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EXPERT WITNESS

Using Experts in Commercial Property Lending Disputes

The property crash of the early 1990s led to a wave of litigation between banks, borrowers, valuers and other professional advisers. Despite the severity of the 2008 financial crisis, commercial property lending litigation has been at much lower levels, in part because low levels of interest rates have enabled lenders and borrowers to defer some of the problems facing them.

This briefing paper provides background on a number of issues which we believe lawyers and their clients will find helpful if they are making or defending claims in this field.

Background

The apparently benign economic conditions in the late 1990s and early 2000s saw again significant credit growth and increasing appetite for risk-taking against a background of excessive confidence and optimism. In addition to the global crisis, some lenders had relaxed mortgage criteria dramatically against a background of rising UK house prices: loans of up to 125% of house values, up to six times income and self-certified loans were available.

After huge growth in US sub-prime mortgages, the US housing bubble burst. The consequences were fuelled by the recent innovations of packaging, securitising and re-selling loans, many related to housing assets. In contrast to previous crises, buyers included international investors seeking higher yields from complex, highly-rated investments who did not appreciate the risks they were assuming. Accordingly, the current crisis has been global and more severe than the earlier crises, with huge losses on toxic assets and bad loans incurred by US, European and British banks and an international liquidity crisis.

Similarities to litigation in the 1990s

A number of elements in current problem lending are remarkably familiar to lenders who lived through the recession of the early 1990s and the wave of litigation which ensued. They include:

- over-optimistic, and in some cases fraudulent, valuations;
- excessive loan to value ratios;
- poor control over disbursements for development lending; and
- defective legal work on Reports on Title and loan security documentation.

All the above provide the raw material for litigation which is, in many cases, virtually a carbon copy of that pursued in the first half of the 1990s.

In addition, many banks sold (or mis-sold) interest rate protection products in the form of interest swaps, collars and other derivatives and these are exacerbating problems for many borrowers. (See our separate Briefing on “Interest Rate Swap Disputes”.)

One major difference is that the present unprecedentedly low levels of interest rates have enabled banks to sit on their non-performing property lending at minimal cost - by comparison, Base Rate stood at 15% between October 1989 and October 1990 and did not fall below 10% until September 1992.

However, there is little prospect that property prices will increase far or fast enough to return defaulting property loans to performing status and we therefore expect to see increasing levels of litigation in this sector as problems are crystallised.

Lessons to be learned?

The victims of the 1970s and 1990s crises were smaller banks, many of which had expanded rapidly, were too dependent on the health of the property markets and were too reliant upon wholesale funding. The current crisis differs, as the scale of problem lending and the risk and complexity of traded assets have caused illiquidity on an international scale and most major banks have been affected.

Common features of all three crises are that in good times there was rapid expansion; too great a concentration on property assets; relaxed, often inadequate, underwriting standards; and insufficient regard to the consequences of changes in circumstances. In each case, this has been followed by falling property values, significant bad debts and a liquidity crisis.

A contributory factor has certainly been that the gap between crises has been some 15 years - long enough for the lessons of the previous crisis to have been forgotten by a new generation of bank management.

For further information

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