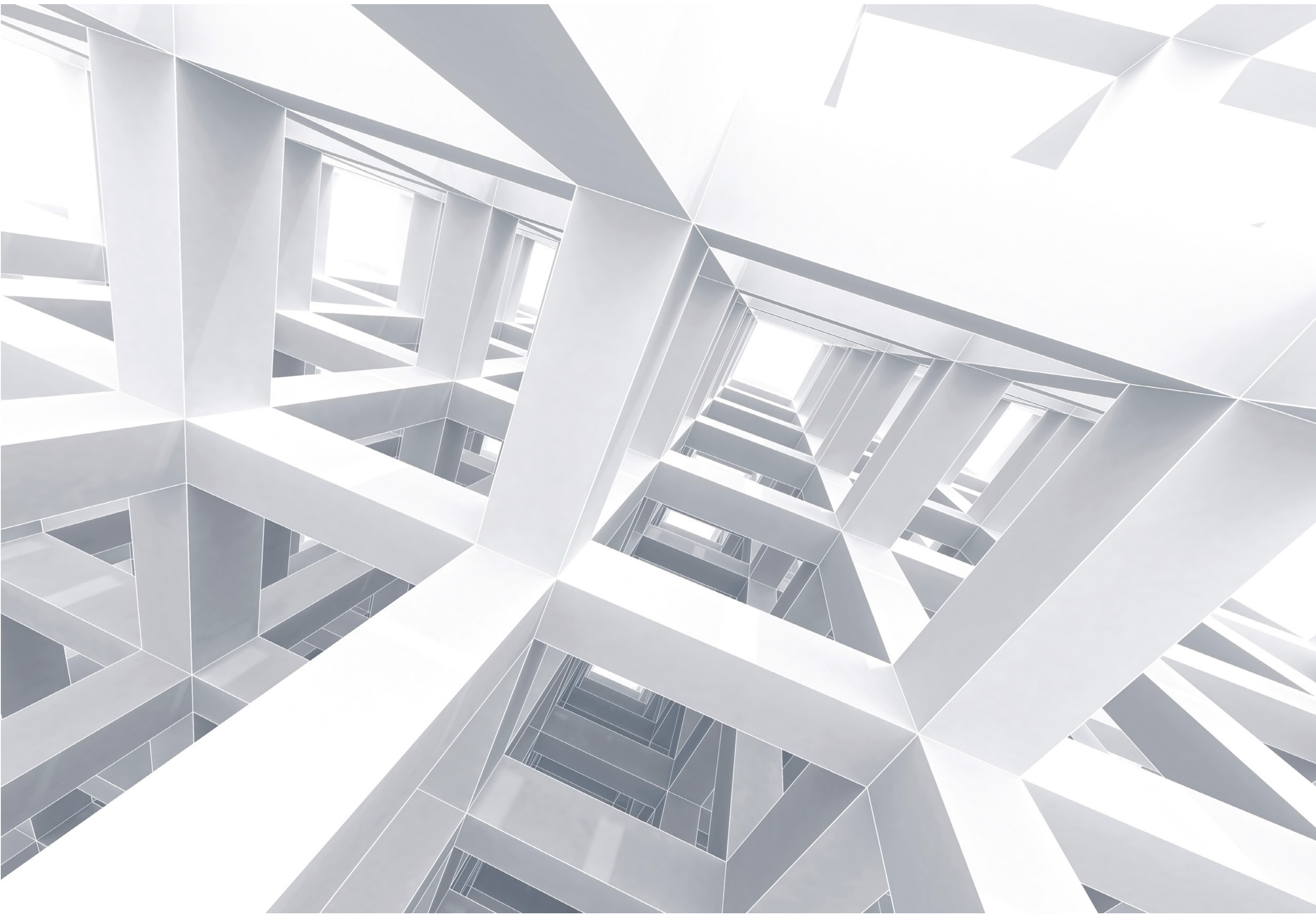
RICS guidance note

RICS professional standards and guidance, UK

Risk, liability and insurance in valuation work

2nd edition, January 2018



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Acknowledgments

Working group

Chairman: Andrew Gooding FRICS (Knight Frank LLP)

Alexandra Anderson (RPC LLP)

Rupert Dodson FRICS (Cushman & Wakefield)

Ben Elder FRICS (RICS)

Will Glassey (Mayer Brown International LLP)

Jeremy Handley MRICS (JLL)

Warren Wright FRICS (Connells Survey & Valuation)

Kevin Webb FRICS (Legal & General Surveying Services)

Tom White (Clyde & Co LLP)

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RICS Publishing

Head of Publishing and Content: Sarah Crouch

Standards Publishing Manager: Antonella Adamus

Standards Publishing Project Manager: Marcus Hardy

Editor: Joanne Fitzpatrick

Contents

RICS professional standards and guidance

RICS guidance notes

Definition and scope

RICS guidance notes set out good practice for RICS members and for firms that are regulated by RICS. An RICS guidance note is a professional or personal standard for the purposes of RICS Rules of Conduct.

Guidance notes constitute areas of professional, behavioural competence and/or good practice. RICS recognises that there may be exceptional circumstances in which it is appropriate for a member to depart from these provisions – in such situations RICS may require the member to justify their decisions and actions.

Application of these provisions in legal or disciplinary proceedings

In regulatory or disciplinary proceedings, RICS will take account of relevant guidance notes in deciding whether a member acted professionally, appropriately and with reasonable competence. It is also likely that during any legal proceedings a judge, adjudicator or equivalent will take RICS guidance notes into account.

RICS recognises that there may be legislative requirements or regional, national or international standards that take precedence over an RICS guidance note.

Document status defined

The following table shows the categories of RICS professional content and their definitions.

Publications status

Type of document	Definition
RICS Rules of Conduct for Members and *RICS Rules of Conduct for Firms*	These Rules set out the standards of professional conduct and practice expected of members and firms registered for regulation by RICS.
International standard	High-level standard developed in collaboration with other relevant bodies.
RICS professional statement (PS)	Mandatory requirements for RICS members and regulated firms.
RICS guidance note (GN)	A document that provides users with recommendations for professional advice and areas of good practice.
RICS code of practice (CoP)	A document developed in collaboration with other professional bodies and stakeholders that will have the status of a professional statement or guidance note.

1 Introduction

1.1 RICS has a responsibility, under its Royal Charter, to maintain standards in surveying services in the public interest. It is important for the effective functioning of markets and their wider economic impacts that consistency, transparency and soundness of valuation advice are secured and the risk associated with that advice is properly identified, fairly apportioned and properly managed.

1.2 This guidance note is intended to assist both members and their clients to understand the main risks and liabilities associated with valuation. It guides members in the negotiation of equitable contracts with clients and the avoidance of major risks and pitfalls.

1.3 RICS recommends that members take a fresh look at the way in which they conclude contracts with their clients. Members are encouraged to revisit their own standard Terms and Conditions, and the basis upon which they engage with their clients, in light of this guidance note.

1.4 After considering this guidance and the appendices to it, members may decide to take advice on specific aspects of their practice from their insurance brokers and/or legal advisers.

2 Scope and purpose

This document provides guidance on the following:

Section 3: The Court's approach to valuers' liabilities

This section covers breach of contract, negligence, the 'bracket', damages and the limitation periods for claims.

Section 4: Liability caps

RICS recommends the use of appropriate liability caps where legally permissible, in order to manage risk in valuation work.

Section 5: Third party reliance on valuations

Clients are increasingly asking valuers to allow non-clients (known legally as 'third parties') to rely on their valuations. RICS recommends that, as a default position, valuers do not permit third party reliance.

Section 6: Contractual terms

The focal document in the contract between the valuer and the client is known as the 'letter of engagement'. *RICS Valuation – Global Standards 2017* (Red Book) requires members to record the terms of valuation engagements. The letter of engagement provides you with an opportunity to think about and manage the risks faced in carrying out each valuation for a client.

Section 7: Professional indemnity insurance

All firms must ensure they have adequate and appropriate professional indemnity insurance in place that complies with the RICS *Rules of Conduct* and RICS Minimum Terms. Having proper cover is a key part of managing your risk.

Section 10: Glossary of terms

All of the terms used in this guidance note are defined in the glossary of terms.

All references in this document to 'members' include RICS regulated firms.

Appendices A and B: Residential/commercial valuation work

RICS recognises that the risks in residential valuation differ from those in commercial valuation. This guidance note is therefore supplemented by an appendix addressing each: Appendix A, Residential (covering mortgage valuations and building surveys), and Appendix B, Commercial (covering valuations for commercial lending). There is overlap in those two practice areas, such as where residential properties are acquired or used as security for commercial ventures, and accordingly both appendices will be relevant to some members.

Appendix C: Valuations for investment funds and public offerings

Appendix C provides guidance on liability issues arising in valuations for some investment funds and in public offerings.

Appendix D: Dispute resolution

Appendix D provides details of dispute resolution mechanisms in valuation disputes.

The document does not extend to providing guidance on valuation quality assurance issues; that is the role of *RICS Valuation – Global Standards 2017* (Red Book).

Members' attention is drawn to the extensive guidance in Red Book on engaging with clients and writing valuation reports. Members' attention is drawn specifically to the following:

- VPS 1
  - agreement of terms of engagement
- VPS 3
  - valuation reports

All members of RICS are required to comply with the Red Book when undertaking valuation. We therefore advise members to resist any requests from clients to diverge from Red Book requirements. There is further guidance on this issue for residential valuers in Appendix A.

Outside of the Red Book, members' attention is also drawn specifically to the following further requirements and materials:

- RICS has in place a separate regime to ensure standards of ethical, professional conduct in the profession, centred around the RICS *Rules of Conduct*.
- Members who undertake valuations to which the requirements of the Red Book apply must join RICS Valuer Registration (VR). Full details of the scheme can be found at www.rics.org/valuerregistration
- All regulated firms need to ensure they have adequate and appropriate professional indemnity insurance in place that complies with the requirements of Rule 9 of the RICS *Rules of Conduct* and the RICS Minimum Terms. See also *Professional Indemnity Insurance*, Version 3, 2015: http://www.rics.org/uk/regulation1/firm-and-individual-guidance/professional-indemnity-insurance-pii/introduction-to-pii/
- See also the RICS user guide, *Reflecting uncertainty in valuations for investment purposes* (2011) found at www.rics.org/uk/knowledge/glossary/piv-uk/

Legal advice

While many of the subjects dealt with are legal concepts, it is not intended that this guidance should provide an alternative to members seeking legal advice where appropriate.

English Law/Scots Law

This guidance is based primarily on English law. Some key differences in Scots law are identified but members are recommended to take specialist advice on issues of Scots law. Similarly, although Northern Ireland law is very alike to English law, firms in Northern Ireland are recommended to take specialist advice on issues of Northern Ireland law.

Outside the UK

It is hoped that the guidance will also serve as a valuable starting point for international members, and for those UK members engaging in valuation work in other jurisdictions.

3 The Court's approach to valuers' liabilities

3.1 Breach of contract

3.1.1 The primary basis for a claim against a valuer is for breach of contract. Usually, this is a claim open exclusively to the valuer's clients: only clients are party to the valuer's contract and therefore only they may take action against the valuer for breach of it.

3.1.2 Whether its terms say it or not, a contract for professional services is usually considered to be subject to an 'implied term' that the services to be provided by the professional will not fall below the standards of skill and care expected from a reasonable body of the professional's peers. In effect, this means that the professional undertakes not to act negligently.

3.2 Negligence

3.2.1 In addition to claims for breach of contract, valuers may also be sued in 'tort'. A 'tort' (the term 'delict' is used in Scots law instead of 'tort') is an umbrella term for all civil wrongs recognised by the law, other than breach of contract. When we refer to claims against valuers in tort, we usually mean claims for the tort of negligence. In practice, a tort claim holds a valuer to the same standard of care as the implied contractual term not to act negligently, as referred to above.

