Hot Legal Issues for Northwest Appraisers

August 18, 2017
Issaquah, WA
ACOW

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Where Are We Going This Morning?

• Overview of appraiser professional liability claims:
  • Basic liability prevention suggestions
  • Understand key elements of negligence claims against appraisers from a very recent WA case
  • Cover some hot issues and dispel a few myths

• Reminder: liability for appraisers in general is not out of control
Five Quick Liability Prevention Tips

1. “Appraise” clients, parties and assignments for unreasonable risk – follow your gut instinct.
2. Focus on precise, narrow descriptions of intended use and intended user – can a party who you really don’t intend to rely on your report (like a borrower) twist your language?
3. Proofread your reports.
4. Get square footage right.
5. Disclose special conditions in clear plain English.
Very Recent Commercial Appraiser Liability Case: RockRock Group v. Value Logic, WA Court of Appeals Opinion Published July 7, 2016

- In mid-2006, a real estate developer had two adjacent properties near Spokane under contract for $475,000 and $300,000.
- One property was 51 acres; the other was 39 acres.
- Both were zoned partially “light industrial” and partially “rural traditional” (a classification permitting minimal use).
- The developer was seeking to flip the properties to other investors.
- LLCs were formed through which the purchases would be made with financing from RiverBank.
- RiverBank engaged Value Logic to appraise the properties – the fees paid were $3,000 and $2,000.
- The appraisals, delivered in October 2006, valued the properties at $4,500,000 and $4,250,000.
The reports contained the following limitations:

This report is prepared for the sole use and benefit of the client. Neither this report, nor any of the information contained herein shall be used or relied upon for any purpose by any person or entity other than the client. The appraiser is not responsible for the unauthorized use of this report.

The liability of [Value Logic] is limited to the client only and only up to the amount of the fee actually received for the assignment. Further, there is no accountability, obligation, or liability to any third party. If this report is placed in the hands of anyone other than the client, the client shall make such party aware of all limiting conditions and assumptions of the assignment and related discussions.
RockRock Group v. Value Logic, WA Court of Appeal
Opinion Published July 7, 2016

- The reports contained the following limitations:

> Without prior written approval from the author, the use of this report is limited to internal decision making and financing. All other uses are expressly prohibited. Reliance on this report by anyone other than the client, [or] for a purpose not set forth above, is prohibited. The author’s responsibility is limited to the client.
The developer received copies of the appraisals and showed them to a few prospective investors or told investors what the appraised values were during investor meetings.

Some of the investors received copies from a closing agent.

The developer’s pitch was that the investor LLCs would be able to flip their interests quickly – the investors purportedly did not know that the developer had the properties under contract for far less than they were paying.

Statements were made by the developer to investors such as: “with the appraisals I got . . . an idiot could get into these properties and make a quarter million dollars.”
The investor LLCs – one named RockRock Group and the other RussellRock Group – purchased 75% interests in the properties.

RockRock paid $1.8m for its interest in the 53-acre property; RussellRock paid $1.63m for its interest in the smaller property.

RiverBank financed the purchases based on the appraisals and with personal guarantees from the investors in each LLC.

After acquiring their interests, RockRock and RussellRock were not successful in re-flipping the properties themselves. The market tanked almost immediately after the purchases were complete.

In 2009, payments came due on the loans, defaults occurred, and the investors were called on their guarantees.
In 2009, a review appraiser for the bank found the original appraiser had overvalued the properties by applying a value per square to the entire properties based on “light commercial” zoning.

Another appraiser valued the properties at $1,220,000 and $520,000.

In 2011, RockRock and RussellRock sued Value Logic and its two appraisers.

The gravamen of the complaint was that Value Logic negligently overvalued the properties in 2006 and that the LLCs would not have completed the purchases but for the overstated values.

The primary theory was negligent misrepresentation.

The damages demanded by the plaintiffs exceeded $5,000,000.
A primary key to any claim for professional negligence or negligent misrepresentation is the concept of duty – the plaintiff must establish that the appraiser owed the plaintiff a “legal duty.”

For the client who hired the appraiser, establishing duty is easy.

Whether an appraiser may be found to have owed a duty to non-clients become fuzzier and, in most states, subject to a test described in what is called the Restatement Second of Torts, § 552.

This is how the WA Court of Appeals applied the test – the duty element:

requires the LLCs to establish they were a limited group of persons for whose benefit and guidance Value Logic intended to supply the appraisal report or knew RiverBank intended to supply the appraisal report.
Value Logic moved for summary judgment, which was granted by the trial court on the basis that Value Logic did not owe the investor LLCs (or individual investors in the LLCs) a legal duty. The WA Court of Appeals affirmed the judgment.

Why? All that good language in the appraisal reports (not contradicted by anything in the engagement agreements or by other evidence).

as evidenced by the reports, Value Logic did not intend for anyone other than RiverBank to be guided by the reports—the reports define RiverBank as the client, state they were prepared for RiverBank’s sole use and benefit, prohibit any person other than RiverBank from using or relying on them, and state the appraisals were confidential between Value Logic and RiverBank.
But I’m a Residential Appraiser, “What Can I Do?”

