

COVID-19 and Valuations in the UK

3 June 2020

The COVID-19 crisis has impacted upon valuations in the UK, with site visits often being impossible. This note looks at the effect on valuations and transactions, as well as possible disclaimers and the margin for error.

1. Practical implications

The practical implication of COVID-19 on valuations is that during lock-down, site visits will often be impossible. Instead, valuers are expected to undertake an initial desk top valuation with a follow-up site visit typically within twelve months to confirm the desk top valuation.

Investors and lenders alike will be concerned that the formal valuation may be lower than the desk top valuation. This will have implications for all transactions where a valuation has significance, but particularly so for an acquisition financing, where it is unlikely that a seller will agree to reimburse a buyer for any difference after completion.

However, valuers see the approach as low risk based on confidence that values will not change, their reasoning being that they will apply the same market conditions for both a desk top valuation and a formal valuation. Further, they note, in many cases the valuer will have historic knowledge of the relevant property.

The one certainty all parties are agreed on is that this approach will cost more than one which involves a site inspection, as the valuer will be carrying out the valuation twice.

2. Knock-on effects on transactions

Loan Agreements: Not all "valuation" definitions in loan agreements will be flexible enough to accommodate desk top valuations. While borrowers will want to be cooperative with creditors, there may be grey areas if 2020 loan to value covenants cannot be run on the basis of the desk top valuation. Borrowers and creditors will need to work together to agree the interim approach.

Certificate of Title: Until site visits can be carried out, any cap on liability by certifying solicitors in any new or refreshed certificate of title will be based on a desk top valuation. We expect some certifying solicitors will want the liability cap to be automatically adjusted downwards if value decreases once the follow-up site visit takes place. If this happens, the party relying on the certificate could consider requiring an upwards adjustment if value increases.

3. Reliance and disclaimers in the desk top valuation

One important limitation of desk top valuations is that they always contain certain standard disclaimers on the basis that the reporting valuer will not have physically inspected the site in a desk top valuation, meaning less reliance can be placed on it than on a formal valuation. The disclaimers make it clear what the valuer has reviewed to produce the valuation, and provide for a further formal valuation to be carried out (if required by the instructing party). The standard wording is as follows:

The figures provided are a desk top valuation. The above figures are provided for indicative purposes only and are based on the limited information made available to us to date [state documentation provided]. We have not inspected the properties and have [not] been provided with Reports on Title, lease(s) or other relevant legal documentation.

Should we be required to carry out a formal valuation of the properties the above indicative figures may change subject to the carrying out of due diligence and inspections. A formal valuation would be carried out in accordance with the relevant edition of the RICS Valuation - Professional Standards (the "Red Book") and the General Terms of Business for Valuations, a copy of which can be supplied upon request.

To specifically address COVID-19, RICS recommend that its regulated members include the following wording to their desk-top valuations if they conclude there is material uncertainty due to COVID-19:

“Material valuation uncertainty due to Novel Coronavirus (COVID-19):

The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a "Global Pandemic" on the 11th March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries. In the UK, market activity is being impacted in all sectors. As at the valuation date, we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement. Our valuation(s) is/are therefore reported on the basis of 'material valuation uncertainty' per VPGA 10 of the RICS Valuation – Global Standards. Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of [this property] under frequent review.

VPGA 10 in the Red Book states that a valuation report must not be misleading or create a false impression; the valuer should expressly draw attention to any issues resulting in material uncertainty in the valuation. A valuer typically therefore adds caveats in unusual market conditions to avoid potential negligence claims for not making it clear that there is uncertainty in the market. There is no standard caveat contained in the Red Book for a pandemic, and the degree to which each valuer considers the valuation to be uncertain will be unique to the valuation and the property. Therefore, we expect to see minor variations in the language of the "material valuation uncertainty" disclaimer used in valuations carried out by different valuers.

To assist valuers further, Ben Elder FRICS, Global Director of Valuation at RICS, issued the following statement on 15 April 2020, which valuers can refer to if there are queries on the additional "material valuation uncertainty" disclaimer:

“Where a material uncertainty clause is being used, its purpose is to ensure that any client relying upon that specific valuation report understands that it has been prepared under extraordinary circumstances.

“The term is not meant to suggest that the valuation cannot be relied upon; rather, it is used in order to be clear and transparent with all parties, in a professional manner that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. Indeed, with regard to the process itself, professional valuers will almost certainly have undertaken far more due diligence than normal, in order to arrive at their estimate of value.”

4. Margin for error in a valuation

In valuer negligence cases, the English courts have previously allowed for a margin for error of around 10-15% for one-off properties and properties which have exceptional features (e.g. *Titan Europe 2006-3 PLC v Colliers International UK PLC (in liquidation)* [2015] EWCA Civ 1083). Where the valuation falls within this margin for error or "bracket," the English courts will not generally find the valuer negligent even if there is some aspect of the valuation process which fell below reasonably competent standards. In these particularly volatile circumstances, it must be expected that the acceptable margin for error will widen.

It will, therefore be difficult to argue successfully that a valuer has been negligent in delivering a particular value in the current climate because the markets are so volatile. That is particularly the case where a "material valuation uncertainty" warning is included in the valuation.

Further, on 15 April 2020, RICS reported anecdotal evidence in relation to COVID-19 valuations of a misunderstanding by the instructing party of the difference between the market value (likely selling price) of a property and the worth (value in use) of it to the instructing party. A dialogue between the valuer and the instructing party is therefore particularly important when settling the terms of engagement to ensure that the purpose and basis of value fully accord with the instructing party's needs. In particular, RICS stated that an instructing party's unwillingness to transact at a certain level, based on their own needs, should not influence the valuer's assessment of market value. If it is an assessment of worth that the instructing party requires, the assessment of worth should be the assessment of the worth of the property to the instructing party. What is evident from this is that the instructing party must set out clearly in the engagement letter the purpose of the valuation, to avoid future disagreements (and potential litigation) on the valuation.

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