it's just as important to ensure they fully understand the implications. Both the HBR PS and BS PN acknowledge this and include the sentence:

> *"If further comment is required it can be included within the appropriate element text box."*

For pitch fibre drains, the text box is in section G6 Drainage. For level two products, the explanation of implications should be concise. With level three products, you may want to include more detail. The BS PN states reports should "identify the nature of risks in areas that have not been inspected" (page 12).

This is best illustrated by an example. Assume you have just inspected a semi-detached property that is part of an estate of similar properties built in the early 1960s. From your own local knowledge, you know that pitch fibre drains are used in some of the neighbouring properties and several have failed and been replaced. However, in this property a large soil-filled planter was positioned directly over the chamber cover preventing a full inspection.

▪ Reporting for level two products:
An example of a comment for the 'limitations to inspection' box based on the above scenario:

> *"I could not inspect the drainage system because a large soil filled planter was positioned directly over the inspection chamber and could not be moved safely."*

Under section G6 Drainage:

"The property is connected to the public sewer and the drainage system consists of a combined drain for both surface water (for example rainwater, water from yard drains) and foul water (waste water from WCs, baths, showers sinks, basins and dishwashers). It is likely the underground drainage consists of pitched fibre pipes. Further investigations are required."

Condition rating 3 (further investigation).

"It is widely known that the underground drainage to properties on this estate may be formed of pitch fibre pipes. This type of pipe can have a limited life and will be costly to maintain and replace. Additionally, these types of pipes may not be covered by standard building insurance policies."
"You should ask an appropriately qualified person to gain access and inspect the drainage system and provide you with a report that includes a quotation for any repairs/ replacement."

▪ Reporting for level three products
Parts of a level three report will be the same. The main difference comes when you report the implications. Under 'limitations to inspection' box:

"I could not inspect the drainage system because a large soil filled planter was positioned directly over the inspection chamber and could not be moved safely."
Under section G6 Drainage:

"The property is connected to the public sewer and the drainage system consists of a combined drain for both surface water (for example rainwater, water from yard drains) and foul water (waste water from WCs, baths, showers sinks, basins and dishwashers). It is likely the underground drainage consists of pitched fibre pipes. Further investigations are required."

Condition rating 3 (further investigation).

"It is widely known that the underground drainage to properties on this estate may be formed of pitch fibre pipes. This type of pipe was commonly used during the 1950s, 60s and 70s was is made of various fibres soaked in black pitch. Over the years, this type of material can deform and deteriorate and often has an economic life of less than 30 - 40 years. If this happens, blockages can regularly occur and in the worst cases, drains may collapse altogether."

"The nature of this type of pipe makes it difficult to repair. In some cases, the existing pitch fibre pipes can be reshaped and lined with a stronger and waterproof 'sleeve' without any excavation. However, if the drains are in a poor condition, this 'no dig' solution will not be an option leaving excavation and replacement as the only alternative. This can be costly."

"The other problem with pitch fibre pipes is some building insurance companies specifically exclude them from their policies. This can result in the building owner having to fund the full cost of the repair. You should contact your building insurance company to discuss this matter."

"Although I was unable to lift the inspection chamber cover, the drainage system in a number of similar neighbourhood properties do include pitch fibre pipes. I have organised repair schemes on behalf of other clients personally. However, to be sure about the true nature of the potential problems, you should ask an appropriately qualified person to inspect the whole system and provide you with a report and a quotation for any identified repairs or replacements. This investigation will usually include:

- *Accessing all parts of the underground drainage system, possibly involving moving heavy objects and/or removing and replacing chamber covers if they cannot be opened. You may need to discuss this matter with the vendor.*
- *A video survey of the drainage system.*
- *Providing a full report together with repair/replacement recommendations.*

"This should be done before you commit to the purchase." "The final recommendations will depend on the discovered conditions but my experience of other properties in the neighbourhood suggests you should plan for considerable amount of repair."

A level three report should provide the client with sufficient information to enable them to come to a purchase decision without having to go to another organisation for advice. We realise there is a risk, but this detail defines the difference between a level two and level three service. In this case, the final paragraph attempts to give the client a clear view of the likely extent of the possible repairs without commissioning (and paying for) a further investigation.

Reporting on other matters

In this feature, we've focused on an example where a full inspection was not possible. Obviously, the circumstances of each job will change. In such cases you should adapt/ adjust/ add to phrases of this type. To summarise:

- Pitch fibre drains are always a condition rating three because they are likely to be at the end of their economic life, and
- Building insurers are unlikely to cover their repair/ replacement.