3.3 The standard of care of a valuer: the 'bracket'

3.3.1 Valuers are expected by the courts to achieve the standard of skill and care expected from a reasonable body of the valuer's peers. Whether a claim against a valuer is brought for breach of contract or in tort, the question the courts ask is whether the valuation given was one that no reasonable valuer in the actual valuer's position could have given. The courts invite expert evidence from other, independent valuers ('expert valuers') to assist their decision-making in each case. If a court decides, after hearing the experts, that a reasonable valuer in the same position could have given the same valuation as the one in question, the valuer will not be found negligent or in breach of contract.

3.3.2 In reaching a decision on this issue, the courts recognise there is subjectivity in valuation: two valuers may reach different valuations of the same property at the same time without either of them being negligent. The usual question the courts ask is what are the maximum and minimum valuations that could be given by a reasonable valuer in the actual valuer's position. To be found negligent, the actual valuation must generally have fallen outside that 'bracket' of hypothetical reasonable valuations.

3.3.3 As well as deciding what the 'bracket' is for a particular valuation, and whether the valuer's valuation falls within the bracket, the courts may sometimes also consider whether there were any specific errors made by the valuer in the course of the valuation. If there were, that could increase the chances of the valuation being held to be outside the bracket. This means that a valuer cannot focus purely on the end figure; the process followed by the valuer and the text of a valuation report are also important.

3.4 The differences between contract claims and negligence claims

3.4.1 A claim for breach of contract can usually only be brought by a party to the contract, i.e. the client. A valuer can be sued in negligence by those third parties (i.e. those who are not party to the valuation contract) to whom the valuer expressly accepts a duty of care, or those to whom the court says the valuer has assumed a duty of care.

3.4.2 A duty of care is a duty to observe the skill and care of a 'reasonable' valuer in conducting a valuation. In English law, it can be a difficult legal question to know whether a duty of care is owed to any particular third party, but the one situation where valuers need to be particularly careful is where they are asked to permit third parties to rely on their valuations. If the valuer does consent to reliance by a particular third party, they will probably be considered to owe that third party a duty of care, therefore enabling that person to sue the valuer for negligence if the valuer has not exercised reasonable skill and care in conducting the valuation.

3.4.3 There are some technical legal differences between claims for breach of contract and claims for the tort of negligence, but the claims are similar, and it is therefore very important that a valuer does not lightly accept a duty of care to a third party, because in large part the practical consequence is to enable that party to have the same rights as a client. A third party who attains that status may also not be bound by the terms of the valuer's engagement, including any liability cap. See section 5 for more information on third party reliance.

3.5 Damages

3.5.1 The remedy for breach of contract and for the tort of negligence is basically the same. If the claimant proves their case, damages will be awarded against the valuer to the extent necessary to put the claimant in the position they would have been in had the contract been performed fully and not been breached, or if the negligent act had not been committed.

3.5.2 The SAAMCO Cap: the most important principle in the law of damages as it presently applies to property valuers is the SAAMCO Cap (the name comes from the House of Lords decision *South Australia Asset Management Corp v York Montague Ltd* in 1996 in which the principle was established). This usually restricts the damages for which a property valuer can be held liable to the difference between the valuer's valuation figure and the figure the court decides was the actual value of the property at the date of the valuation. For example, if a valuer values a property at £140,000 but the court decides the valuation was negligent and the actual value was £100,000, the maximum damages for which the valuer can be liable is £40,000 (plus interest), even if the client's losses are higher than that amount. Importantly, this means that valuers are not generally liable for additional losses suffered by their clients by market depreciation in the property between the date of the valuation and the date of the claim.

3.5.3 It is important to note that the SAAMCO Cap is based on the principle that providing a valuation is only, in legal terms, providing 'information'. The cap does not apply if a valuer goes beyond the provision of information and advises a client whether to proceed with a transaction. The 2017 case of *BPE v Hughes Holland* indicates that, where a valuer provides only part of the material on which a claimant relies when deciding how to proceed, that will be treated as giving information. Only in cases where the valuer advises the claimant on the whole transaction and how the claimant should proceed will the valuer be treated as giving advice. Valuers should therefore be careful to ensure that they do not cross this line.

3.5.4 Indemnities: occasionally, clients ask valuers to include an indemnity in the terms of engagement, which 'holds harmless' or 'fully indemnifies' the client in respect of all losses flowing from negligence in the valuer's valuation. Members should be aware that clients may seek to argue that an indemnity of this type extends the valuer's liability beyond the scope of the conventional liability for common law damages. Members should bear this in mind when deciding whether to agree to such an express indemnity. RICS recommends that the giving of such indemnities should be avoided.

3.6 The purpose of the valuation

3.6.1 A valuation report and engagement letter must state the purpose for which a member has provided a valuation (VPS3 7c). RICS recommends that, where possible, members should be more specific than saying only that a valuation is provided, for example, 'for secured lending purposes'. Although a member may not have full visibility of what a client hopes or intends to use the valuation for, they should record what they consent to it being used for. They should consider including wording along the following lines (again, secured lending is used as an example):

'Where you have explained to us that the valuation is required for your use in a particular secured lending transaction, we consent to its use solely for that purpose. Where you have not instructed us as to the purpose for which the valuation is required, we consent to its use only in a single secured lending decision.'

3.7 The legal entity that provides the valuation/personal liability

3.7.1 In general, a claimant will bring any negligence claim in respect of a valuation against the entity that provided the valuation. If the client is bringing the claim, this will mean the claim will be brought against the entity that entered into the retainer contract with the client. Usually, this will be the valuer's firm.

3.7.2 If a firm carries on practice as a partnership, and it is the partnership that enters into the engagement contracts with the firm's clients, the partners are individually responsible for the firm's liabilities, including claims. If a claim succeeds against a partnership for, say, £500,000 in damages, the claimant can choose to enforce the claim against as few or as many partners as the claimant wishes until the full amount is paid. The partners are able to insist on sharing partnership liabilities according to their partnership agreement and partnership law, but vis-a-vis the claimant, they each have 100 per cent liability. In Scotland, the position is different because, unlike in England and Wales, a partnership is a separate legal entity from the partners in the partnership. Scottish firms should take specialist advice about the implications of this.

3.7.3 By contrast, if the firm's business is conducted through a Limited Liability Partnership (LLP) or a Limited Liability Company, that should mean that the partners in the firm (strictly speaking, they are called 'members' in an LLP, but they are usually still referred to as partners) and the Directors of the company, are not personally liable for the firm's debts. This should also mean that they are not personally liable for any liabilities the firm has for professional negligence claims. Therefore, from a risk perspective, the use of an LLP or a Limited Liability Company confers a significant advantage.

3.7.4 Occasionally, claimants try to bring claims against individual partners, or individual employed valuers, even if the services are provided by an LLP. This means that it is prudent to include a clause in the valuer's terms of engagement excluding all personal liability; see section 6 for more information on addressing contractual terms.

3.8 How long after a valuation can a claim be brought?

3.8.1 Statutory limitation periods control the time allowed for a claimant to commence court proceedings. Commencing court proceedings is what is meant in this section by 'bringing a claim'. Generally speaking, the limitation period for bringing a claim against a valuer will be six years from the date of the valuation. Members in Scotland should note that the applicable period there is five years. This period can be longer, particularly where the claim is brought as one for the tort of negligence (see section 3.4) rather than for breach of contract. In a professional negligence claim, there are two ways in which the period may be longer than six years from the date of the valuation, as follows. Please note, this describes only the legal position in England and Wales; Scottish firms should take specialist advice.

3.8.2 The six-year period for bringing a professional negligence claim does not begin until the claimant incurs loss, which may not be the date when the negligent professional services were provided. In a valuation claim, this requirement for loss can lead to a delay in the commencement of the six-year period. By way of example, in the context of a valuation provided to a lender, this will mean that the six-year period for a claim in tort does not usually begin to run before the date on which the borrower draws down the loan, rather than the date of the valuation.

3.8.3 In addition, in 1986, an important change was made to the *Limitation Act* 1980 to allow an extra period for a claim to be brought, because it was seen to be unfair that the six-year period could run out before the claimant realised they were legally entitled to bring a claim. Therefore, in a negligence claim, the *Limitation Act* gives the claimant three years to bring a claim, beginning on the date on which the claimant learned about his or her entitlement to bring the claim. This three-year period applies even if it results in a period longer than the conventional six-year period referred to above, but it is subject to a 'long-stop' period of 15 years from the date of the negligent act, which in a valuation context will usually mean 15 years from the date of the valuation report. This is the position in claims for financial loss or property damage; a different statutory regime applies to personal injury claims.

3.8.4 These two points can lead to complex factual and legal issues, particularly in determining when the claimant suffered loss and when the claimant acquired the knowledge necessary to bring a claim. Those issues are beyond the scope of this guidance, but the important point to emphasise is that in some situations, a claim in respect of a valuation can be brought more than six years after it was provided to the client.

3.8.5 Additionally, if a professional were to be retained to provide services under a Deed (which is a special type of contract), the limitation period would be 12 years from the date of breach.

3.8.6 There are insurance consequences of the limitation periods referred to previously. Section 7 is devoted to professional indemnity insurance (PII), but the fundamental point must be made in this introduction to the key concepts that PII is provided to firms of valuers on a 'claims made' basis. This means that in order for there to be insurance for a claim, there must be an insurance policy in place when the claim is made, regardless of when the valuation was conducted. For example, for valuations conducted in 2017, the firm should continue buying insurance every year until at least 2023. There is still a risk of a firm or its partners being sued if it ceases practice during that intervening period, which is why RICS requires firms to buy 'run-off' PII to cover the period after ceasing practice. RICS' regulatory requirement for run-off cover is contained in *Professional Indemnity Insurance*, Version 3, 2015, found at:

http://www.rics.org/uk/regulation1/firm-and-individual-guidance/professional-indemnity-insurance-pii/introduction-to-pii/

4 Liability caps

4.1 A liability cap is a contractual agreement that a client can only claim damages up to the amount agreed, even if the law would otherwise award a greater sum in damages.

4.2 As a profession, surveyors have been slower than some to embrace the use of liability caps, but liability caps are now used more and more frequently by members in valuation work. One of the most important purposes of this guidance is to explain what liability caps are and how they work, and to encourage members to use them.

4.3 RICS recommends the use of liability caps to members, where legally permissible and following the principles of good practice set out in this guidance note, as a way to manage the risk in valuation work, and to ensure that there is a fair allocation of risk and reward between members and their clients. From 1 July 2017, the Red Book requires valuers to include a statement in their terms of engagement and within the valuation report, setting out any limitations on liability that have been agreed. VPS3, paragraph 1.2 of the Red Book provides guidance where, due to the client's standard reporting form or format, it is not possible to provide this statement within the valuation report.

4.4 This guidance note contains some additional, more specific guidance about capping liability in the residential and commercial context in Appendix A and Appendix B respectively.

4.5 Capping liability is a common way to regulate risk in a client relationship. Legally, liability caps are enforceable as long as they are properly incorporated into the contract, and they are at a 'reasonable' level. Extra care is required when dealing with a consumer, particularly as any contract between a business and a consumer will fall within the jurisdiction of the Competition and Markets Authority, which has wide powers to challenge the conduct of any business that is seeking to impose terms that cause unfair detriment to consumers. Members must also ensure that any liability cap does not contravene the RICS *Rules of Conduct*.

4.6 If it is drafted properly, a liability cap specifically applies even where a valuer has conducted a valuation negligently. RICS recommends using a liability cap along the following lines:

'RICS recommends the use of liability caps to members as a way in which to manage the risk in valuation work. Our aggregate liability arising out of, or in connection with, this valuation, whether arising from negligence, breach of contract, or any other cause whatsoever, shall in no event exceed £[x]. This clause shall not exclude or limit our liability for actual fraud, and shall not limit our liability for death or personal injury caused by our negligence.'

