

Section 3

Assessment of security

Introduction

Before entering into any mortgage contract, the lender will ensure that a valuation is carried out to assess the adequacy of the security for lending purposes. This is a matter of prudent lending for all institutions, but it is a legal obligation for building societies.

Section 3 details explanations for the process for assessing the property as security; the different types of valuations and surveys; describes matters affecting the value of the property; and explains the importance of planning consent and building regulations.

Section 3 covers parts 2, 5, 6, 7 of the syllabus for Unit 4.

3.1 Survey and valuation products

There are essentially three types of service available for mortgage applicants: a basic valuation; a homebuyer's report; a full building survey.

3.1.1 Basic valuation

The **basic valuation** is carried out on behalf of the lending institution to assess the adequacy of security for mortgage purposes. The valuer may be a professional (independent *panel*) valuer or an employee of the lending institution. The task is carried out on behalf of the lender rather than the applicant, although the applicant pays any fee charged. Any contract is between the lender and the valuer.

It is vital that the mortgage adviser stresses to the applicant the limitations of a basic valuation. If the mortgage is granted, the borrower will be paying out thousands of pounds over several years; it is in his own interest to get value for money from this major purchase. A basic valuation often takes as little as half an hour and is, by definition, a fairly superficial inspection – only obvious visible defects will be reported. The valuer completes a report to the lender, recommending whether or not the property is acceptable as security for the advance requested, the value of the property for lending purposes and the insurance value. It is important to note that the valuation for lending purposes is not necessarily the same as the market value of the property. The report will also highlight any essential repairs.

Typical defects identified in a valuation report are:

- ◆ leaking or damaged flat roof;
- ◆ damaged roof tiles;
- ◆ obvious damp or rot – the report will be limited to pointing it out rather than investigating its cause;
- ◆ poor woodwork condition.

Based on the valuer's recommendations, the lender will decide whether to lend and, if it chooses to do so, how much. It will also decide whether to insist that the applicant undertakes to carry out specified repairs within a given period, or even to hold back some of the advance money pending such repairs (known as a retention).

All lenders disclaim any responsibility for the condition of the property and will specifically state that they do not give any warranty of the reasonableness of the purchase price.

In isolated cases, borrowers have brought actions for negligence against valuers, claiming that a duty of care is owed. These cases are less likely to succeed, now that lenders give specific advice on the limitations of the basic valuation but, where such cases do succeed, it is usually on one of two grounds:

- ◆ the lender's disclaimer was insufficiently prominent;
- ◆ the borrowers were inexperienced.

The cases of *Smith v Bush* [1987] and *Harris v Wyre Forest District Council* [1989], both heard in the House of Lords in 1990, established that these criteria might lead to negligence being established.

In *Smith v Bush* [1987], it was held that a valuer could not avoid liability for losses caused by his negligent valuation simply because he had included a disclaimer – despite the fact that it had appeared on both the mortgage application form and the copy of the valuation report sent to the buyer. A key factor was the Smiths' level of *perceived experience in property matters*: the courts found that the disclaimer was 'unreasonable' because the Smiths were 'first-time buyers at the lower end of the market'.

This contrasts with the case of *Stevenson v Nationwide Building Society* [1984]. Here the plaintiff's attempt to claim for losses caused by a negligent valuation – irrespective of the fact that there was a disclaimer – failed because:

- ◆ he was himself an estate agent (and could therefore be expected to have a good understanding of property matters);
- ◆ he had also signed a form that included the disclaimer in a *prominent position*.

It is worth noting that Mr Stevenson, in bringing this case, sought to rely on the fact that the disclaimer used in the valuation was 'unreasonable' under the Unfair Contracts Terms Act 1977. This legislation – now updated by the Unfair Terms in Consumer Contracts Regulations 1999 – aims to protect consumers from terms that are unfair and to the detriment of the consumer, where the terms have not been individually negotiated. While Mr Stevenson failed in his particular case, the legislation might arguably be relied on in certain circumstances.

The question of whether a lender is better to use in-house or external valuers is a matter for the lender's policy. In-house valuers offer advantages in that:

- ◆ consistent standards will be applied to properties against which the lender lends;
- ◆ the lender may earn profit from its valuation activities.

The use of external valuers, however, has counterbalancing advantages in that:

- ◆ in the event of problems with the valuation, there is some external redress – the valuer is likely to have professional indemnity cover, in the event that he is sued;
- ◆ external valuers may be better able to accommodate ebbs and flows in business volumes, which can be harder to deal with as the department of a single lender;

- ◆ external valuers may also have wider experience because they are dealing with other lenders and types of property.

