Editorial

Journal of Building Appraisal (2007) 2, 267–269. doi:10.1057/palgrave.jba.2950058

The appraisal of a building will often involve some assessment of the value of the building. That approach will involve the collection of data about condition, comparable sales and tenure. In a market where prices are rising and transactions are taking place in millions of pounds, minor errors in any of these data can make large differences in the ultimate value. With market yields less than 5 per cent any mistake is multiplied by 20. This is the market where fraud is now being unearthed.

In the first-half of 2006, over 123 fraud cases worth an estimated £650m were pursued through the UK courts. Against this background, one of the biggest ongoing fraud investigations of the year is being undertaken into the alleged overvaluation of commercial and residential property. This was triggered by the discovery of a potential £10m fraud at Cheshire Building Society, involving lending on commercial properties with falsely inflated valuations. Other lenders who are alleging that they have been caught by suspected copycat frauds include the Nationwide, Halifax and Bank of Scotland and Société Générale. A recent survey of the construction industry finds that fraud is on the increase. So far, 26 properties in London, Birmingham, Manchester, Leicestershire and Hertfordshire have been raided by the Serious Fraud Office (SFO) in pursuit of its investigation that is believed to relate to fraud approaching £100m.

In 1990, I conducted an investigation into mortgage fraud that came to light as a result of the property crash in 1988. The sudden drop in the value of property, especially residential property, brought to light some very shady activity. The traditional signs of mortgage fraud following the property crash included sub-sales. The scam operated at the upper end of the market where a purchaser would negotiate a sale with the vendor, a second party would raise the funding on the basis of a higher priced transaction and the contract for the first sale was turned the same day for the second. Out of the mortgage loan, the miscreants then paid for the purchase and pocketed the surplus. Usually they made no mortgage payments and all was not discovered until the building society foreclosed. To enable this action, they needed a valuation that would support the higher price. This was usually achieved by conning the valuer when he came to carry out the valuation. The valuer would know the price being paid. He would be plied with comparables by the purchaser who ‘just happened’ to be at the property when he/she called. With the evidence of sales to support the transaction, the knowledge that the price was being paid, many valuers innocently overvalued. There may have been a need for the conveyancing to be dealt with by a legal team who did not ask too many questions.

Unfortunately, not all valuers were innocent. It was common to find that some engaged in the work of mortgage valuation had entered into the market on their own account. With prices rising steeply everyone becomes a speculator, with the chance of making large amounts of money by just holding property for a year or so. Inventing false names, they valued their own purchases to enable them to put together their portfolio, based on borrowed funds. When the crash came, the properties were not worth what had been paid. Sometimes, overvaluation had taken place to enable the valuer to fund through the borrowing, the improvements to raise the value of the building. If the market held, these actions would go undiscovered.

In 1998, the Council of Mortgage Lenders issued a paper summarising the ways that were being discovered. Although not a comprehensive list of ways to perpetrate fraud or criminal deception in the mortgage area, it listed the following:

- (a) The mortgage applicant himself giving a false income to increase the size of the mortgage to enable him to buy a property that he could not otherwise afford.
- (b) Stating that the property will be used for owner-occupation when the applicant's real intention was to let it.
- (c) Falsification of personal details relating to income by introducers on behalf of their clients to obtain mortgages that they would not otherwise be granted.
- (d) False valuation of properties by valuers to obtain a higher mortgage than is necessary to purchase the property, or where there is collusion between the valuer and the purchaser to defraud the owner.
- (e) Fraud by professionals can involve introducers, solicitors, licensed conveyancers, valuers and accountants, either individually or in collusion. Mortgages may be obtained for applicants who do not exist, or on properties that do not exist. Alternatively, a number of mortgages may be obtained from different lenders on the same property at the same time.
- (f) Staff fraud. A member of staff processes the fraudulent mortgage application(s) with full knowledge and participation in the deception.

But that was then. Things have changed. Money laundering regulations make using a false identity much more difficult. That may be the reason why the focus has shifted towards valuations being overstated. This is achieved by a variety of routes, sometimes by the naive being coerced to assist, or on other occasions by the valuer may be party to the fraud from the beginning.