4.7 It is important to distinguish between a liability cap and a firm's professional indemnity insurance limit:

- The insurance limit is set out in the firm's insurance policy and is fixed on the annual PII renewal; it is the maximum amount insurers will pay in any particular claim.
- A liability cap is an agreement between a member and their client, fixed when they enter into a valuation engagement.

4.8 The two are not really related, and there is no legal or regulatory reason why a liability cap needs to be as high as the insurance policy limit or anywhere near it. It would be unwise to agree a liability cap greater than the insurance policy limit, but it would still be better from a risk perspective than not agreeing one at all.

4.9 If a claim arises for an amount greater than the agreed liability cap, and the client tries to challenge the liability cap, the court will need to ask:

(a) whether the liability cap was properly incorporated into the contract and

(b) whether the level of the cap was at a 'reasonable' level when it was agreed.

4.10 Some of the factors the court will consider in determining reasonableness are set out in 4.11, but essentially, in a contract that has been freely negotiated between two commercial parties, the court will usually find liability caps to be enforceable.

4.11 The level of a liability cap is a matter for each member to negotiate with their client. In doing so, some assistance can be derived from the key factors the court will look at in deciding whether a cap is 'reasonable', some of which are set out below. All of these are to be judged as at the time the engagement was entered into between the valuer and client:

- **The level of risk in the engagement.** This included the purpose of the instruction, the characteristics of the property to be valued, the time available to complete the work, the scope and complexity of the instruction and the parties who may rely upon the valuation.
- **The level of fees.** Seeking to cap liability to an amount less than the anticipated fee will generally not be reasonable. However, there is no reason for the liability risk to be disproportionate to the reward.
- **The limit on the professional indemnity insurance policy, and the cost to the firm of buying the insurance.** The limit of PII cover is a factor the court may take into account when considering the reasonableness of a cap but, as stated previously, there is no need for the cap to be the same level as the insurance limit, or even necessarily near it. For obvious reasons, it would be unwise to agree to a cap in excess of the insurance limit.

- **The potential liability that might be incurred without a cap.** In a valuation instruction, this factor should cause members to consider what loss their client may incur if a valuation is negligent, but again, there is no need for the cap to be at or necessarily near that figure. The guiding principle is reasonableness, and parties are free to negotiate any figure that together they consider to be reasonable.
- **The degree of sophistication and the relative bargaining position of the parties to the contract.** If the court forms the view that the provider of services has imposed a liability cap on a customer who had limited or no bargaining power, that will increase the chance of the cap being held to be unreasonable. In the valuation context, this may require particular consideration if the client is a domestic consumer, but it is less likely to be an issue if the client is a commercial organisation that has a similar bargaining position to the member firm, or a stronger one.
- **How effectively the cap is brought to the client's attention.** Best practice is to draw a client's attention to a liability cap, particularly the first time it is incorporated into a valuation contract; it should not be 'buried away' in fine print

4.12 The level of the liability cap can be negotiated on different bases, including as a multiple of the proposed fee, a percentage of the anticipated level of value to be reported, or a percentage of the amount intended to be loaned (in the case of valuations for loan security purposes). Some further guidance is given in Appendix A (residential) and Appendix B (commercial). In Appendix A it is noted that particular caution must be exercised when setting liability caps with 'consumers' (i.e. those who are not acting in the course of a trade or profession, which may include buy-to-let clients). RICS recommends that members seek legal advice when seeking to impose a liability cap in a contract with a consumer, particularly given the potential involvement of the Competition and Markets Authority.

4.13 The terms of master valuation contracts that seek to set a liability cap at the same level across differing valuation instructions from a particular client should be considered very carefully, because the question of what level of liability cap is reasonable may vary from one instruction to another.

4.14 If a liability cap, or the basis for calculating the liability cap, is included in a firm's standard terms and conditions, rather than being included in an engagement letter that is specific to a particular valuation instruction, it should be in a prominent position. RICS recommends that members refer to any liability cap in the engagement letter, to ensure it is given sufficient prominence to satisfy the rules on enforceability. It may improve members' position further to refer to the existence of the liability cap in the body of the valuation report.

4.15 There are some circumstances in which the use of a liability cap is limited or prevented by law. For example, valuation reports prepared for inclusion within prospectuses under the FCA Listing Rules may not exclude liability to parties other than the addressee of the report (see Red Book UK Appendix 7, FCA Listing Rules). Specialist legal advice may be required in such situations. See above and Appendix A in relation to 'consumers'.

4.16 In law, any clause that attempts to exclude liability for personal injury or death will be unenforceable.

4.17 Where valuers are asked to provide multiple valuations under one instruction, the engagement letter should set out whether the agreed liability cap applies to each valuation, or to the whole engagement 'in the aggregate'. A cap expressed to be 'in the aggregate' provides more certainty to the valuer as to the maximum liability for the whole instruction.

4.18 In some situations, the law permits a professional to go beyond capping or limiting liability by excluding legal liability altogether. The most common situation in which valuers do so is if they provide advice without charging a fee. It may also be reasonable to exclude liability altogether in other client contracts, but this would usually be possible only where your client is a business user, not a consumer. To maximise the chances of such a complete exclusion being enforceable, RICS recommends that members should ensure the exclusion of liability is in writing and is specifically drawn to the attention of the recipient of the advice. (Where a member provides advice free of charge, they should still ensure that the advice given falls within the scope of their business services, as defined by their policy, or they may have no insurance in the event that the person who received and relied on their advice makes a claim.)

5 Third party reliance on valuations

5.1 As explained in section 3, a third party is any party who is not party to the valuer's contractual engagement, i.e. parties other than the firm's client. By way of example, if the firm's valuation client is a lender, third parties may include the borrower, or another lender or investor who is investing in the lender's loan.

5.2 Increasingly, valuers are being asked by their clients to agree to permit third parties to rely on their valuations. RICS wishes to ensure that members appreciate the risks in permitting third party reliance, and make a decision to permit third party reliance only on an informed basis.

5.3 This guidance note contains some additional, more specific guidance about third party reliance in the residential and commercial contexts in Appendix A and Appendix B respectively. One of the points made in the residential context is that RICS recognises there is a practice of permitting valuations of residential properties provided to lenders to be disclosed to the borrower/purchaser. In certain circumstances, this may extend the duty of care to that borrower/purchaser.

5.4 Other than where the practice identified in 5.3 is adopted by agreement between firms and their lender clients, RICS recommends that valuers do not permit third party reliance and that terms and conditions exclude third party reliance, with any exceptions made clear, taking into account the points highlighted below and in section 6.

5.5 Permitting third party reliance is different from merely permitting a third party to 'see' or to have 'disclosed' to them the valuation report as it does not automatically give rise to a legal duty to the third party. However, members should still take care even in allowing this, because there is a risk this might be construed as the same thing as permitting reliance. If members do agree that a valuation may be 'shown to' or 'disclosed' to a third party, they would improve their position by making it clear, in writing, not only to their client but also to the third party, that this is being permitted without assumption of any legal liability to that third party. It is recognised this may not be possible in all circumstances, but it is important that members understand the risks entailed.

5.6 Client relationships should be based on mutual trust. Permitting third party reliance can expose valuers to third parties whom the firm does not know, who might look on the valuation very differently, and who might have a different attitude to bringing claims against a firm.

5.7 Permitting third parties to rely on a valuation has the effect of permitting them to be treated as the member's client. RICS perceives the following risks in this practice:

- Permitting disclosure in the regulated investment context may entail regulatory risk (i.e. exposure to the risk of regulatory investigations) as well as more conventional liability risk.
- Some of the third parties with whom valuations are shared might be based in different jurisdictions, and may try to bring claims before the courts of those jurisdictions, with very different laws from the laws that govern the relationship between members and their clients. It is also possible that such claims may not be covered by the member's PII, if they are brought in jurisdictions that do not fall within the geographical limits of the PII policy.
- Members' contractual terms of engagement (including the terms set out in this guidance, such as the liability cap) may not be binding on the third parties. In addition, some of the legal defences members might be able to raise if faced with a claim from a client may be more difficult to raise in response to a claim from a third party.
- Members should be particularly careful if they are asked to give consent to third party reliance at a date later than the effective date of their valuation. Valuers will improve their position in that situation if they tell both the client and the third party, in writing, that they have not re-valued the property, and the valuation may already be out of date, because the effective date of the valuation has not changed.
- Members should think carefully about whether they had communications with the client at the time of submitting the valuation that affect the way in which the valuation should be used. Is it necessary for those communications to be passed to the third party so that the valuation report is placed in the proper context? If so, members should try to influence the way in which the valuation report is passed to the third party, to ensure where possible the valuation report is passed on only together with those other communications.
- Permitting reliance by third parties who are in a different position from the client (such as the property owner, where the client was the lender) may expose members to claims of a different type.
- Members' PII may impose specific conditions concerning third party reliance on valuations, and may exclude indemnity in relation to certain third party claims – see paragraph 5.10.

5.8 If members do agree to permit third party reliance, they should be as specific as possible about who the permitted third parties are – permitting an entire 'class' of third parties to rely on the valuation will add greater risk. The note at the end of Appendix B comments on what members should do if asked to issue a fee invoice to a third party.

5.9 RICS recommends that where members do permit third party reliance, this is done only in a way that ensures:

- the third party is bound by the terms and conditions of the firm's contract with its client (including the liability cap)
- the third party understands and acknowledges (if it is the case) that the firm has not conducted a fresh valuation and the effective date has not changed simply by the act of permitting third party reliance and
- the purpose for which the valuation has been provided has not altered simply by permitting third party reliance.

5.10 In considering whether to permit third party reliance, it is important for members to bear in mind the scope of their PII. The RICS Minimum Terms permit PII insurers to limit the cover available for claims brought by third parties to whom the valuation contract has been assigned; the Minimum Terms require cover for only two successive assignments. RICS recommends that members take specialist advice from insurance brokers or solicitors if they decide to permit third party reliance in the course of their practice, as they may need broader insurance cover.

5.11 This is particularly important if members permit reliance for the purposes of the securitisation of loans, loan syndication, stock exchange listing and other investment memoranda. Depending on their structure, those processes may entail transfer of loans, and assignment to the buyer of the loans of the ability to bring negligence claims against the original valuer. If a firm has only the 'two assignments' cover of the Minimum Terms, that may not be enough. Members should therefore review their individual insurance arrangements to verify whether they are suitable for their practice.

5.12 If a valuation fee is being paid by a third party, it is important that members consider whether their client requires that third party to be entitled to rely on the report. If not, the engagement letter and valuation report should make that clear, because otherwise, the third party may seek to argue that they are entitled to rely on the report by reason of having paid the fee.

5.13 Like all decisions involving risk, members should consider whether permitting third party reliance should, where practical or possible, command an additional fee to cover the relevant insurance cost and any additional risk.

6 Contractual terms

6.1 Engagement letter

6.1.1 An engagement letter is the contract between the valuer and the client, though in Scots law, there are differences as to what makes up the contract with a valuer and how the contract is concluded; specialist Scots law advice should be sought. Recording the terms of contract in an engagement letter is required by the *RICS Valuation – Global Standards 2017* (Red Book). Red Book PS2 7.1 states:

'It is fundamental that by the time any written *valuation* is concluded, but prior to the issue of the report, all the matters material to the report have been fully brought to the client's attention and appropriately documented'.

6.1.2 It is also an important opportunity for the valuer to regulate the risks that attend the engagement, and that opportunity should not be passed up.