It is clear that any valuation is a very important document to lenders and borrowers alike. Borrowers have to be made fully aware that it is in their interests to look closely at the condition and value of the property they are considering buying, before going ahead. Buying a house may, after all, be one of the most expensive purchases they ever make.

3.1.2 Homebuyer's report

The **homebuyer's report** is a compromise between basic valuation and a full building survey. It is easy to condemn a borrower for not commissioning a full survey but the price is prohibitive to many, especially when one accepts that moving house is a very expensive time. Because of this, lenders offer the homebuyer's report as a moderately priced option, well within the budget of most prospective mortgagors. The commissioning of a homebuyer's report establishes a contract between the applicant and the surveyor.

The report identifies any problems that are relatively obvious: the valuer will walk around the property and identify any problems that are visible to him. He will not, however, lift carpets, or shift heavy furniture about, etc to discover what problems may be hidden by them.

The homebuyer's report is limited in focus and will cover only those things that can be seen fairly easily. There is little comeback in the event that serious problems are encountered later. The applicant does, however, have a good chance that major defects will be identified, allowing them an opportunity to reject the property, make an amended offer or plan expenditure necessary to counter the problems.

Typical defects identified in the homebuyer's report would be:

- ◆ dry and wet rot where symptoms can be seen;
- ◆ damp-proof course condition and position;
- ◆ the interior of the roof space – beams, rafters and the underside of the roof. This may be limited by accessibility;
- ◆ pointing.

The main difference between this and the basic valuation is that the homebuyer's report will provide more detail about issues identified, will make

recommendations about remedial action and recommend specialist reports where necessary.

3.1.3 Full building survey

A **full building survey** is a thorough and complete inspection of the property carried out by a qualified professional surveyor, engineer or architect. It is expensive but worthwhile for many mortgage applicants. If the property is defective, this will almost certainly be discovered by a full survey. If it is not discovered, the borrower has some comeback against the surveyor, whose duty of care is only to the applicant.

Such a survey will be more detailed than the homebuyer's report, comprising an inspection of the state of the electrical system, drains, damp-proofing and damp-coursing. It should be thorough enough to identify any major, and indeed more minor, problems. It should be carried out to certain standards and so, in the event of later problems, the valuer may be liable for any losses as a result of negligence.

In some instances, the lender will not accept a full building survey that has been commissioned by the buyer and will still insist on a valuation for its own use. This may happen, for example, if the surveyor is unknown to the lender and if it will necessitate considerable time or expense to validate the surveyor's credentials. This has been the subject of a Monopolies and Mergers Commission report in 1994.

To reinforce your study of this area, you should read your organisation's literature on survey and valuation services thoroughly. It will also be useful for you to know your way around the valuation report form used by your organisation's in-house valuers, if they exist.

3.1.4 Relative costs

It is not possible to give exact costs for each type of survey, but typical costs for a £250,000 property would be:

- ◆ basic valuation – £250–300;
- ◆ homebuyer's report – £450–550;

- ◆ full building survey – £600 or more, depending on the size, structure and age of the property.

In the event that a valuation or survey identifies a potential concern, further specialist reports may be required.

It is important to bear in mind that there is no refund on a survey or valuation if the sale does not go through.

3.1.5 Simultaneous survey and valuation

It can be beneficial for a prospective purchaser to have a ***simultaneous full building survey and valuation***, so that the additional cost of the basic valuation is eliminated. The adviser should take great care early on in the application process to recommend that anyone contemplating this should check first to ensure that the surveyor used is acceptable to the lending institution – otherwise, the valuation fee will be incurred anyway.

This was subject to comment by the Competition Commission in a report in 1994. Members of the Council of Mortgage Lenders now undertake, through a statement of practice, to advise the applicant of this possibility as early as they can to avoid unnecessary expense to the buyer.

Advisers must not *recommend* a specific type of survey, eg a homebuyer's report or a basic survey: if the adviser specifically recommends a homebuyer's report and something later comes to light that would have been picked up by a full survey, the adviser may be subject to a claim. If the *surveyor* misses something that *should* have been covered by the homebuyer's report, the adviser will not be liable.

3.2 Gazumping and gazundering

Gazumping and gazundering are rather ugly terms – and represent ugly practices.

- ◆ *Gazumping* is the situation where, having formally accepted an offer on a property, the vendor accepts a better offer. Under current legislation, this is not illegal and happens often in a buoyant market. Many people blame estate agents for gazumping, feeling that, once an offer has been made, they should not entertain others. The problem is that estate

agents are obliged to obtain the best price for the vendor and to pass on all offers made.

One solution may be to take the property off the market once an offer has been accepted – but an offer is not binding until contracts have been exchanged. This means that the buyer might drop out at any stage before exchange of contracts with no penalty – the sale is not guaranteed. If this happens, the vendor will have lost valuable time and the property will have to be remarketed; better to keep it on the market just in case.