The popularity of buy-to-let mortgages has been responsible for the substantial increase in the amount of mortgage lending in recent years. The slow down in the property market and the increase in the number of reposessions has resulted in the discovery of an increasing number of cases where properties have been deliberately overvalued in order to circumvent the more restrictive lending criteria of buy-to-let mortgages, leaving lenders at risk of suffering losses when the borrowers default.

While the level of earnings entered on a mortgage application is often overstated, and the mortgages on buy-to-lets frequently overstate the borrower's position (where that is declared), the transparency of residential property prices should make fraud more difficult. The delay of three months in releasing price information and a move to selling off plan, however, circumvent this protection.

Large developments often place large number of flats on the market during the development stage, resulting in a rush of people wanting to put down a deposit. The valuer is then advised that these units are being bought at a price, and the queue is round the block, so surely this has to be the market price — as it is paid by a willing buyer in the open market. Unfortunately, this may not be the case. Some developers may have salted the mine by setting up some 'in-house sales'. On other occasions, the developer has reached agreement with groups of investors to offer a discount for bulk purchases, the discount being returned in cash after completion — and therefore, the price of the sale that is disclosed is higher than was paid.

The presence of sales at a given level makes it difficult for the valuer to go against this evidence. The Royal Institute of Chartered Surveyors (RICS), however, has now changed the Red Book. The original guidance was that undue reliance should not be placed on the

price being paid (GN 3.10 — 1998 edition). The 2006 changes follow complaints from the Council of Mortgage Lenders that its members could not rely on the valuations given by RICS members on new-build buy-to-let properties. In December 2005, the Portman Building Society announced that it was stopping all lending on such properties because valuation in the sector was ‘more of an art than a science’. Lenders complained that valuers were rubber-stamping developers’ ticket prices for new flats at far higher levels than the market could sustain, and demanded far more rigorous guidelines for the profession (Estates Gazette 03/06/2006). The working party set up to review the changes advised the profession that it is important that valuers look in the vicinity for comparables, and take note of the prices achieved in the second-hand market to ensure the gap between new and old is as it should be (Andrew Gooding, RICS valuation faculty director).

The commercial details of commercial property transactions are not as accessible as those within the residential sector. Once an overstated valuation has been produced, money can be borrowed against the value of the asset. A run-down commercial property without a tenant may be valued on the basis of a new lease at a substantial rent. Only when the mortgagor forecloses does the fraud come to light, by which time money and participants may be long gone. A current allegation relates to a property that was valued at between £10.5 and £16m, but when it was reassessed it was valued at close to £2m (Property Week, 26th March, 2006). The frauds — according to details in the Estates Gazette (April 2006) — have been perpetrated by providing lenders with false valuations of properties against which they provide finance. The valuations were inflated by either exaggerating the number of properties or by the use of false leases. These leases, which the purchaser creates, have the effect of falsely bumping up the annual rent available from the properties that in turn inflates their value. So, for example, if the actual rent from a property is £100,000 and a valuer uses a 5 per cent yield, then they can say the property is worth £2m. But if false leases are used to inflate the annual rent to say £500,000, the false value becomes £10m. (Mail on Sunday, 9th April, 2006). The SFO’s latest searches indicate that its investigation could widen to include valuation teams in a number of west end and city firms. One source said the fraud could reach £100m and may involve more than a dozen properties (Estates Gazette 21/07/2006).

Perhaps the 2006 list of fraud may be summarised as follows:

- (a) Salting the mine — creating leases at inflated rents to support overstated commercial valuations.
- (b) Hype — a campaign to persuade buyers to buy off plan at inflated prices. Buildings of iconic status attract overpriced bids on buy-to-let basis, that are not achieved in actual sales.
- (c) Criminal action — presentation of false details to the valuer to obtain a higher valuation of a property.
- (d) Little bit on the side — valuers enter into market on their own account and overvalue to get inflated loans.

If we do not have a secure evaluation of the worth of property, the market is vulnerable. Real Estate Investment Trusts (REITs) rely on a reliable assessment of the property that is the core of the investment. Without reliable valuation, there can be no reliable market for property transaction.

Malcolm Hollis
Managing Editor