6.1.3 Before turning to the terms of engagement, it should first be noted that ultimately there is no compulsion on the part of valuers to accept a valuation instruction. Where, in the valuer's opinion, the risks and rewards are not balanced, the valuer should consider whether it is appropriate to accept the instruction.

6.1.4 In this section, we set out the clauses of an engagement letter that are the most important from a risk perspective. Where appropriate, an example clause is given after the explanations below. These clauses are generic examples only and will not suit all situations; members should consider taking legal advice on their requirements for specific situations.

6.1.5 Although we use the word 'clause' and we refer to a 'contract', the engagement letter can have the appearance of any other business letter; there is no particular form in which the clauses need to be set out.

6.1.6 Many firms choose to prepare standard terms and conditions for all retainers. This enables engagement letters for individual matters to be prepared very easily, by reference to those standard terms and conditions, and it will usually mean that negotiation with the client at the outset of each new matter can be confined to the key points specific to that matter.

6.1.7 Frequently, a client will ask a valuer to agree to provide a valuation on the basis of the client's own standard terms and conditions, which might include a Service Level Agreement or Master Services Agreement, the terms of which will bind both parties for the duration of the specific agreement. The question of whose terms and conditions prevail is a subject for commercial negotiation with the client, but if the client's terms and conditions prevail, members should read them and bear in mind that, like every contract, their terms should be capable of negotiation. Where the client wishes to have a standard Service Level Agreement in place, this will help facilitate instructions for the period of its duration, but the member should still read its terms carefully prior to signature and, where appropriate, seek to negotiate those terms, to ensure that they fairly apportion risk and reward between the parties.

6.1.8 Even where a firm does have standard terms and conditions for valuation work, there are at least three key terms that should be considered by the firm from a risk perspective in the context of every valuation instruction, as set out below. These terms should be regarded as related, and therefore considered alongside one another in the context of each instruction.

1. The scope of the work: the requirements for a valuation engagement letter in scoping each instruction are set out in full in the Red Book.
2. The fee: the Red Book also requires that the engagement letter specify the basis on which the valuation fee will be calculated. Fees are also addressed later in this section.
3. The liability cap: liability caps are discussed in section 4.

6.2 Contracting entity/ exclusion of personal liability

6.2.1 The engagement letter should state the entity that is entering into the contract to provide the valuation.

6.2.2 The firm's name shown on the front/back of the valuation report should be consistent with the engagement letter. This is important for the reasons given in section 3.8.

6.2.3 The engagement letter can include a clause that expressly prevents any of the firm's individual partners or employees being named as a defendant in any claim brought relating to the valuation. This requires wording along the following lines:

'None of our employees, partners or consultants individually has a contract with you or owes you a duty of care or personal responsibility. You agree that you will not bring any claim against any such individuals personally in connection with our services.'

6.3 Proportionate liability

6.3.1 Sometimes the services of a valuer are provided in a particular matter alongside those of other professionals, such as quantity surveyors, solicitors, architects, engineers, buildings surveyors, etc. If the client sues more than one of these professionals, all of the defendants can in some cases be categorised as 'joint tortfeasors', or both be held liable for the same damage. If that happens, and the claimant succeeds in a claim against more than one of them, the claimant can choose to enforce 100 per cent of its judgment against as few or as many of the defendants as the claimant wishes to. If one of the defendants is unable to pay a fair share of the claimant's loss (for example, if that party has no insurance and/or is insolvent), the others are required to step in and meet the judgment in full. This may mean, for example, that even though an engineer was also responsible, the valuer has to pay all of the loss because the engineer has gone insolvent and does not have run-off insurance.

6.3.2 It is possible to contract out of this effect, by including a clause in the valuation engagement letter which says that, even if the valuer is negligent, the extent of the valuer's liability is restricted to the loss which can properly be said to have been caused by that negligence. Note that such a clause is different from a 'liability cap', as explained below. A proportionate liability clause would be along the following lines:

'If you suffer loss as a result of our breach of contract or negligence, our liability shall be limited to a just and equitable proportion of your loss having regard to the extent of responsibility of any other party. Our liability shall not increase by reason of a shortfall in recovery from any other party, whether that shortfall arises from an agreement between you and them, your difficulty in enforcement, or any other cause.'

6.4 Liability caps

6.4.1 Section 4 is devoted to liability capping clauses, and the subject is also addressed in Appendix A (residential valuation) and Appendix B (commercial valuation). However, these clauses are also included in this section, because, together with the fee clause and the scoping clause, liability caps are one of the three clauses of engagement that RICS recommends should be thought about from a risk perspective in accepting every valuation instruction, rather than being left for inclusion in standard terms and conditions.

6.5 Fees

6.5.1 The fee to be charged should be considered in the context of every valuation instruction, and not left for inclusion in standard terms and conditions, even with regular clients.

6.5.2 The size of the liability risks attendant on a valuation can be disproportionate to the fee charged. Accordingly, RICS recommends that within each firm, those members who are responsible for pricing valuation work should ensure that they are aware of the cost to their firm of buying and maintaining professional indemnity insurance, as well as all other costs of the business.

6.5.3 The firm should consider the scope of work that it is intended will be provided for the fee, and then ensure the client's expectations in that regard are the same as the firm's. See generally the scope of work in section 6.6, by way of specific examples:

- What is the nature of the inspection to be conducted?
- Will the valuation include any measuring services?
- Will the valuer need to call on other specialist input (for example, from quantity surveyors) from within the firm?

6.5.4 See the note at the end of Appendix B if asked to issue a fee invoice to a third party.

6.6 Scope of work

6.6.1 Frequently, claims against valuers arise because of a mismatch between the work the valuer intended to do to prepare the valuation, and the work the client anticipated the valuer would do. The engagement letter is the valuer's opportunity to ensure that the client's expectations match those of the valuer as to what the valuer is going to do and, just as importantly, what the valuer is not going to do.

6.6.2 The 'scoping' process should be aligned with the process of calculating an appropriate fee and liability cap (see section 4).

6.6.3 The scoping process is also a good opportunity for the valuer to state those areas of specialist work the valuer is not going to deliver in this instruction. The valuer may believe the client knows that these specialist works are being provided by other specialists, but it is preferable to state this in express terms. For example, if the valuer is not going to carry out the following services, the valuer should consider saying so in terms:

- Inspect the property in person (i.e. the valuer is to carry out a 'desk-top' valuation only).
- Measure the property.
- Inquire into the accuracy of planning information provided to the valuer.
- Comment on condition.
- Examine the structural soundness of the property.
- Comment on the strength of a tenant's covenant in valuing a property that has been let.
- Inquire into the accuracy of passing rental figures provided to the valuer.
- Read leases or other legal documents other than where the valuer has expressly undertaken to do so.

6.6.4 Members' attention in this regard is also drawn to VPS1 Terms of engagement (scope of work) of the Red Book.

6.7 Dispute resolution

6.7.1 If no other provision is made, the default position in England and Scotland is that disputes between valuers and their clients are to be referred to the courts, for litigation. Appendix D addresses this subject.

6.8 Third party reliance

6.8.1 Section 5 is dedicated to the subject of third party reliance on valuations. As a default position, RICS recommends that valuers include a clause in their engagement letters that prevents third party reliance. This can be included in a firm's standard terms and conditions. For completeness, RICS recommends that this clause is replicated in a prominent position in the body of the valuation report as well. The clause can be along the following lines:

'Our valuation is provided for your benefit alone and solely for the purposes of the instruction to which it relates. Our valuation may not, without our written consent, be used or relied upon by any third party, even if that third party pays all or part of our fees, or is permitted to see a copy of our valuation report. If we do provide written consent to a third party relying on our valuation, any such third party is deemed to have accepted the terms of our engagement.'

6.9 Governing law and jurisdiction

6.9.1 Some clients (or third parties who bring claims against a member firm) may try to bring claims in their 'home' jurisdiction. If successful, members might find themselves being judged under a different system of law from that with which they are familiar or had in mind when they accepted the relevant valuation instruction. It is also possible that the member's PII will not cover the claim, if the policy contains geographical limitations on cover.

6.9.2 Members can prevent this happening in the vast majority of cases by including a simple clause stating that the contract, and any claims arising from the valuation, are subject to the exclusive jurisdiction of the courts of England and Wales, and English law. This is even necessary within the United Kingdom: if valuing a Scottish property, or sending a valuation to a client in Northern Ireland, this may create uncertainty as to governing law and jurisdiction, so it is recommended to include an express choice. The clause can be along the following lines:

'Our contract with you for the provision of this valuation is subject to English law. Any dispute in relation to this contract, or any aspect of the valuation, shall be subject to the exclusive jurisdiction of the Courts of England and Wales, and shall be determined by the application of English law, regardless of who initiates proceedings in relation to the valuation.'

6.9.3 This clause can be adapted for Scottish use by replacing 'English law' (in both places) with 'Scots Law' and 'the Courts of England and Wales' with 'the Courts of Scotland'.

7 Professional indemnity insurance (PII)

7.1 All regulated firms need to ensure they have adequate and appropriate professional indemnity insurance in place that complies with the requirements of Rule 9 of the RICS *Rules of Conduct* and the RICS Minimum Requirements (http://www.rics.org/Global/RICS%20622%20PII%20Policy%20WEB.PDF). See also *RICS Professional Indemnity Insurance* (Version 3, 1 November 2015) found at: http://www.rics.org/uk/regulation1/firm-and-individual-guidance/professional-indemnity-insurance-pii/introduction-to-pii/

7.2 Insurance is a key part of managing risk. That firms maintain insurance is also in the interest of members' clients and therefore the reputation and standing of the profession. This is one of the main reasons RICS takes a role in ensuring that firms are adequately insured.

7.3 All members should be aware of the following points about PII:

- In arranging PII, members should ensure the amount of cover purchased is consistent with the nature of the firm's practice and proportionate to the risks taken by the firm. Members should always consult specialist insurance brokers in arranging PII.
- When choosing the level of insurance that is required, it is important to consider the effect of the aggregation clause in the policy. This clause will typically provide that where a number of claims arise from the same originating source or cause, such as a repeated error or omission, then all claims will be treated as one, attracting only one limit of indemnity, which may be insufficient.
- Member firms' risk management must not begin and end with putting in place professional indemnity insurance, because insurance is a contract that contains limits, conditions, and exclusions: it is not a guarantee, and it will not cover everything. Careful attention to the terms of engagements (including the use of liability caps), and ensuring consistent quality in valuation practice and reporting, continue to be fundamental to effective risk management.
- Claims on a firm's PII directly affect the cost and terms of insurance in the future. In practice, that means it is in the interests of the firm's partners and senior staff to maintain an active involvement in risk management, so as to minimise claims under the policy.
- Valuers' PII policies typically are provided on a 'claims made' basis, almost invariably on an annual basis. This means the policy that responds to a claim is the annual policy in force when the claim is made, regardless of when the relevant work was done. This offers great simplicity, but it does entail some pitfalls, in particular if a firm were to allow its insurance to lapse from a certain date, it would have no insurance cover for claims made after that date.
- Member firms should ensure at all times that in the event of the firm's practice ceasing, there will be 'run-off insurance' in place to protect the firm's partners and its customers. There will remain a risk of claims against the firm and its partners for at least six years after a cessation, and those claims may not be covered if the firm does not have run-off insurance for the duration of that period. This is a subject that should be considered by all firms at all times, not only those for whom a practice cessation is an obvious or imminent threat. As can be seen from section 3.8, six years should be looked on as a minimum, because it is possible that claims may be brought more than six years after a valuation has been provided.

7.4 RICS requires firms to put in place run-off cover. In addition to the consequences detailed in the paragraph above, a failure to comply with this obligation may be a disciplinary matter.