VALUING DEVELOPMENT SITES: LESSONS LEARNED

THE LESSONS THAT CAN BE LEARNED FROM DUNFERMLINE BUILDING SOCIETY V CBRE LTD

CHRIS RISPIN MANAGING DIRECTOR, BLUEBOX PARTNERS

In 2017, a claim was heard for a breach of professional negligence by CBRE Ltd on a development site for mortgage valuation purposes undertaken for the Dunfermline Building Society back in 2007.

This is the sort of valuation only undertaken by firms with significant cover through professional indemnity insurance, but there are a few points from the case worth considering. I've taken the case as a basis and looked at the methodology to see what could be applied to other development valuations.

The case

This was a six-acre site in Reading including a four-storey office building and industrial units. Adjacent was a 45-metre-high gas holder and the main rail line to London. There was outline planning consent for mixed use development (mainly residential). The end figure for the completed development was anticipated at around £107m.

The lender wanted to lend funds on the current value of the site, which was given by the defendant as £17.5m. As a result of this valuation, the lender agreed a loan of £8.7m

This already complex case became more so when the borrowers defaulted at the time of the market crash. Receivers were appointed and in 2012 the site was sold for £3.75m. It was accepted that the market had dropped, but even so the original valuation had allegedly been overstated by £3.25m.

Value implications

Setting aside the facts, let's look at the value implications for this type of development and the valuation methodology that would need to be adopted.

The former use of the site indicates possible contamination, so the developers would need to allow for appropriate investigation and clear up. Undoubtedly, the demolition or modification of existing buildings and preparation of the site following that would be needed, along with associated health and safety provisions. All these costs must be accounted for professionally when determining the current value of the site. The valuer would be expected to review the papers.

End value considerations

The end value of the development is also going to be interesting given its location and speculative use. There must be room for error/variation.

It would be surprising to find comparable evidence to support a current valuation as the site was in a unique location. The site also had specific criteria regarding current status, meaning the most likely valuation method to adopt would be the residual one.

This involves taking the end value of the completed development and deducting all relevant costs and developer profits. There was considerable discussion in the Court on the valuer's use of the figures to make up the residual calculation and whether the actual selling price of the site was relevant.

Reference was made to the Information Paper 12, which relates to Development Valuations. However, this was effective from 2008, which is after the date of the valuation. They also related to the Information Paper on Comparable Evidence in Property Valuation, which dates from 2012.

DUNFERMLINE
SCOTLAND'S BUILDING SOCIETY

Here's what we can learn

Lesson 1

Apparently the Courts will apply guidance produced after the date of the valuation to determine their rulings. Undoubtedly both the parties would have agreed on acceptable guidance. If the guidance merely consolidates previous convention then this seems reasonable, however it's not clear how this is decided.

The **Valuation Information Paper No. 12: Valuation of development** land suggests two methods should be adopted: the residual and the comparable method. The paper, Comparable evidence in property valuation indicates that some references to offer prices is not unreasonable. The definition of Market Value also supports this.

Given the complexity of this situation, best practice and common sense would be to use differing methods to look for commonality in the results to support the figure produced. Wide variations would indicate a level of uncertainty that makes the valuation more unreliable. The methods should be independent of each other. Reliance on an agreed price is more likely to be acceptable with evidence of substantial research and a more scientific method, particularly for commercial cases. This is part of the Red Book criteria for market value.

Lesson 2

If there are alternative ways to produce a valuation, they should be analysed independently to find out if the outcome is consistent. The constituent parts of the residual valuation should be supported by professionals in the hope that another valuer would have less scope for a difference of opinion. The lack of comparable evidence does raise the level of uncertainty. This uncertainty is reflected in the 'bracket', i.e... the acceptable level of tolerance around a non-negligent valuation. In this case the experts agreed the bracket was +/-15%. The claimant's expert put forward a valuation of £13.645m, therefore putting the original valuation in jeopardy, while the defendant put forward £16.25m, which would be within the bracket.

Lesson 3

The level of risk and uncertainty in the final valuation must be truly reflected in the report produced. The role of a valuer is to identify the risks and set them out in a consistent way so the client can take appropriate action.

Valuation is based on the interrogation of the market and where there is not much to go on, the answer will be more opinion than fact. The Courts and the AVM (automated valuation model) providers recognise this.

The full judgement should be analysed to understand the various arguments made in this case, especially considering the market movement at the time of the original valuation. Where there is a complex development, pricing of the completed development may take place well before the proposal is put to the banks and seen by a valuer.

RICS standard VIP 12 requires the valuer to look at the projections for the completed properties and see whether anything had happened in the intervening period to suggest whether they might be higher of lower. Other considerations include timescales allowing for planning matters, environmental considerations and numerous other factors. What happens after a valuation is made can't always be anticipated

Lesson 4

Look carefully at any market evidence relating to the information you have and value at the date of the valuation. Any speculative assumptions should be agreed and clearly stated if they qualify the valuation. Small scale developments, such as self-builds with no track record for the developer, should be supported by professional costings and projections. The outcome of this case saw the Judge determining the value to be £16.2m. This was virtually the same as the defendant's expert. It's interesting to read the full case to understand how the Judge decided such a small discrepancy in a situation where the margin of error was 15%.