Include a specific advisory in form reports directed to purchasers/borrowers and sellers. Example:

“The appraiser has not identified any purchaser, borrower or seller as an intended user of this appraisal and no such party should use or rely on this appraisal for any purpose. Such parties are advised to obtain an appraisal from an appraiser of their own choosing if they require an appraisal for their own use. This appraisal report should not serve as the basis for any property purchase decision or any appraisal contingency in a purchase agreement relating to the property.”
“Wait . . . What About the Statute of Limitations? That appraisal was more than 5 years old.”

Statutes of limitation for claims against appraisers:

- Have no relationship to USPAP’s 5-year recordkeeping requirement
- May be subject to the “discovery rule”
- Are extended for the FDIC and some others
- Vary by the type of claim
- Vary by state

So how long is it here in WA? 3 years but WA applies a “discovery rule.”
What To Do if It Happens to You?

- Don’t ignore it
- Get legal assistance
- Handle the lawsuit appropriately if you are served
Get Legal Advice – Not Internet Advice

Anyone have experience with that Llano company trying to come after you for an old appraisal completed? I have a buddy who is no longer in the business getting letters from them on something he completed as an associate in late 2007.

Just tell him to tell them he burned the files a few years back and have no idea what they are talking about? If they want a new appraisal, maybe he can recommend you but do you really want to hear from these guys years from now on an old report?

after. Like I said tho, he was just a trainee, so I can't see how much of anything could fall on him legally, even if within discovery.

It would be on the supervisor that signed the report
October 28, 2015

James V. Noonan
Damon G. Newman
Noonan & Lieberman, Ltd
105 W. Adams, Suite 1800
Chicago, IL 60603

RE: [Redacted] All American Appraisals Civil Action No. 15 CV 332

To Whom It May Concern:

I sold All American Appraisals in October or November of 2007 to Mr. [Redacted] for $20,000.00. To my knowledge, he then filed as owner with the State of Indiana. He lived also in Crown Point, In.

My husband and I moved to Florida in November of 2007 and retired. I have never owned or operated any business while living in Florida.

I am 76 years old. I am retired. My husband passed away January 2013 and I have since remarried and am now [Redacted]. The only money I have is my retirement. I cannot afford to hire an attorney. My present husband is 79 years old and travel is not an option.

The appraisals were made at the peak of property market values in their locations in 2006. I provided 6 comparable sales for each of the two appraisals to establish their market value at that time. Surely, I cannot be held responsible for the economic crash and decline in property values in late 2007.

Sincerely,

[Signature]
Common Reasons Why Appraisers Don’t Have Coverage for Claim Under Their E&O

• No current policy or no “tail” coverage.

• The “prior acts” or “retroactive” date on the appraiser’s E&O policy does not cover the time when the appraisal was performed.

REAL ESTATE APPRAISERS ERRORS & OMISSIONS INSURANCE POLICY
DECLARATIONS PAGE

This is a claims made and reported policy. Please read this policy and all endorsements and attachments carefully.

Policy Number: NJA313536

1. NAMED INSURED: 
   STREET ADDRESS: 
   Gainesville, VA 20155

2. POLICY PERIOD: Inception Date: 12/18/2014
   Expiration Date: 12/18/2015
   Effective 12:01 a.m. Standard Time at the address of the Named Insured.

3. LIMITS OF LIABILITY:
   Each Claim: $1,000,000
   Aggregate: $1,000,000
   Claim Expenses have a separate Limit of Liability:
   Each Claim: $1,000,000
   Aggregate: $1,000,000

4. DEDUCTIBLE: Each Claim: $0 Aggregate: $0

5. RETROACTIVE DATE: 12/18/2012
   If a date is indicated, this policy will not provide coverage for any Claim arising out of any act, error, omission or personal injury which occurred before such date.
Common Reasons Why Appraisers Don’t Have Coverage for Claim Under Their E&O

- The appraiser is sued for an appraisal he or she signed as a supervisor, or
- The appraiser is sued for an appraisal by an employee or subcontractor,
- And, the appraiser has an “individual only” policy:

**Appraisal Services** does not include the supervision of, subcontracting to, assignment to or referral of any portion of any contract, project or engagement by the **Named Insured**.