7.5 All insurance policies will have an uninsured excess (or deductible) that is payable by the firm, a limit on the maximum amount the insurers will pay on any single claim, and may have an overall maximum amount the insurers will pay in a single policy year. Sometimes policies are also subject to 'sub-limits' relating to certain types of claims, such as loss of documents.

7.6 Although larger firms sometimes have designated partners or employees who manage the firm's insurance arrangements, it is important that all partners and senior valuers are involved to an appropriate extent and have at least a working knowledge of the firm's professional indemnity insurance, including the cost of arranging it, and the points set out above. This is to ensure that:

- They comply with the requirements of the policy, including giving appropriate disclosure to the insurers and giving prompt notification of claims, and circumstances that may give rise to claims.
- They are able to have informed engagement with clients about allocation of risk in their firm's engagements.
- They more readily appreciate the importance of prudent risk management and the use of appropriate terms of engagement including liability caps.

8 Conclusion

8.1 Effective risk management is a dynamic process. It is intended that this guidance, the *RICS Valuation – Global Standards 2017* (Red Book), and the other materials referred to in this document will equip members and their clients to understand the issues they address, but they cannot be a substitute for firms and individual members constantly seeking to identify the risks which confront their practice, and to take steps to control and manage those risks. For further guidance on dealing effectively with complaints and claims, members are referred to *Complaints handling*, 1st edition guidance note at

http://www.rics.org/uk/knowledge/professional-guidance/guidance-notes/complaints-handling-1st-edition/

8.2 This is the responsibility of all members: a responsibility they owe to their profession, to their clients, and to all participants in property markets.

8.3 By necessity, the coverage of some subjects in this guidance is brief. As well as taking steps generally as referred to immediately above, it is one of the stated objectives of this guidance to encourage members to take a fresh look at the Terms and Conditions on which they engage with their clients. In doing so, members are encouraged to take specific legal advice on the particular points to which their practice gives rise. However, members are also referred to the further reading materials referred to in section 9, all of which are available to members on RICS' website, to assist further in that process.

9 Further reading

9.1 *RICS Report on Professional Indemnity Insurance (PII) for Valuations in the UK* October 2012 http://www.rics.org/uk/regulation1/firm-and-individual-guidance/professional-indemnity-insurance-pii/pii-and-valuation-guidance/

9.2 *RICS Valuation – Global Standards 2017* (Red Book): http://www.rics.org/uk/knowledge/professional-guidance/red-book/rics-valuation-global-standards-2017/

9.3 *RICS Rules of Conduct* found: www.rics.org/uk/regulation1/rules-of-conduct1/

9.4 RICS Valuer Registration (VR): www.rics.org/valuerregistration

9.5 RICS *Professional Indemnity Insurance* (Version 3, 1 November 2015): http://www.rics.org/uk/regulation1/firm-and-individual-guidance/professional-indemnity-insurance-pii/introduction-to-pii/

9.6 *Reflecting uncertainty in valuations for investment purposes* (2011): www.rics.org/Global/User_guide_reflecting_uncertainty_in_valuations.pdf

9.7 *2015 RICS Policy Wording (Minimum Terms)*:

http://www.rics.org/Global/Downloads/professional_indemnity_insurance_policy_wording_UK_120816_JD.pdf

10 Glossary

ADR	Alternative dispute resolution. Process of resolving disputes, including negligence disputes, other than by litigation. See particularly Appendix D.
AIF/AIFMD	The Alternative Investment Fund Directive is a European Directive setting rules for alternative investment funds such as hedge funds, and it contains specific requirements for valuations. See particularly Appendix C.
Arbitration	A private dispute resolution process. See particularly Appendix D.
Assignment	The process whereby an entire contract, or the benefit of it, is transferred by one of the original parties to a 'third party'. If a valuation contract is assigned, the assignee is effectively treated as the valuer's client. Assignment can be prevented by express words in the contract. See particularly Appendix B.
Bilateral loan	A simple type of commercial loan. See particularly Appendix B.
Bracket	The bracket of hypothetical reasonable valuations that is used to assess whether the valuation actually given was negligent. See particularly section 3.
Claims made	The basis on which most professionals' (and all valuers') professional indemnity insurance is provided. It means that the relevant policy for any claim is the policy in place when the claim is made (not when the work is provided to the client, or any other time). See particularly section 7.
CMBS	Commercial Mortgage-Backed Security: a type of finance transaction. See Appendix B.
Common law damages	The recognised body of judge-made law, from decided cases, about the appropriate damages to award, as opposed to principles set out in statute, or express provisions about damages made in a contract.
Delict	Used in Scots law instead of 'tort'.
Desk-top valuations	Valuations conducted without a site visit.
Disclosure	Permitting a valuation to be seen by or disclosed to a third party (i.e. a person or entity who is not party to the valuer's contract of engagement) without assumption of a duty of care.
Duty of care	The duty in 'tort' assumed by a professional to observe the skill and care of a 'reasonable' valuer in providing professional services. Such a duty may in certain circumstances be assumed to a 'third party' as well as to the professional's contracted client.
Engagement letter	A letter issued by a valuer which records the contract with the valuer's client. It may be accompanied by terms and conditions. See particularly section 6.
Expert valuers	Independent valuers giving expert evidence to courts and tribunals.
Facility agent	A bank that acts in some capacity on behalf of another bank.
Facility agreement	An agreement or letter in which a lender sets out the terms and conditions on which it is prepared to make a loan facility available to a borrower.
HMO	Houses in Multiple Occupation. See Appendix A.
Implied terms	Terms of a contract that are not stated expressly but which 'go without saying'. In a contract for professional services this includes a term that the services to be provided will not fall below the standard of skill and care which would be expected from a reasonable body of the professional's peers.
Indemnity	A contractual agreement sometimes given by a party providing professional services to 'hold harmless' or 'make whole' the client in respect of the client's losses arising from the matter. See paragraph 3.5.4.
Issuer	A legal entity that develops, registers and sells securities.
Joint and several liability	The liability partners have to claimants for claims against the partnership, co-defendants and 'joint tortfeasors' have to claimants. See paragraph 6.3.

Joint tortfeasors	Parties (usually professional firms) who take on responsibilities 'jointly and severally' to a particular client or claimant, when they work alongside each other – see 'joint and several liability' and paragraph 6.3.
Liability cap (or limitation of liability)	A contractual agreement that a client can only claim damages up to the amount agreed, even if the law would otherwise award a greater sum in damages. See section 4 and Appendices A and B.
Limitation periods	The periods specified by statute and the common law for a claimant to commence legal proceedings. The periods vary depending on the type of claim and the type of services provided. When the period is over, the claim becomes 'statute barred' and can no longer be pursued. See paragraph 3.8.
Limited Liability Partnership (or LLP)	A type of legal entity for carrying on business, governed in the UK by the *Limited Liability Partnerships Act* 2000 and the *Limited Liability Partnerships Act (Northern Ireland)* 2002. Unlike a partnership, an 'LLP' does have a legal existence as an entity separate from its partners (called 'members' in an LLP), and it is that entity which enters contracts and provides services. Practising through an LLP is an effective and recognised way for partners in professional firms to manage the risks associated with personal liabilities.
Litigation funders	Parties that make a business out of investing in litigation. Litigation funders are not party to the litigation, but they fund the costs for one party or the other, in exchange for taking a share of any success.
Mediation	The principal form of ADR. See Appendix C.
Members (LLP)	See 'Limited Liability Partnership' above. Although many firms that operate as LLPs still refer to their principals as 'partners' the technically correct term for the principals of an LLP is 'members'.
Mezzanine loan	A high risk/high reward form of lending. See Appendix B.
Negligence	Negligence is a 'tort'. In the case of a professional, negligence is a failure to provide services with the standard of skill and care which would be expected from a reasonable body of the professional's peers.
PII	Professional indemnity insurance.
PII limit	A firm's PII limit is the maximum amount the firm's PII insurer will pay in the event of a claim. It is sometimes wrongly confused with a liability cap. See section 4.
Pre-Action Protocols	The regime applicable to legal disputes in England and Wales whereby parties exchange correspondence and documents before commencing formal legal proceedings, with a view to avoiding altogether the need for formal legal proceedings if possible. There is a specific Pre-Action Protocol applied to professional negligence claims. See Appendix C.
Proportionate liability	Liability that is limited to the damage actually caused by the particular defendant. A 'proportionate liability clause' is a contractual mechanism whereby the liability of a valuer can be limited to the valuer's proportionate liability. See section 6.3.
Red Book	*RICS Valuation – Global Standards 2017.*
RMBS	Residential Mortgage-Backed Security: a type of finance transaction. See Appendix A and B.
Run-off insurance	A form of insurance that can be bought to provide cover for claims arising after a firm or individual has ceased trading. Valuers have a particular need for it because valuers' PII is provided on a 'claims made' basis, meaning that there will only be insurance cover for a claim if there is a policy in place when the claim is made – even if the claim is made after the valuer (or firm of valuers) has ceased practice. See section 7.
SAAMCO Cap	An important principle in the common law of damages as it applies to property valuers, which ensures that valuers can only be liable for the losses they can properly be said to have caused. See paragraph 3.5.2.
Securitisation	A type of commercial finance transaction whereby a primary lending bank bundles loans, and sells them to investors. See Appendix A and Appendix B.
Security agent (also known as 'collateral agent')	In a syndicated lending situation, the party that holds the collateral on behalf of the lenders.

Sub-limits	Specific limits within a PII policy for certain specified types of claims, such as loss of documents.
Syndicated loan	A commercial loan that is shared by a group of lenders. See Appendix B.
Third party/third parties	Anybody who is not a party to the valuation contract. Usually this means anyone who is not the valuer’s client. Examples include the borrower, in a situation where the valuer’s client is a lender. See section 5 and Appendices A and B.
Third party reliance	Third party reliance happens when a 'third party' relies on a valuation that has been prepared for a valuer's client. See section 5.
Tort	The umbrella term for all civil wrongs recognised by law other than breach of contract. The most commonly referred to tort is the tort of negligence. See section 3.

Appendix A: Residential valuations and building surveys

This appendix is intended to provide guidance to valuers advising in residential mortgage valuation and 'consumer' work (as opposed to commercial lending situations and other commercial valuation situations, addressed in Appendix B). RICS recognises that there is not a hard and fast distinction between 'commercial' and 'residential', and it may be helpful for valuers to read both appendices.

The main body of this guidance note sets out the principles that apply generally to risk, liability and insurance in valuation work. This appendix addresses some points that apply specifically to residential valuations and building surveys.

A1 Issues specific to valuations in the residential sector

A1.1 Buy-to-let properties

Valuations of buy-to-let properties carried out for lenders in connection with the mortgage loan process have been a source of many claims against valuers. This includes claims by borrowers who have received a copy of the valuation provided to their mortgage lender, and have then sought to argue that they relied on the valuation.

The current legal position is that a valuer appointed by a lender in a buy-to-let transaction will not owe a duty of care to the borrower. The valuer's only duty is to the lender, unless the valuer is appointed directly by the borrower or expressly permits the borrower to rely on the valuation.

It is important for members who provide valuations for buy-to-let transactions to consider whether their insurance provides cover for valuations for commercial lending. While buy-to-let properties are residential properties, insurers may take the view that the valuation is for the purpose of commercial lending, if the borrower is seeking to purchase a portfolio of properties for the purposes of running them as a commercial venture. If a member is instructed to carry out such a valuation, they should check whether their policy provides cover for such valuations, and if they are under any doubt, raise this point with their insurance broker to ensure they are not left without cover in the event of a claim.

A1.2 Houses in Multiple Occupation (HMO)

The number of HMOs continues to rise and valuations of these properties present unique risks for valuers. In recent years, some professional indemnity insurers have begun to treat HMOs as valuations for commercial lending on the basis that the value of the property, at least in part, relies on its ability to generate income. In light of this, RICS advises members whose professional indemnity cover is limited solely to valuations for residential lending to consult with their brokers and/or professional indemnity insurers regarding coverage of any claim before agreeing to value an HMO.