- ◆ *Gazundering* is the situation where, having had an offer accepted, the potential buyer finds a reason for reducing the offer. In some cases, this is entirely reasonable – the survey might have identified problems or other factors might have come to light. In many cases, it is pure opportunism – the buyer makes a last-minute reduction in the offer, gambling on the fact that the sale has almost gone to exchange of contracts and the vendor will not want to start again. As with gazumping, this practice is not illegal.



In Scotland, an offer to buy is legally binding and a contract for the sale of a property can, in principle, be concluded very quickly. In practice, the conclusion of *missives* (ie the acceptance by the seller of all the terms of the buyer's offer) takes some time and, in the interval, either party may withdraw from the bargain. Therefore, both 'gazumping' and 'gazundering' can, in principle, occur in Scotland. The practice of setting a closing date for the submission of all offers, and the tendency to favour unconditional offers over conditional, has generally meant that the problem is not widespread in Scotland.

3.3 Matters affecting the value of property

3.3.1 Tenure

The vendor must have title to the property in order to sell. If it is in dispute, the property may be worth less – it may even be unsaleable.

Land in England and Wales is either freehold, leasehold or commonhold as covered in Unit 3. There can, however, be many factors that can create defects in title that have a knock-on effect on market values.

Some land has rights attached for the benefit of others. In England and Wales these are usually easements (such as rights of way, rights of light and the right to hang a sign on someone else's building).



In Scots law, the technical term for these is *jura in re aliena* (rights in a thing belonging to another, or servitudes). A creditor might, for example, have some right over his debtor's property pending settlement.

The value of freehold property can be affected by easements and covenants: a property with a right of way through its garden, for example, is likely to be valued lower than a similar property without such as easement. A restrictive covenant may also affect the value.

Properties on long leases sell at significantly higher prices than those on short leases. Most lenders insist that leasehold properties have a specified minimum unexpired period on the lease beyond the end of the mortgage term. If the remaining term of the lease, after the end of the mortgage, is less than 30–40 years, the lender will be reluctant to lend because in the event of default, it may be left with a property to sell with a short lease. In addition, problems can arise in respect of 'common areas' of freehold flats (ie one person's ceiling is another person's floor). As a consequence, many lenders will not consider freehold flats for mortgage. Many lenders will also not lend on ex-local authority flats.



In some parts of Scotland, property has to be *decrofted* before a title can be created for a new purchaser. This often occurs when a farmer sells off a portion of agricultural land so that a purchaser can build a dwelling on it. This action can be time-consuming and is quite technical.

All of these matters can affect value. If not apparent to a valuer, they will be discovered by the solicitor acting.

3.3.2 Location

Geographical location is of great importance when considering the value of a dwelling. Generally, areas of economic prosperity attract population clusters that drive up demand. This is not to say that sparsely populated areas will have lower property prices: sometimes this results in higher prices to reflect exclusivity.

Even within certain towns and cities, the very name of a district can add value to a property. Think of your own area and you will easily come up with names of districts that are considered 'up-market' and those which are deteriorating.

3.3.3 Type and design of the property

Quite obviously, the *type of property* will have an impact on its value. Generally flats are less valuable than houses, and detached houses are more valuable than terrace and semi-detached houses. Bungalows are often more expensive than a house with a similar number of bedrooms, although bungalows do appeal to a more limited market. This may mean they are less sought after in areas where there are many bungalows.

The *design of a dwelling* is very much a matter of personal taste: what is delightful to one person is hideous to another. Obviously, lenders like to see mortgage customers obtain the type of dwelling they prefer but, sometimes, a property can be so unusual that the lender will seriously doubt its resaleability. As well as looking at market value, a lender must consider value in a 'forced sale situation' where possession is taken due to default on the loan. If there is a limited market for the property, or even no possibility of a buyer, the land is almost worthless to the lender in the short term.

3.3.4 Age of the property

The *age of the property* will be another factor in determining its value. Period property with original fixtures and fittings can often be valued at a premium over its modern counterparts providing, of course, that it is in sound condition. The amount of similar property in an area will be a contributory factor – where there is a glut of older property, the premium may be reduced; where period property is rare, it can increase. Ultimately, the price achieved for a property, new or old, will depend on its appeal to the buyer, its condition and potential.

3.3.5 Method of construction

Bricks, blocks and tiles are orthodox media for constructing properties but, over the years, there have been many innovations, some of which have enhanced quality and some of which have reduced it. Property of standard construction is highly mortgageable; non-standard buildings can be difficult to mortgage, as a result of which the value can be reduced.