This case highlights a number of points. The most important is the need for valuation practice to be supported by good guidance. The discussions in Court inevitably referenced key documents, including some that had not been written at the time. Nevertheless, they provided good benchmarks against which to make sound judgements.

TIUTA INTERNATIONAL V DE VILLIERS SURVEYORS [2017] UKSC 77

TWO VALUATIONS OF A RESIDENTIAL DEVELOPMENT

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The claim (Tiuta International v De Villiers Surveyors [2017] UKSC 77) under discussion involved two valuations of a residential development.

The facts

In February 2011, De Villiers valued the security against which Tiuta lent £2.475m to a developer. By late 2011 the developer needed to release further finance and in December, De Villiers provided an updated valuation. As a result of the new valuation, Tiuta increased its funding to £3.088m. However, the developer defaulted, and receivers were appointed.

The price achieved on forced sale was inadequate to pay off the debt. Tiuta accused the surveyors of negligently overvaluing the security in December 2011, although no allegations were made about the February 2011 report.

Tiuta looked to recover its overall transaction loss, which was set at £890,000. In response, De Villiers argued that as Tiuta was already exposed to an indebtedness of £2.799m immediately before the criticised December 2011 valuation, its liability (if any) should not exceed the new money made available in reliance on that valuation. This would mean the amount in question is £289,000. De Villiers invited the court to resolve the issue summarily.

First instance

In March 2015, De Villiers were successful on the basis that losses attributable to the pre-existing indebtedness had not been caused by the December 2011 valuation. The Judge found that the 'but for' test excluded all losses that would have been incurred even if the December 2011 valuation had resulted in no further lending.

Court of Appeal
Tiuta's appeal was upheld in July 2016. The court said that the starting point required determination of the precise nature of the transaction and the part the surveyor played.

As a consequence, where Tiuta entered into an entirely new facility and took a fresh legal charge over the security in reliance on De Villiers' December 2011 valuation, it should be able to pursue a claim for the totality of the losses that flowed from that valuation. The Judge felt that it was completely irrelevant that part of the new facility had been used to discharge an existing debt owed to Tiuta.

The Rt Hon LJ Richard McCombe disagreed in what was a majority decision. He felt that the usual 'but for' test should prevail and exclude all losses that would have arisen in any event. He went as far as to say that the contrary view risked creating an inherent unfairness, in allowing the lender to saddle the surveyor with liability for *"advances made long before the allegedly negligent valuation was provided and in respect of which it already stood to make a loss"*.

Supreme Court
The court unanimously allowed the appeal, noting that the majority of the second facility had been used to redeem the first and considered that this could not be ignored. If Tiuta had not entered into the second facility (which it said it would not have done if the second valuation had not been a negligent one), it would still have sustained a substantial loss when the developer defaulted.

Giving the lead judgment, Lord Sumption said that determination of the issue required a perfectly straightforward application of the ordinary principles of the law of damages. This would restore the claimant as nearly as possible to the position he would have been in if he had not sustained the wrong. In other words, consideration of the 'basic comparison' as described by Lord Nicholls in *Nykredit Mortgage bank plc v Edward Erdman Group Ltd (No 2) [1997] 1 WLR 1627.*

The judgment makes clear that precisely what was in the valuer's reasonable contemplation when carrying out the second valuation was only relevant to determining what responsibility was assumed. That was irrelevant to the entirely different issue of the 'basic comparison'. That, Lord Sumption said, *"involves asking by how much the lender would have been better off if he had not lent the money which he was negligently induced to lend"*. This was a purely factual enquiry.

If Tiuta had not lent in reliance on the second valuation, it would not have been able to redeem the first facility and would therefore have lost that full indebtedness, less the security's actual value, on default. That was a loss that was wholly unconnected to the second valuation and would have been sustained in any event – thereby putting Tiuta back into its pleaded position. But for the second valuation/facility, all losses attributable to the first facility would still have arisen.

Tiuta, recognising this difficulty, tried to argue that the funds applied to redeem the first facility amounted to a collateral benefit which should not be taken into account when computing its loss.

Again, this received short shrift. The general rule is that where a claimant has received some benefit attributable to the events which caused his loss, it must be taken into account in assessing damages. Further, and as recently touched upon by the Supreme Court in the case of *Swynson Ltd v Lowick Rose LLP (in liquidation) [2017] 2 WLR 1161,* collateral benefits are those *"whose receipt arose independently of the circumstances giving rise to the benefits"*.