A1.3 Securitisation

Securitisation involves banks selling bundles or 'books' of loans to investors. It has been used extensively since the mid-2000s, particularly by banks operating in the sub-prime market. Banks continue to produce packaged products comprised of residential mortgage loans, often referred to as Residential Mortgage-Backed Securities, or RMBSs, which are sold on to third party investors.

To facilitate securitisation, lenders often request that valuers permit third parties to rely on their valuations. This presents a clear risk for valuers who may then face claims by parties who were not clients of the valuer. The issues and risks presented by third party reliance are discussed in Section 5. In summary, RICS recommends that, as a default, valuers do not permit third party reliance.

The typical form and structure of securitised loans is set out in some detail in Appendix B. Where packages of loans, whether commercial or residential, are sold repeatedly, these transactions will usually also entail repeated assignments of the right to sue the valuer who provided the original valuation. There are three practical points coming out of this:

1 Some professional indemnity insurance policies provide cover for a restricted number of assignments (the RICS Minimum Terms requires cover for two). Members should check what their policies provide.

2 Members should consider including in their engagement contracts an express prohibition on the assignment of their contract without their consent. See paragraphs 5.9 and 5.10 and the sample wording included under section B2.

3 Where possible, members should include any terms and conditions limiting or excluding liability in the valuation report itself, to ensure that any third party that comes to rely on the report is aware of the limits or exclusions.

A2 Nature of building surveyors' liabilities

This part explains the key principles that apply to claims against members relating to residential building surveys and what action members should be taking to limit their risks in this regard.

A2.1 The standard of care

In cases where a claimant alleges that a surveyor failed to identify a specific defect at a property, the claimant has to show – by using expert evidence – that no reasonably competent surveyor would have failed to identify and report on that defect.

The type of report the surveyor is instructed to produce will affect the extent of the inspection required. For mortgage valuations and inspections, a brief and reasonable visual inspection, which enables the surveyor to provide a valuation and general guide as to the property's condition, is sufficient. By contrast, a surveyor carrying out a building survey is expected to inspect all visible parts of the property, although not unexposed parts. The surveyor is not expected to test the services at a property as part of a building survey.

For HomeBuyer Reports, the surveyor is required to exercise the same standard of care that would apply to a building survey, within the agreed confines of the inspection.

A surveyor will be at risk of a finding of negligence if they fail to identify defects that would have been observable, had the inspection of the property been in accordance with the standards identified above or, if having identified a potential concern, the surveyor does not carry out further investigations or advise that further investigations ought to be undertaken.

To ensure that the extent of the inspection is clear, the engagement letter and report to the client should clearly record any limits to the inspection, including any areas of the property that will not be inspected and any issues that will not be dealt with in the report.

A2.2 Damages

For claims arising from the failure to identify and report on specific defects at a property, the measure of loss is the diminution in the property's value caused by the defect. In other words, the value of the claim will be the difference between the value of the property as described in the surveyor's report (without accounting for the defect) and the value of the property in its actual condition (subject to the defect), as at the date of the report.

Claimants will often seek to recover the cost of remedial works needed to repair or remove the defect (known as rectification costs). Those costs are rarely awarded and will only be considered by a court in cases where diminution in value would be an inappropriate measure of loss.

A2.3 Limitation

Limitation periods for negligence claims on building surveys are the same as for valuation claims: see section 3.8. In brief, the limitation period for advancing a claim in contract against a surveyor is six years from the date of the surveyor's report, and for claims in tort, the period is six years from the date when the claimant first suffered a loss. For claims brought by the owner of a residential property, this will usually be the date on which the property was purchased.

The period for a negligence claim can be extended if there was a delay in the claimant spotting the defect and finding out about their claim: they will have three years from the date when they found out or should have found out. This extended period is subject to a 'long stop' period of 15 years from the date of the negligent act regardless of when the claimant found out about their claim. This will usually mean 15 years from the date of the survey report.

Given the 'long stop' date of 15 years, RICS recommends that members retain their files for 15 years after carrying out a survey, to ensure that they have the records necessary to respond to a claim. Any updated advice provided in connection with an earlier survey should also be retained for 15 years from the date of that advice as a new limitation period will apply to each new piece of advice provided to a client.

A2.4 Third party reliance

The issue of third party reliance and the risks to valuers is discussed in section 5.

RICS recognises that there is a practice of permitting valuations of residential properties provided to lenders to be disclosed to the borrower/purchaser, and that sometimes this is done on a basis which permits the borrower to rely on the valuation, i.e. extending the duty of care to that borrower. Members should ensure, wherever they can, that if they do permit borrowers to see their lender valuation reports, they make it clear to the borrower (whether in the report itself, or a letter to the borrower, or both) whether the borrower is entitled to rely on it or not.

The same third party reliance issues affect surveyors when providing surveys of residential properties to lenders. RICS advises surveyors to ensure the engagement letter and report clearly records that the survey is provided for the use of the addressee only and that no third party may rely upon it.

A3 Liability caps

When providing valuations and surveys of residential properties, members will often be dealing with clients who are 'consumers' (i.e. those not acting in a business, trade or professional capacity). Buy-to-let investors may be regarded as consumers in this context.

The use of terms in consumer contracts that exclude or cap liability is controlled strictly by law. All contractual terms in consumer contracts must meet a test of fairness. Contractual terms that exclude or restrict liability where one of the contracting parties deals as a consumer or on the other's written standard terms of business must be fair and reasonable, having regard to all the circumstances known to the parties, or within their contemplation, at the time the contract was made. The party seeking to rely on a particular term has to be able to prove that it is reasonable.

Contract terms that have not been individually negotiated – for example terms that have been drafted in advance and that a consumer has not been able to influence – will be deemed unfair if they cause a significant imbalance in the parties' contractual rights and obligations, to the detriment of the consumer. If deemed unfair, the terms will cease to bind a consumer.

Generally, RICS does not recommend attempting to limit liability by reference to a multiple of the fees for a residential survey or valuation, particularly where the fee for the job is modest. Such clauses are likely to fail the test for reasonableness and fairness, particularly in a consumer context. Limits by reference to the value of the property, or agreeing a reasonable share of responsibility for the cost of repairs in any survey claim, are more likely to be regarded as fair and reasonable, but again this will depend on the level agreed. Further, any clause would have to be drawn specifically to the client's attention, not buried in small print, and even then it would always be subject to a reasonableness and fairness test.

Appendix B: Valuations for commercial lending

This appendix is intended to offer guidance to valuers providing advice in commercial lending situations and other commercial valuation situations (as opposed to residential mortgage valuation and 'consumer' work, which is addressed in Appendix A). RICS recognises there is not a hard and fast distinction between 'commercial' and 'residential', and it may be helpful for valuers to read both appendices.

Generally speaking, valuations for loan security purposes constitute the highest risk category of valuations undertaken by Registered Valuers.

Within that category, the liability risk for the valuer increases as:

- more parties are permitted to rely on the valuation
- the level of debt increases (particularly when the loan to value ratio increases) and
- investment instruments such as bonds are issued and secured on the debt, particularly if those instruments are issued in public markets.

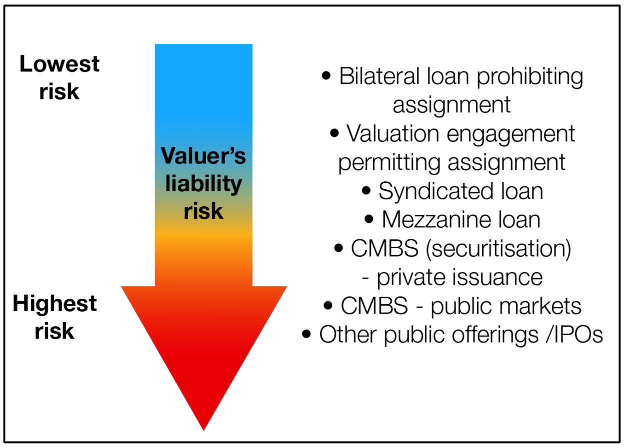

Figure 1: Valuers' risk - indicative only

Valuers' risk can also be significantly increased by third parties (i.e. individuals and companies who are not party to a valuer's engagement contract) being permitted to rely on the valuation. This opens up the possibility of the valuer's liability to those third parties for the tort of negligence – see sections 3.4 and 5.

RICS strongly recommends members adopting as a default position in their terms of engagement that the valuation is to be relied upon only by the lender client who directly instructs the member firm. Members should understand the risks of broadening the permitted reliance, and only consent when they have understood those risks.

The core concepts and lending structures members would need to understand are described in this section. However, members should appreciate that lender clients will have taken legal advice on these structures, and it is important that members do the same before permitting reliance on a broader level. It is beyond the scope of this guidance note to give members anything more than a general understanding of the risks and basic terminology.

In more sophisticated and higher value loan structures, members' liability caps become increasingly important. The other clause of the engagement contract that is very important is what it says about assignment (see B2).

B1 Bilateral loans

A bilateral loan is the simple situation where one lender lends 100 per cent of a loan amount to one borrower. From a structural perspective, these are the least high risk secured lending valuation engagements for valuers. As there is only intended to be one lender client and the engagement is a relatively simple one, the instruction will in many cases be covered by an umbrella Service Agreement or other standardised documentation. If this is the type of loan that a lender client is making, members should ensure that their engagement contract reflects this, and does not include consent to the use of the valuation in other, more sophisticated, lending transactions (see below).

One specific point that is relevant even in the bilateral loan context, and is equally relevant in all of the more complex situations addressed below, is whether the lender client can use the valuation report for additional lending decisions made after the initial loan, without further reference to the valuer. It would be risky for a lender to try to do this without consulting the valuer further, but members should ensure that wherever possible their engagement letter and report record the lending decision for which the valuation is to be used, for the avoidance of any doubt. See section 3.6.

B2 Assignment of your valuation engagement contract

The engagement between members and their clients for the preparation of a valuation is a contract. Please see section 3 for the basic principles concerning the contract.

In general, as a matter of English law, the benefit to a client of the contract can be assigned by the client to a 'third party' (i.e. someone who is not already party to the contract), unless the contract expressly prohibits assignment.

When a lender client sells a book of loans, one of the assets it will typically wish to sell with that book of loans is the benefit of the engagement contracts with the relevant valuers. In such a transaction, the assignment of the contract with the valuer would typically be part of the loan sale agreement. In general, if the valuer's contract does not prohibit assignment without the valuer's consent, the client would not have to seek consent to that assignment, or involve the valuer in that process in any way. The valuer should receive notice of the assignment, but in practice, may not even be notified until long after the loan sale, and usually, will not be able to object.

This means that members may effectively end up in a contract with a party they do not know, without knowing it has happened.

However, this will not be possible if members include a clause in their terms of engagement by which they prohibit assignment of their engagement contract without their consent. A typical wording to use for this purpose would be as follows:

'[Client's name/you] may not assign this valuation engagement, or any of its rights or obligations under this valuation engagement, without the prior written consent of [valuation firm/us].'

If members do not prohibit assignment, they should at least give thought to including a mechanism to ensure that any assignees are expressly bound by the original instruction terms (including the liability cap). This should happen as a matter of law, but the safest course is to deal with it expressly in the engagement contract.

Note that the concept of assignment is a different legal concept from 'third party reliance', which is the process whereby a valuer can acquire non-contractual legal liability to a third party who is permitted to rely on the valuation, or to whom the valuer assumes a 'duty of care'. That subject is addressed below.