Regardless of the property's age, surveyors will distinguish between traditional and non-traditional construction. *Traditional construction* is, generally speaking, bricks, mortar and tiled roof. *Non-traditional construction* might involve pre-cast

concrete panels attached to a steel or timber frame. For non-traditional construction, there may be inherent faults that reduce the potential lifetime of the property. For example, many new builds are constructed using non-traditional methods. For new builds, lenders consider whether the builder participates in the Buildmark scheme.

For non-traditional construction completed prior to the launch of these schemes, lenders may not be willing to lend. Many council houses were built after the Second World War using pre-formed concrete panels slotted between steel rods. They were only intended to last 20 or 30 years. Many of these houses are still standing but the rods have corroded; expensive repairs or rebuilding will be required. As a result, lenders will not consider them for mortgages.

It is important to note that buildings constructed in the traditional way may also be subject to property defects, as outlined in Unit 3.

The materials used in construction can crucially affect the value and expected life of the dwelling – and this is very important to a lender with a 25-year loan secured on the property. A house with a large proportion covered by a flat, felt-covered roof, for example, may need the felt replacing regularly. The insurance company may also impose a higher premium for buildings cover.

3.3.5.1 Quality of construction and contract guarantees

For new properties, lenders prefer that the builder is a member of the National House Building Council (NHBC). This organisation introduced a scheme in 1965 that provided a guarantee against major defects.

The scheme was relaunched in 1988 as the **Buildmark scheme**. It serves as both a protection scheme and as a warranty. To join the NHBC, builders have to satisfy certain quality standards and as part of the Buildmark scheme, builders have to confirm that the property has been built to NHBC standards. In addition, NHBC personnel conduct site inspections to monitor standards.

The Buildmark scheme provides protection against all defects and damage during the first two years, where it is caused by the builder's failure to meet NHBC standards. For the balance of the first ten years, it provides insurance for the full cost of damage over £500 caused by defects in the building's structure. It details how a purchaser must make a claim, if the need arises. The claim is made to the builder initially, but it will go to the NHBC in the event of a dispute.

A similar scheme was started by the Municipal Mutual Insurance Company Ltd and has now been replaced by a scheme with the Zurich Mutual Insurance Company. The main difference is that the scheme covers a 15-year period.

If the builder is not a member of NHBC or a similar scheme, the lender usually insists on a qualified supervising architect regularly inspecting the property under construction.

Second-hand properties that are more than ten years old have to be taken on merit and valuer's recommendation or otherwise. Some lenders insist on a detailed survey for properties over a certain age (for example, 50 years).

3.3.6 Condition of the property

That the *condition of a property* affects value is obvious. A prospective purchaser might be willing to invest additional capital in a property to improve it and this can represent an opportunity to lend more if the eventual value is likely to be much enhanced by the work to be done. One factor to consider is whether similar properties in the locality are in better condition: if so, are there any on the market and what are their prices?

Valuers will take special note of necessary repairs and report these back, with recommendations, to the lender.

Example

A property with dry rot that has remained untreated for some time can pose serious problems to the owner or a potential purchaser. Dry rot spreads rapidly because it is carried by spores that quickly affect other areas. Consider a property with ten internal doors and frames, all affected by dry rot. The minimum a buyer can expect to pay to remedy this is about £150 per door – total outlay £1,500 – and that is without considering any window frames or other woodwork that might be affected.

3.3.7 Multiple-use property

Some property is designed for more than one use: a building containing a shop and a flat above, for example. The *multiple-use aspect of a property* can have a detrimental effect on the flat and some lenders may decline to lend.

3.3.8 Vacant possession

Although quite rare, some properties are sold with a *sitting tenant*, someone who has a tenancy agreement with the current owner and is protected by law. A sitting tenant will devalue a property. Most buyers will want *vacant possession*, which means that they will have unrestricted use of the property and no sitting tenants. Few mortgage lenders will lend on properties without vacant possession.

3.3.9 Insurance issues

Insurability can affect the valuation of a property; some properties are uninsurable or, at best, difficult to insure. This is the case with properties on flood plains and near rivers where flooding is commonplace, and properties on or near cliffs where erosion is evident. In many cases, it will be difficult to obtain a mortgage on these properties.

Insurance companies are also reluctant to cover property in areas where subsidence has occurred, or properties with a history of subsidence that has not been professionally rectified with guarantees. Again, the property value will be reduced in this situation and lenders may be reluctant to lend on this type of property.

3.3.10 Planning consent and building regulations

When a property owner builds, extends or undertakes other building work on a property, he may be required to seek *planning permission* or follow specific *building regulations*. Failure to do so can result in a compulsory order to reinstate the property to its original state; permission is rarely given retrospectively. In terms of property values, failure to obtain the necessary consents will seriously devalue the property and is likely to result in lenders choosing not to lend on the property. Unfortunately, the failure of a previous

owner to gain planning consent or satisfy building regulations will not prevent the new owner from suffering the consequences.