The Supreme Court felt that on the facts of this case there was no collateral benefit conferred by redeeming indebtedness out of the fresh advance, so no question arose as to whether it should be taken into account or left out. In any event, as it was an express term of the second facility that the vast majority of the advance was used to discharge the existing indebtedness, it could not be said to be collateral in any way.

In short, Tiuta never intended to lend more than £289,000 of new money, did not do so and its losses (if the second valuation was in fact negligent) should be accordingly restricted. While accepting that the position might be very different if both the first and second valuations were alleged (and ultimately found) to have been negligent, that was not the case.

Our analysis

This appeal did not unduly trouble the Supreme Court who unanimously considered the answer to be a fairly straightforward one. A lender cannot (however it chooses to structure its business practices from an internal perspective) look to recover losses that it would have sustained in any event. That must be right and is a welcome and clear clarification of the law.

So, whenever a professional is faced with a refinancing transaction it can now use this Supreme Court authority to restrict potential exposure to the new money lent. There will likely be many other issues to consider, liability aside, given that in our experience lenders are not immune from throwing good after bad to salvage an existing debt which has gone wrong.

Before the Court of Appeal, but not seemingly the Supreme Court, Tiuta had made great play of the inequity that the first instance decision created in light of the 2002 Court of Appeal authority of Preferred Mortgages v Bradford & Bingley Estate Agencies. Does today's judgment, when combined with the 2002 decision, preclude lenders from recovering anything other than the new money on any refinancing exercise?

Here is the twist. Lord Sumption referred to the possibility that if *"the valuers had incurred a liability in respect of the first facility, the lender's loss in relation to the second facility might at least arguably include the loss attributable to the extinction of that liability which resulted from the refinancing of the existing indebtedness"*.

It is not known why Tiuta did not simply assert that both valuations were negligent, and it is unlikely, against known fact, that limitation (at least at common law) has expired. Will it therefore look to amend the claim to include allegations about the first valuation or, as suggested by Lord Sumption, to plead a fresh head of loss along the above lines? In the latter event, scope of duty arguments about what was or was not in the reasonable contemplation of the parties will surely arise.

All in all, a case of watch this space...

Preferred Mortgages v Bradford & Bingley Estate Agencies

In the 2002 Court of Appeal case of Preferred Mortgages v Bradford & Bingley Estate Agencies, a professional negligence claim against a firm of surveyors accused of overvaluation was dismissed because the lender's loan and supporting legal charge, which had been made in reliance on the valuation, had subsequently been fully redeemed. Even though the redemption had been achieved using Preferred's own money; it had chosen to treat a modest further advance as a full re-mortgage; that made no difference. The Court of Appeal found that there could be no continuing liability as the 'transaction' entered into in reliance on the valuation had not created any loss; having been fully redeemed when the account was closed, and the legal charge formally cancelled.

WHAT IS YOUR POSITION IF YOUR CUSTOMER CANCELS THE HOME CONDITION/BUYERS SURVEY?

SOLICITOR NIK CARLE FROM BROWNE JACOBSON LLP ADVISES

NIK CARLE SOLICITOR, BROWNE JACOBSON LLP

A survey has been booked and you've spent time organising the file, arranging an inspection date, completing pre-inspection checks and obtaining signed terms of engagement. However, your client has different ideas and cancels one day before the inspection because their mortgage lender insists on organising a survey. Is this ethical practice and where does it leave you?

We asked Nik Carle, a solicitor specialising in PI claims and risk management advice for property professionals, for advice. Here's what Nik said:

Q: Can the client cancel the report prior to the inspection date, even if some work has been carried out, if so, can I recover costs incurred?

A: "The Consumer Contracts Regulations (2013) can give clients a pretty much unqualified entitlement to cancel in this sort of scenario. It's a 14-day cooling-off period but only if the surveyor has supplied all of the requisite pre-contract information correctly. If the materials haven't been provided in a way that's compliant with the regs then the client's right to cancel can persist for a lot longer than 14 days. As to your fees already incurred, you can only hope to recover these if the client expressly requested "on a durable medium" the

starting of work before the 14-day cooling-off period had expired.
It's worth adding that failing to give the client the requisite 'right to cancel' information is, unhappily, a criminal offence"

Q: Are the lenders actions defined as aggressive behaviour?

A: "Yes, a commercial practice is aggressive if it significantly impairs (or is likely to significantly impair) the average consumer's freedom of choice. Potentially, in this situation, we're concerned with undue influence by the lender, which causes or is likely to cause the consumer to move the instruction away from you. (This all stems from the EU Unfair Commercial Practices Directive)."

Q: What can I do to avoid losing out?

A: "You can build an explicit note in to the Terms of Engagement recording that: 'you, the client, have instructed us to start work immediately' (i.e. while the cancellation period is still running.)"

Home Condition Survey

RICS
HomeBuyer Report...