B3 Syndicated loans

Syndicated loans are loans where there is a group or syndicate of lenders. This structure is usually used for higher value loans than bilateral loans (see above). It may be one of two broad types:

1. a 'pre-syndicated loan' (also known as 'club deals'), where the syndicate is formed before the loan is made or
2. a 'post-syndicated loan', where the syndicate is formed after the loan has been made, and the lender 'sells down' or 'novates' a part of the loan to each member of the syndicate.

In the case of a pre-syndicated loan, the valuer will typically enter into an engagement contract with all of the syndicate members (or with the syndicate lead as agent for all of the members). In a post-syndicated loan, the valuer will not necessarily even know about the proposed syndication when the valuation instruction is received. However, the syndicate members will wish to ensure that they are legally entitled to rely on the valuation and typically they will seek confirmation of this directly from the valuer.

Valuations for syndicated loans may be commissioned under bespoke engagement contracts with the valuer, an umbrella Service Agreement, or an existing Service Agreement may be supplemented with clauses specific to the engagement. Whenever members enter into an engagement contract, they should look on it as an opportunity to ensure that their liability cap and fee are proportionate to the risks to the firm.

If providing a valuation for a syndicated loan, members should think about how to make sure all of the lenders are bound in to the terms of their engagement contract (and if some of those other lenders are also clients of the firm, members should ensure that the terms for this contract prevail over the general terms in any Service Agreements with those clients). If liaising only with the lead lender as agent for all the lenders, members should ensure that the lead lender has confirmed that all lenders who wish to rely on the valuation are bound by the member's terms of engagement, including the liability cap. If this is not possible, members should consider a direct agreement with each party confirming those terms, and their report should state clearly that no party may rely on their valuation without their express permission and without being bound by their terms of engagement, including their liability cap.

See section 4 about liability caps.

B4 Valuations for mezzanine financing

Mezzanine finance is used in situations where a higher Loan to Value (LTV) is required by the borrower or, for example, where the value of the project is expected to grow quickly such as development and refurbishment situations. It gets its name because it is the middle layer of debt, falling between the secured 'senior' debt of a conventional lender, and the equity of the project owner. A mezzanine lender will usually have the right to convert the debt to an ownership or equity interest in the project if the loan is not paid back in time and in full. Mezzanine finance is usually 'subordinated' to the lending provided by the senior lender, and secured by a second ranking mortgage.

Mezzanine finance is often provided quickly, with relatively little due diligence on the part of the lender. This, and the fact that it is subordinated to the senior debt, means that it is usually higher risk lending, and therefore relatively expensive finance for a borrower.

For a valuer, it is important to understand that:

- a mezzanine lender is usually the first lender to be exposed in the event that a project fails or a borrower defaults and
- a mezzanine lender lends against the security of the highest tranche of equity in the property that forms the security.

These factors mean that the liability risk for a valuer in advising mezzanine lenders about the value of a property is high. Members should ensure that their fee and liability cap reflect this level of risk. A default in the mezzanine debt tranche could increase the risk to the senior tranche for the valuer as there can be a greater potential for distress throughout the debt stack once one tranche is in default.

B5 CMBS (Securitisation)

Securitisation (or CMBS, which stands for 'Commercial Mortgage Backed Security') is the process in which multiple loans are pooled by the originating lender so that they can be repackaged into interest-bearing securities.

Lenders use securitisation to transfer the credit risk of the assets they originate from their own balance sheets to those of other financial institutions, such as other banks, insurance companies, investment funds, and hedge funds. The interest and principal payments from the assets are passed through to the purchasers of the securities.

CMBS essentially takes two forms, of which the most common is 'conduit CMBS', addressed here. The other is 'agented CMBS', which is similar but is not specifically addressed here.

There is also a practical distinction between CMBS in which the securities are sold on a restricted, private basis, and those where the securities are sold publicly, in the capital markets.

Typically, a bank will make a number of loans over a period of time, then sell those loans to a 'Special Purpose Vehicle' (SPV) issuing entity. The SPV will raise money to buy the loans by issuing tradable, interest-bearing securities (usually bonds) that are sold to investors. The security issue is supported by the security for the original loans (i.e. the mortgages given by the borrowers). The transfer of the loans typically takes place by way of 'novation' from the original lender to the issuing SPV. The SPV then becomes the lender under the loan agreement.

As the SPV has no employees and no real existence other than acting as a flow-through vehicle, it has to delegate all of its functions to third party service providers. It therefore typically appoints a servicer to manage the loan on its behalf (although sometimes the original lender will also retain the servicing role). The investors receive fixed or floating rate payments from a trustee account funded by the cashflows generated by the underlying loans.

The property valuation will typically be referred to in the 'offering circular' for the CMBS, which is the document sent to prospective buyers of the bonds to advertise the investment. The arranging bank may also seek to make the valuation available on a data website for investors.

In English law, a valuation cannot be referred to in an offering circular without the permission of the valuer. This means that the initiating lender will need to obtain the valuer's permission before carrying out the CMBS transaction. That may present the valuer with an opportunity to ensure that the firm's fee – and, where appropriate, the liability cap – are commensurate with the risk to the firm.

The risks for valuers in a public CMBS are greater than they are in a private CMBS. This is essentially for two reasons:

1. In a private offering, the valuer will have a better awareness of which investors are involved, and will probably have an opportunity of agreeing contractual terms with all of them (including, where it can be negotiated, a liability cap).
2. In a public offering context, the valuer will not have knowledge of who the investors may be, will not be able to agree contractual terms with all of them, and there may be regulatory restrictions on the terms that can be included in the engagement (including as to liability cap).

Please see the guidance in B6 concerning liability caps in the context of public offerings generally, that apply equally in the specific context of CMBS transactions.

Unless members have competent in-house expertise and capability, RICS recommends that members should not provide valuations for CMBS transactions without taking specialist legal advice.

B6 Crowdfunding and peer to peer lending

As of the date of publication of this guidance note, the use of valuations in crowdfunding and peer to peer lending is undeveloped. However, the preliminary view of RICS is that the risks can be similar to the risks entailed in public offerings, because the valuer may not know who the investors are who wish to rely upon the valuation, and is unlikely to be able to agree contractual terms with each of them. The arranger of the crowdfunding or peer to peer lending may be content for the valuation report to be provided to potential investors for their information only, on a 'non-reliance' basis, which will reduce the risk for the valuer. If so, members should ensure that both their engagement letters and valuation reports make this basis clear, and should ask the arranger also to include a note on any website to which the valuation report is uploaded, expressly recording this basis for the valuation. RICS recommends that until the principles affecting the use of valuations in these situations become clear, members should take specialist legal advice if asked to provide a valuation for use in crowdfunding or peer to peer lending.

B7 Restricting third party reliance

Section 3.1 explains that a claim for breach of contract can only be brought by a party to the contract, i.e. the client, but that a valuer can be sued in negligence by those who are not party to the valuation contract (i.e. third parties) to whom the valuer expressly accepts a 'duty of care', or those to whom the court says the valuer has assumed a 'duty of care'. That will usually include any third parties who the valuer has permitted to rely on the valuation.

Valuers therefore need to ensure there is appropriate language in both the instructions they accept and also their reports which suitably restricts the ability of third parties to rely on the report and valuation. In practical terms, the reader of the report should be put on notice by its terms or by the correspondence under which it is distributed as to who may rely on the report and who may not.

In general terms, the addressees of the report (sometime called the beneficiaries) will be able to rely on the report. Members' engagement letters and reports should state that any party entitled to rely on the report will be deemed to accept the whole terms of the instruction including the cap on liability.

As mentioned above, valuers should also prohibit assignment of their engagement contracts to third parties, unless they understand the risks of permitting assignment, and decide it is appropriate to take those risks in the context of any particular engagement.

If consenting to a report being seen by a third party, it is important to specify in the engagement letter and in the report itself whether the third party is also permitted to rely on it, or it is provided for information only on a 'non-reliance' basis. A reliance letter or a non-reliance letter is a useful tool in this respect.

Parties who often ask to be permitted to rely on loan security valuations include:

- Arranger.
- Agent for lenders or investors (NB: If dealing with agents for lenders, including a lead lender acting as agent, a member should seek confirmation that they are authorised on behalf of other lenders).
- Lenders under the original loan documentation (other finance parties).

Parties who it may be appropriate to exclude from reliance on loan security valuations include:

- Borrower or sponsor.
- Loan servicer.
- Receiver.
- Transferees, successors or assignees of the loan.
- Other potential lenders, if the original lender decides to syndicate the loan.
- Lenders' other advisers.
- Bond holders (where the bonds are a private issuance – see CMBS section).
- Hedging and swap counterparties.
- Lenders for other loans on the property (e.g. mezzanine lenders when valuing for the senior lender).
- Trustees.

B8 Invoicing parties other than the client

Care needs to be taken if the commercial valuer is asked to invoice a party who is not the client. The following issues could arise:

- By issuing an invoice to a non-client, members could inadvertently permit the party to whom the invoice has been issued to rely on the valuation. Therefore members should issue a clear statement alongside the invoice to the effect that by invoicing the requested party, they are not permitting reliance on the valuation.
- Without a direct contract or fee agreement, it may not be possible to pursue the invoiced party for non-payment. Members should consider raising this risk with the client.
- Members should ensure that they are not inadvertently becoming involved in VAT or other tax evasion, and if unsure of the position, take specialist tax advice.

RICS recognises that lenders sometimes ask their borrower customers to pay the costs of valuations provided to the lender. The safest way for a valuer to deal with this in order to avoid the risks described above is to issue the invoice to the lender client and ask the lender client to reclaim the cost from the borrower.

B9 Vacant possession valuations

It is common for clients, especially lenders, to instruct valuers to provide a vacant possession value (VPV) for investment properties. This should be instructed as a special assumption valuation See VPS 1 (i), VPS 3(i) VPS4 (3) for guidance.

As there is no specific definition or guidance on the basis of VPVs in *RICS Valuation – Global Standards 2017* (Red Book), there is therefore a heightened risk of misunderstanding. For investment properties, it is recommended that the valuer is either instructed on the following points by the client, or that the valuer clearly states their approach, for example:

Assumed physical state:

- Is it assumed that the property is in the same state as it currently exists or that the occupier has complied with their repairing and reinstatement obligations?
- Has vacant possession been achieved by a managed exit or by way of a default?
- Is any dilapidations money assumed available that can be applied to any refurbishment or repair costs?

Property use:

- Is the VPV considered only for the current use or are alternative uses to be reflected included redevelopment?
- What assumptions and investigations are to be made into planning?

Market context:

- Is it assumed that the present occupier is/is not 'in the market' in the event of the hypothetical vacancy, either to buy or lease the property.

The list above is not exhaustive and may vary depending on the circumstances.

B10 Reinstatement cost

It is common for clients, especially lenders, to instruct valuers to provide a reinstatement cost (RC). It is important to understand if this will be used as the basis for insuring the property or as a guide that the current/proposed insurance is broadly appropriate.

If the client wishes to be entitled to place reliance upon the RC for making commercial decisions, it should be undertaken by an appropriate and experienced qualified person, such as a building surveyor. More commonly, lenders only require RC for guidance and formal reliance is not required. In these circumstances, and subject to appropriate guidance, the RC can be undertaken by valuers. In this case the following must be made clear in the letter of engagement and the report:

- The RC is provided as a guide only and without liability, and any decisions taken on the basis of it are entirely at the user's risk.
- The RC has been undertaken by a valuer and is provided in the context of a valuation instruction.
- A clear statement of what has been reflected in the RC, which may include: demolition costs; fees (including project management); external works (e.g. car parking and landscaping). The treatment VAT, which is generally not included, should be clear.
- Assumptions on planning and building regulations, particularly for older buildings.
- If the property is in a conservation area, is a listed building or an unusual construction, the valuer may wish to either decline to provide a RC, or state that there is a risk of much higher variation on the cost.