Town and country planning legislation is complex but much more far-reaching than a buyer might think. Anything that changes the external appearance of a property substantially is likely to require approval. Typical work that will require planning permission would include:

- ◆ building a new property;
- ◆ converting an existing building – a barn, for example;
- ◆ additions and extensions that:
 - mean the property will be closer to a road, lane or footpath than before, unless there is at least 20 metres between the extended house and the ‘highway’;
 - are higher than the roof of the original building;
 - are more than four metres high and within two metres of a boundary;
 - mean more than half the land surrounding the original building is covered by buildings;
 - extend terraced houses by more than the greater of 10% of the original house or 50 cubic metres,
 - extend other houses by more than the greater of 15% of the original house or 75 cubic metres,
 - in all cases where the increase is more than 115 cubic metres;
- ◆ dividing a single property into separate homes;
- ◆ work that would contravene original planning permissions – building a two-metre wall where the original permission was for a one-metre wall, for example.

The examples given are by no means exhaustive.

The general procedure for seeking planning permission is as follows.

- ◆ Contact the local authority/council planning department and tell them the plan in outline.
- ◆ If they think planning permission might be needed, an application form should be completed.

- ◆ Submit an outline plan or detailed plan: an outline plan saves money and will enable the council to give an idea of acceptability; detailed plans are more costly.
- ◆ The application is placed on the application register for public inspection. Notices will be posted on, or near, the site to inform neighbours.
- ◆ The planning committee will make the decision.

A serious situation will arise if planning consent has not been granted on a property that is subject to a mortgage because the local authority is unlikely to accept the work and may force the borrower to change the property back to how it was. To make matters worse, if the borrower defaults in the meantime, the lender can be left with a property that is not saleable because it does not comply with planning laws and is subject to an enforcement order. This can result in heavy expenditure by the lender, which it may not be able to recoup from the borrower.

3.3.10.1 Listed buildings

Listed buildings are subject to restrictions on changes to the fabric of the building. This means that permission must be sought when changes are planned. This can affect the value of a property in two ways:

- ◆ the limitations placed on listed buildings means that a new buyer may not be able to make changes to the exterior or even the interior, in some cases. While this might preserve the heritage of the building and the area, it can be restrictive and potential buyers who see potential in a property may be put off by the requirements. Repairs may also be expensive, in that they have to be carried out according to strict rules and often have to use expensive original materials;
- ◆ if a listed building has been changed during a previous ownership, the potential buyer must ensure that any work carried out in the past has been the subject of relevant permission. If this is not the case, the property may need to be reinstated or the work carried out again, on the same basis that applies to planning permission.

Listed building consent is required where the owner wants to demolish a listed building or change or extend it in a way that will affect its character as a building of special architectural or historical interest. Such work is covered by

statutory legislation – primarily the Listed Building and Conversation Area Act 1990.

The procedure for seeking permission to alter or demolish a listed building is similar to obtaining planning permission. The listing applies to the building and anything attached to it, and any buildings in its grounds. It should be recognised, however, that some of the requirements may be very detailed.

- ◆ Grade 1 buildings are of exceptional interest and represent 2% of all listed buildings.
- ◆ Grade 2 buildings are of particular importance and represent 4% of all listed buildings.
- ◆ Grade 3 buildings are of special interest and represent 94% of the total number of listed buildings.

Proposed changes to Grade 1 and 2 buildings will involve National Heritage and various historical societies. The Secretary of State will be informed once a local authority has reached a decision relating to the proposed demolition of a listed building and any alteration to a Grade 1 or 2 building.

Owners should also be aware that they may be required to carry out repairs on listed buildings as dictated by the local authority.

3.3.11 Environmental factors

Increasingly, the **environment** in which a property is located has a major effect on its desirability and therefore value. There have been two comparatively recent developments that have had a serious effect on owners of certain houses; neither would have bothered would-be purchasers even a few years ago.

- ◆ *Radon gas* – this is a radioactive gas that is present in high concentrations in certain parts of the UK. It is believed to be highly carcinogenic. To remove its effects, the owner of the property must install fans and pipes in the property literally to blow the gas around the house and into the atmosphere.
- ◆ *Overhead electric power lines* – these are also thought by some to cause cancer, though there is little conclusive evidence. The controversy is sufficient to make some lenders reluctant to accept mortgage business in respect of properties with cables above them or where an electricity substation is in the vicinity.

Road-widening schemes are both common and controversial. In the early 1990s, some householders in Luton had a portion of their gardens compulsorily purchased in order that the M1 motorway could be widened. The compensation offered was at then-current values that were, of course, lower than had been the case only two years earlier due to the property slump. Lending institutions must be aware of such developments and their likely effects on neighbourhoods.