Note: If the valuer is adjusting floor areas to a different basis for the reinstatement cost calculation, e.g. from NIA to GIA or from IPMS 3 to IPMS 2, the adjustment factors should be stated.

B11 Summary: key questions

When agreeing a commercial lending valuation instruction, address the following questions:

- Who can rely on the valuation, and for what purpose? For example, senior debt provider or mezzanine lender, etc.
- Should the engagement contract with the client include a clause preventing the client from assigning the benefit of the contract to third parties?
- Is the purpose of the report clear and specific? For example, in connection with new lending, loan monitoring, default, CMBS, etc?
- In defining the purpose, members should try to be as specific as possible about the lending transaction for which they are permitting the valuation to be used. Members should consider making it clear – preferably in both the engagement letter and the valuation report – that the valuation may not be relied upon for different, or subsequent, lending decisions.
- Are both the engagement letter and the valuation report clear about who the report is to be addressed to, and whether third party reliance is permitted?
- Is it necessary/appropriate to deal expressly with reliance by specific third parties such as receivers, rating agencies, and other advisers?
- What liability cap is agreed?
- Consider the basis of the liability cap. For example, a cap for each party or claim, or a total cap for the entire instruction.
- Please see section 4 concerning liability caps generally.
- Particular care should be taken where accepting instructions from a mortgage broker, i.e. where the valuer may be at ‘arm’s length’ from the lender client, in order to ensure that the issues raised in this guidance note are properly considered.

Appendix C: Valuations for investment funds and public offerings

C1 Public offerings including IPOs

As well as CMBS, there are other transactions in which finance will be raised in capital markets against the security of property. The most obvious example is an operating company whose property assets form a significant part of its balance sheet value, which either floats on the Stock Exchange for the first time (an 'Initial Public Offering', or IPO), or is already listed and seeks to raise more finance through the Stock Exchange. In a London Stock Exchange public offering, and in the case of most comparable jurisdictions, including Ireland and the United States, the prospectus or equivalent document must refer to a valuation from an independent valuer. That can only be done with the consent of the valuer.

If asked to consent to a valuation being referred to in this context, members should take specialist advice, because the risks associated with the valuation being relied upon by investors – including potentially investors in other jurisdictions – are significant. For example, it is not usually legally permissible to agree a liability cap in this context.

Where the valuation is referred to in a public offering document, members should consider taking specialist legal advice about limiting liability. However, in broad terms, it is not permitted for a valuer to impose a liability cap on the purchasers of the investment instruments issued, but:

- it should be possible to limit liability to the lender and other professional parties and
- where there is a private offering to a finite number of investors on a limited number of loans (such as in a private CMBS), it may be possible to agree with those investors a cap on the valuer's liability.

It is important to note that the valuer should only approve references to their own valuation, and not inadvertently approve the whole prospectus or circular, as this significantly increases the valuer's responsibility and liability.

C2 AIFMD

Alternative Investment Funds (AIFs) include private equity funds, hedge funds, retail investment funds, investment companies and real estate funds.

The EU Alternative Investment Fund Managers Directive (AIFMD) was issued in 2011 and implemented in UK law by various regulations including particularly the FCA Handbook rules and the *Alternative Investment Fund Managers Regulations* 2013.

RICS has published a detailed briefing note on the AIFMD, which is available on the RICS website: http://www.rics.org/uk/news/news-insight/news/valuations-in-accordance-with-the-alternative-investment-fund-management-directive/

AIFMD sets out requirements relating to the valuation of the assets of AIFs. Article 19 of AIFMD deals with valuation and requires that an AIFM, for each AIF that it manages:

‘appropriate and consistent procedures are established so that a proper and independent valuation of the assets of the AIF can be performed in accordance with this Article, the applicable national law and the AIF rules or instruments of incorporation’.

The legislation requires the AIFM to ensure that fair, appropriate and transparent valuation methodologies are applied to the AIFs that they manage. The AIFM must also ensure that the valuation policies set out the obligations, roles and responsibilities of all parties involved in the valuation process. Valuations must be performed impartially and with all due skill, care and diligence.

Article 19(4) of the AIFMD says that the valuation function can be performed either by the AIFM itself, or by an 'external valuer', ‘being a legal or natural person independent from the AIF, the AIFM and any other persons with close links to the AIF or AIFM’.

If members are appointed as the external valuer, that will entail specific risks. In particular, it is not possible to limit liability when acting as external valuer. It may be possible instead to be instructed to provide a valuation without being appointed as the external valuer, but even in that lesser capacity, members should take specialist advice before providing valuation advice to an AIF. Please see the RICS 2015 AIFMD briefing note.

Appendix D: Dispute resolution

If the contract between a firm of valuers and their client is silent as to how disputes are to be resolved, the default position will be litigation, i.e. formal proceedings in the court.

The parties can choose not to go to court. The principal alternatives are explained below. These alternative choices can be made after a dispute has arisen, but by that stage, one party may already have resolved to go to court, so if a firm prefers one of these alternative routes for resolving disputes with clients, it would be better to agree that 'up front' in the engagement letter or standard terms and conditions.

RICS requires all firms to have a complaints-handling process in place. This document must also include an ADR provision as a part of RICS' commitment to promoting ADR as a means of resolving disputes. In addition to the alternatives to litigation described below, RICS' Dispute Resolution Service (DRS) has been providing ADR services for over 40 years and has developed a new form of ADR designed specifically for the resolution of claims relating to residential valuations. For more information see www.rics.org/drs

D1 Court proceedings/ litigation

The court process is usually the most reliable and thorough way to resolve a dispute, but unfortunately it can also be slow and expensive and is public. Over the past decade, the English courts have taken steps to address this, first, by requiring more active 'case management' by the courts, and secondly, by implementing the Pre-Action Protocols.

There is a specific Pre-Action Protocol for professional negligence claims, which includes claims against valuers. The purpose of the Protocol is to require the parties to exchange correspondence and documents, and investigate the dispute fully and to consider ADR before commencing court proceedings.

A claimant is supposed to start proceedings only if the Protocol has been complied with and it has not brought the matter to an end.

It is important to understand the costs consequences of court proceedings. The basic rule is that the loser pays the other side's costs as well as their own costs (although in fact the other side's costs are generally reduced by approximately 10 – 40 per cent depending on the nature of the costs order made, or even more in Scotland).

The courts are taking an ever more proactive role in managing legal costs. Since April 2013, parties to most types of UK litigation have been obliged to prepare detailed costs summaries, which must either be agreed or approved by the court, and which then set the maximum limit of recoverable costs. Litigants therefore need to manage their legal costs carefully, or risk facing a substantial exposure to costs even if they win the case. It should also be noted that the basic 'loser pays' rule can be displaced – or watered down – if the court is informed at the costs stage that the winning party refused unreasonably to participate in a mediation at an earlier stage.

D2 Arbitration

Arbitration can be similar to litigation, but the parties appoint their own judge (arbitrator) when the dispute arises. The most important difference from court proceedings is that the arbitration process is private; the judgment (called the award in an arbitration) is confidential to the parties. It can be quicker and less expensive than court proceedings, but that is not always the case. As in court proceedings, the arbitrator will make a decision about the costs of the process after deciding the substantive dispute, and just as in court proceedings, the default position is that the loser pays both parties' costs. An arbitration award can sometimes be appealed to the courts, but only in limited circumstances.

D3 Expert determination

Expert determination is similar to arbitration, but it is less formal. Arbitration is an 'adversarial' process, like litigation, where each party presents its case and the judge/arbitrator makes a decision. By contrast, expert determination is essentially an 'inquisitorial' process, whereby the expert conducts inquiries with the parties' assistance before making a decision, but the process can include elements of the adversarial process. Expert determination is usually less expensive and quicker than court proceedings, but because the process for expert determination and arbitration is more flexible, it is not possible to say which will be quicker and less expensive in any given case as between expert determination and arbitration. The process is best suited to resolving disputes over specific technical issues. It is often used in valuation disputes, but it must be understood that it can also be less thorough than court proceedings or arbitration. The expert is usually not bound to apply legal principles, and the decision can only be challenged in extremely limited circumstances.

D4 Mediation

Mediation is a negotiation, facilitated by a mediator. The mediator does not have to be a lawyer, and in many valuation disputes, it is a chartered surveyor.

Mediation will only resolve the dispute if both parties agree to the outcome. The mediator does not make a decision, or even (unless specifically asked to by both parties) express a view on the merits of the dispute. Because it is consensual, it works best against the backdrop or pressure of one of the more formal processes outlined above. Often, contractual parties, including valuers and their clients, agree at the outset of an engagement that, if a dispute arises, they will at least try mediation before resorting to more formal processes.

D5 Ombudsman

The Financial Services Ombudsman has jurisdiction to hear complaints and to award financial redress of up to £150,000 if a firm is carrying on regulated activities, or is providing ancillary services, including providing valuation advice, in connection with regulated activities. The Ombudsman may become involved if a valuer's services are provided as part of a mortgage application.

In addition to the Financial Services Ombudsman, there are currently two government-approved providers of Ombudsman services for property services businesses:

- Ombudsman Service: Property (OS:P) and
- The Property Ombudsman (TPO).

Both of these providers offer consumer redress for firms involved in the property sector, including estate agents and valuers, without charging the consumer for the use of the service.

Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 125,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our professionals are involved the same standards and ethics apply.

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United Kingdom RICS HQ
Parliament Square, London
SW1P 3AD United Kingdom

contactrics@rics.org

Media enquiries
pressoffice@rics.org

Ireland
38 Merrion Square, Dublin 2,
Ireland

t +353 1 644 5500
f +353 1 661 1797
ricsireland@rics.org

Europe
(excluding UK and Ireland)

Rue Ducale 67,
1000 Brussels,
Belgium

t +32 2 733 10 19
f +32 2 742 97 48
ricseurope@rics.org

Middle East
Office B303,
The Design House,
Sufouh Gardens,
Dubai, UAE
PO Box 502986

t +971 4 446 2808
ricsmiddleeast@rics.org

Africa
PO Box 3400,
Witkoppen 2068,
South Africa

t +27 11 467 2857
f +27 86 514 0655
ricsafrica@rics.org

Americas
One Grand Central Place,
60 East 42nd Street, Suite #542,
New York 10165 – 2811, USA

t +1 212 847 7400
f +1 212 847 7401
ricsamericas@rics.org

Latin America
Rua Maranhão, 584 – cj 104,
São Paulo – SP, Brasil

t +55 11 2925 0068
ricsamericalatina@rics.org

Oceania
Suite 1, Level 9,
1 Castlereagh Street,
Sydney NSW 2000. Australia

t +61 2 9216 2333
f +61 2 9232 5591
oceania@rics.org

Greater China (Hong Kong)
3707 Hopewell Centre,
183 Queen's Road East
Wanchai, Hong Kong

t +852 2537 7117
f +852 2537 2756
ricseastasia@rics.org

Greater China (Shanghai)
Room 4707-4708, 47/F
Plaza 66, Tower 1, No. 1266,
Nanjing Road West, Jing'an District,
Shanghai, 200041, China

t +86 21 5243 3090
f +86 21 5243 3091
ricschina@rics.org

Japan
Level 14 Hibiya Central Building,
1-2-9 Nishi Shimbashi Minato-Ku,
Tokyo 105-0003, Japan

t +81 3 5532 8813
f +81 3 5532 8814
ricsjapan@rics.org

ASEAN
#27-16, International Plaza,
10 Anson Road,
Singapore 079903

t +65 6812 8188
f +65 6221 9269
ricsasean@rics.org

South Asia
GF-17, Ground Floor, Block B,
Vatika Atrium, Sector 53 Gurgaon,
Haryana 122002, India

t +91 124 459 5400
f +91 124 459 5402
ricsindia@rics.org

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