In addition to the above, surveyors will take into account the geology of the land: homes built on 'London clay', for example, can be prone to slippage and subsidence.

Subsidence most commonly affects properties that are built on a clay soil and results from a drop in the water table after a long, dry spell of weather or because an excessive amount of water has been sucked out of the soil by trees and bushes. Subsidence can also be caused by water leaking into the soil over a long period of time. The signs of subsidence include:

- ◆ new or expanding cracks in the plasterwork;
- ◆ new or expanding cracks in external brickwork;
- ◆ rippling wallpaper that is not caused by damp.

Although subsidence can usually be rectified, it may be that a property with a history of subsidence cannot be insured and will consequently not be considered a suitable security for a mortgage. Any evidence of past or present subsidence will be highlighted by a basic valuation but the valuer is likely to recommend that a specialist report be obtained before the mortgage application is approved and an offer of advance issued. Even if such a property is insurable as a result of past subsidence having been remedied, the proposed purchaser may well decide to withdraw and look for another 'safer' property.

Other environmental factors include proximity to flood plains, busy roads, mobile phone masts, substations, etc. These factors are unlikely to affect the lending decision, however they may affect the future marketability of the property and therefore the value of the lender's security.

3.3.12 Agricultural holdings

Agricultural properties bring with them some special areas for care. Not only is farming a far from trouble-free industry, but there is some specific legislation that may mean that expert advice should be taken. The Agricultural Holdings Act 1948 gave tenants of agricultural land a high degree of security of tenure (ie they could be very hard, if not impossible, to evict). Further, where there was evidence of poor land management, the Act allowed land to be taken out of the owner's control under a supervision order. Subsequent legislation by way of the Agricultural Holdings Act 1986 and the Agricultural Holdings (Amendment) Act 1990 updated the situation to an extent, but loans against the security of farmland and other agricultural land should still be approached with care and advice should be taken where necessary.

As a consequence of the difficulties and uncertainty that this legislation presents to lenders, in terms of their ability to exercise their security promptly and effectively, some do not lend against land classed as agricultural land at all. Even the question of what is or is not classified as 'agricultural land' for the purposes of the Act can demand fairly fine detail regarding its use. Applicants for a mortgage on this type of property may need to seek out lenders with expertise who are comfortable lending on such security.

3.3.13 The valuation report

The **valuation report** forms the basis of the lending decision and will influence the following:

- ◆ whether to lend at all;
- ◆ the size of the advance;
- ◆ the percentage advance (loan-to-value ratio) that should be made available;
- ◆ insurance value (which can often be different from the market value);
- ◆ the recommended conditions of the advance.

Most basic valuations are reported on the lender's standard form for this purpose. The questions will be relatively few in number and mostly non-technical although, invariably, lenders leave space for the valuer to make detailed comment.

3.3.13.1 Contents of the report

The list below represents one lender's approach to the structure of valuation report. You should compare the valuation report of your own organisation with this list:

- ◆ details of the property to be mortgaged;
- ◆ when the property was built;
- ◆ dimensions of the property (with sketch);
- ◆ approximate floor area;
- ◆ tenure and, if leasehold, term unexpired;
- ◆ valuation for mortgage purposes;
- ◆ valuation for insurance purposes – main property and outbuildings;
- ◆ evidence of subsidence, heave or landslip affecting the property or the immediate neighbourhood;
- ◆ essential repairs;
- ◆ minor repairs;
- ◆ major defects;
- ◆ recommendation for a specialist report;
- ◆ recommendation for undertaking or retention;
- ◆ recommendation for reinspection;
- ◆ a narrative report on the property in the valuer's own words;
- ◆ a disclaimer notice (this will stress the limited nature of the valuation as a superficial inspection for assessing the security for mortgage purposes, rather than as a survey to evaluate the property's condition). It will also state that the lender is not making any comment upon the reasonableness of the purchase price, whether explicit or implied, in its decision whether to lend or not);
- ◆ signature and date.

The *disclaimer* that is invariably included by all lenders in respect of the condition of the property has to be prominent to be effective. In the famous *Yianni* case, which was ruled upon by the House of Lords in 1981, the judge ruled that the disclaimer had to be sufficiently prominent to reflect its

importance. Some lenders insist that the applicants sign or initial that they have read and understood the disclaimer.

In the case cited, *Yianni v Edwin Evans and Sons* [1981], Mr Yianni had bought a house for £15,000, having received a valuation supporting this price. He was told shortly afterwards that repairs to the house costing around £18,000 were necessary. Mr Yianni sued the valuer for negligence and the valuer admitted that he had been negligent; he claimed, however, that his duty had been to the lender and not the mortgage applicant, and he also sought to rely on the presence of a disclaimer.

The courts found in favour of Mr Yianni: firstly, on the basis that a valuer can have a duty of care to a mortgage applicant despite having no contractual relationship with him; secondly, and importantly, that this duty could not be avoided through reliance on the disclaimer because it had not been sufficiently prominent. (The implication was that, if the disclaimer had been more prominently displayed, then the courts might have found in favour of the valuer.)

3.3.13.2 The valuer's recommendations

The valuer can recommend a number of alternative actions to a lender:

- ◆ *acceptance* – the property is good value as security for the loan sought and there are no problems;
- ◆ *rejection* – the property is not a suitable security for a mortgage and should be declined;
- ◆ *conditional recommendations for acceptance* – the valuer may make two types of conditional recommendation:
 - an *undertaking* to repair or make alterations is recommended when the property is basically good security but certain work needs to be done;
 - a *retention* is more serious. This is where the lender holds back a sum of money from the advance, pending repairs being carried out to the lender's satisfaction;
- ◆ *higher or lower valuation* – the valuer may consider the property to be of greater value as security than suggested by the price or if the valuation is substantially lower than the price, might recommend a reduced advance.

If the valuer considers that the property is worth less than expected by the vendor and/or the purchaser, there can be significant consequences. This may result in a smaller mortgage being offered by the lender. There are several possible outcomes:

- the purchaser may make a reduced offer to the vendor;
- the purchaser may remain committed to buying the property – if the vendor will not move on the selling price, the purchaser will need to meet the increased balance between purchase price and mortgage offer from personal resources;
- the purchase and sale may fall through altogether if the purchaser is put off by the factors that underlie the reduced valuation.

If a valuer is in doubt about any features of the property, he will recommend a further, more detailed report, prior to final consideration for mortgage. In particular, any evidence of subsidence or heave (where the ground is unsound beneath the property – will need to be investigated fully. A large number of insurance claims for such defects actually result in abandoning the property to the insurer. It is, therefore, important to identify these problems before the lender enters into any commitment.

Fortunately, problems of subsidence or heave are often localised or predictable. They are caused either by the geological nature of the land beneath a dwelling or by previous use of the land (eg mining beneath the land or use as a landfill site).

Valuers sometimes recommend the involvement of specialists such as structural engineers, drainage experts or arboriculturists (tree experts).

3.3.13.3 Assessment of security and the risk decision

The valuation should ideally be approached as independently as possible, even by a staff valuer; the lending decision-takers should not seek to influence the valuer's judgment in any way. This is especially important for building societies, which must comply with the specific requirements of the Building Societies Acts.

The risk decision should take full account of the recommendations in the valuation report, alongside the lender's own experience of similar mortgaged properties. All of these factors must, of course, be viewed alongside the assessment of status (see Section 2) and affordability (see Section 1.2.1).

3.3.14 Reinstatement value

Although it does not directly impact on the value of the property, the **reinstatement value** is a vital part of the insurance cover. The reinstatement value will be the valuer's estimate of the cost of rebuilding the property from scratch in the event of destruction by fire or another catastrophe. The value will be based on the size of the property and building costs for the area. The amount is usually increased in line with inflation each year to ensure that the insurance remains adequate. With properties of standard construction, the reinstatement value will be considerably less than the market value; in the main, this is due to the fact that the market value includes the price of the land, which is not a cost when rebuilding.

A property of unusual design and constructed of non-standard materials, eg timber, may have a reinstatement value that is approximately the same as, or even higher than, the valuation for mortgage purposes. This reflects the likely higher cost of the non-standard materials.

3.4 Local authority and town planning consents

All major property developments require consent by the local authority, as do a good many minor changes that individuals make to their homes.

It is most important to consider these at the application stage. All lenders ask whether substantial changes have been made to a property, and, if they have, documentary evidence will be sought to confirm that these have had full consent of the planning authorities.

Examples of matters requiring planning consent are:

- ◆ where a new building is to be erected (sometimes a piece of land will be sold with outline planning permission for a building – this will be a broad, but not necessarily detailed, sanction specifying, for example, a three-bedroom bungalow);
- ◆ where a structure is to be erected adjacent to a property, such as a garage;
- ◆ where an extension is to be built;
- ◆ where the external appearance of a building is to be altered to the extent that it will change the physical appearance of the general neighbourhood;

- ◆ where the kitchen is to be moved from one room to another;
- ◆ where changes are to be made to a building that is 'listed';
- ◆ in some cases, where the property will be painted a different colour;
- ◆ where certain types of trees are to be felled;
- ◆ where the use of the building is to be changed.

This is not an exhaustive list: prospective purchasers should always ensure that the work they intend to do has the full sanction of the local authority. Likewise, it falls to the lender's solicitor to ensure that the proposal will satisfy planning laws. If in doubt, the lender should seek specific guidance from the solicitor.

In addition to the need to comply with planning law, developers also have to be aware of their responsibilities under the building regulations. These are not especially detailed, although they do cross-refer to various British Standards conventions. Local authorities have the discretion to overrule building regulation requirements in instances where they are clearly inappropriate.

Further advances are often made for home improvements, so it is necessary to ensure that the proposals by the applicant have consent before any advance is made.

As a matter of principle, local authorities are highly unlikely to grant planning permission retrospectively, so if a landowner makes changes to the property that have not been sanctioned, these changes will almost certainly be rejected later on. The importance of this is twofold:

- ◆ firstly, if the borrower is instructed to tear down or remove the changes that have been made to a property, and put it back the way it was before, then it may be worth less money than it appeared to be when the advance was made – and so the lender's position may be less secure;
- ◆ secondly, and whether or not the removal of the feature reduces the property's value, it is likely to cost money actually to make the changes. The borrower will need to find this money somewhere, and this may impact on his ability to service his mortgage.

3.5 Building regulations

The **building regulations** are contained in the Building Act 1984, which is applicable only in England and Wales. The majority of building projects must conform to the regulations and their main purposes are to:

- ◆ ensure the health and safety of people in and around all types of buildings;
- ◆ maximise energy conservation.

Building work covered by the regulations includes:

- ◆ the erection of a new building;
- ◆ the extension of an existing building;
- ◆ cavity wall insulation;
- ◆ a loft conversion;
- ◆ the underpinning of a building's foundations.

Projects that are exempt from building regulations include:

- ◆ a carport extension, open on at least two sides and under 30 square metres in floor area;
- ◆ a detached garage under 30 square metres in floor area and built at least one metre from the boundary of the property;
- ◆ a new garden or boundary wall.

3.6 Disputes

Disputes between neighbours have become increasingly common in recent years. The causes of such disputes range from excessive noise and nuisance to disagreements over property boundaries, rights of way and problems caused by trees and bushes. The vendor of a property now has an obligation to disclose any such disputes with neighbours in the pre-contract information that is passed to the purchaser's conveyancer. Such information may result in the proposed purchaser withdrawing from the transaction.

If a vendor fails to disclose details of any dispute with a neighbour, even if this has been resolved, he may be subject to legal action if the next owner of the property subsequently becomes aware of that dispute.

3.7 Covenants and easements

Covenants and easements were covered in detail in Unit 3. Both could impact on the value of a property where they are seen to be a hindrance to the owner, or where they imposed a burden on him. For example, the existence of a right of way over a property could reduce its value.

Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 3. Review the text if necessary.

Answers can be found on page [4] 84.

1. What is the difference between a 'retention' and an 'undertaking'?

Answer true or false for each of these statements.

2. A basic valuation is for the benefit of the lender and is paid for by the lender.
3. A homebuyer's report is expected to report on the existence and condition of a damp-proof course.
4. All new houses have a guarantee of either 10 or 15 years against major defects.
5. Lenders generally require valuers to specify both the value for lending purposes and the insurance value of a property.
6. Lenders sometimes require borrowers to carry out certain repairs within a specified time as part of the mortgage contract. This is known as an 'undertaking'.
7. Local authorities generally give retrospective planning permission if all their requirements have now been met.
8. A car port would be exempt from building regulations.
9. A survey shows significant work is required on a property's roof. The lender is likely to require an undertaking.
10. Where the valuer identifies a problem with a property, he can recommend an increase in the interest rate.

Answers

1. A **retention** is where the lender holds back (retains) part of the mortgage advance until certain work or repairs have been done. There will probably be a reinspection to ensure the work has been carried out. An **undertaking** is where the lender asks the borrower to carry out certain minor work or repairs within a stated time-frame. Although the lender reserves the right to a reinspection, this is not usually required.
2. **False**: a basic valuation is paid for by the borrower.
3. **True**: the homebuyer's report will also the state of beam, rafters, etc, and any sign of dry or wet rot, etc.
4. **False**: this guarantee exists only if the builder is covered by the NHBC or Zurich schemes.
5. **True**: the insurance value is often different from both the value for lending purposes and the selling price.
6. **True**: If they hold back part of the loan until it is done, it is called a retention.
7. **False**: local authorities rarely grant retrospective planning permission and taking down an 'illegal' extension can reduce a property's value, so lenders require all permissions to have been obtained.
8. **True**: a car port is exempt from building regulations.
9. **False**: the lender on a property needing extensive roof repairs is likely to insist on a retention.
10. **False**: recommending an increase in interest rates that is outside the valuer's remit.