**X. Professional Services** rendered by any person or entity other than the **Named Insured**;

**Y. Professional Services** rendered by the **Named Insured** if such claim was based on or arising out of such **Named Insured’s** supervision, subcontracting, assignment or referral of any portion of any contract, project or engagement.
Hot Topic: Trainees

- In 2005-07, 25% of claims involved trainee-related appraisals.
- AQB and regulatory changes addressed key big issue of supervisors with many trainees.
- Supervisor and trainee each have full potential liability.
- Lawsuit almost always names supervisor, usually also names trainee.
- Three key items:
  - Don’t cut corners using trainees (signatures, inspections).
  - Have the right insurance coverage – don’t rely on trainee having their own E&O.
  - Work files are key to supervisors ability to defend.
Hot Topic: Trainees

- For liability prevention, supervisor appraisers should require trainees to maintain the following items for each assignment and either maintain custody of the file or a full copy of work file themselves:
  - Clear notes taken during inspection that address special issues or problems with the subject property, including property condition and any information supplied by the owner.
  - Notes of conversations with agents, brokers, and clients.
  - Data for comparable sales used in the report, with notes detailing the reasons for their inclusion.
  - Data for comparable sales not used in the report, with notes detailing the reasons for their exclusion.
  - All photographs of the property — not just those included in the report.
Telltales of a Claim

- Telephone call
- Subpoena for deposition testimony or documents (appraisal, work file)
- Administrative/licensing complaint
- Demand letter
- Served with a lawsuit
Hot Topic: Square Footage Claims

• Number #1 claim issue after pure value claim
  • Get the measurement right
  • Double check your calculations and sketches
  • Proof for typos
  • Don’t trust borrowers, sellers, MLS, public records
  • Use plain English for special situations:
    Example language: Appraiser notes that public building records, tax records and information supplied by the owner differ with respect to the square footage of the building structure. Floor plan is unique and difficult to measure. Appraiser’s measurement is approximate.
Don’t Trust Borrowers, Sellers or MLS
“Hot” Topic: Septic Tanks

• Number #2 non-value claim issue
• Claim usually made by property purchaser – property on failing septic tank but appraiser reported property was served by sewer
• Appraiser’s error in report commonly caused by:
  • Using template report that always states sewer
  • Blindly relying on MLS
  • Actual error in the field
• When there is doubt or special issue, use plain English to disclose the situation.
“Hot” Topic: Septic Tanks

- Example plain English disclosure:

Appraiser is unable to verify whether property is serviced by sewer or septic due to inconsistent information provided in public records/data sources and the property owner. Owner advises he thinks property is connected to public sewer; however, connection cannot be confirmed in available public records. Further inspection is recommended if the issue is material to the client’s decision making.
What About This?
Marijuana Issue: “The appraiser observed approximately 60 plants believed to be marijuana growing in basement under lighting strung from bare wires suspended from ceiling. See photo.”
Date: 10/20/2009

To whom this may concern:

My name is Patricia [redacted], and I purchased a home through [redacted] Mortgage in the year 2000. [redacted] was the person who appraised the property. This was a FHA loan 291-275 [redacted] (mortgage insurance case number). This home was said, to have had a complete new roof, "Routine roof maintenance over ownership and complete replacement in 1999."

Last fall, I noticed I had some water damage on the outside and inside of my home. I contacted a contractor for an estimate and to evaluate the problem. I have sent 3 pictures, you can see there is mold growth in the ceiling.

If I do not hear from you within 30 days, I will file a complaint with FHA and if necessary I seek legal action.

yours truly,

[redacted]

Patricia [redacted]

[redacted] MO [redacted]

816- [redacted]
Special Attention of:  
All FHA Approved Mortgagees  
All Direct Endorsement Underwriters  
All FHA Roster Appraisers  
All FHA Approved 203(k) Consultants  
All HUD Approved Housing Counselors  
All HUD Approved Nonprofit Organizations  
All Governmental Entity Participants

Transmittal: Handbook 4000.1  
Issued: August 26, 2015  
Effective Date: Varied

1. This Transmits:


- Doing Business with FHA - Other Participants - 203(k) Consultant, DE Underwriter, and Nonprofit and Governmental Entity
- Quality Control, Oversight and Compliance - Other Participants - 203(k) Consultant, DE Underwriter, and Nonprofit and Governmental Entity
- HUD REO purchasing requirements as established in Mortgagee Letter 2015-17
FHA Assignments Do Not Overall Cause More Liability Risk – Just Different

• Lender claims overall are lower compared to non-FHA lending assignments: FHA insurance, greater scrutiny, better appraisal practices, lower loan limits – are all factors that decrease claims. The negative factors are higher LTV and lower borrower credit ability.

• Borrower claims are where we do see increased claims, as compared to “regular” assignments. Thus, let’s focus liability prevention there.
FHA Liability Prevention: Use and Build on the FHA’s Guidance about Intended Use and Intended Users

b. Intended Use and Intended Users of Appraisal

The intended use of the appraisal is solely to assist FHA in assessing the risk of the Property securing the FHA-insured Mortgage (24 CFR § 200.145(b)).

FHA and the Mortgagee are the intended users of the appraisal report.

The FHA Appraiser does not guarantee that the Property is free from defects. The appraisal establishes the value of the Property for mortgage insurance purposes only.
And, the FHA’s Advisory to Borrowers

For Your Protection:
Get a Home Inspection

Why a Buyer Needs a Home Inspection

A home inspection gives the buyer more detailed information about the overall condition of the home prior to purchase. In a home inspection, a qualified inspector takes an in-depth, unbiased look at your potential new home to:

- Evaluate the physical condition: structure, construction, and mechanical systems;
- Identify items that need to be repaired or replaced; and
- Estimate the remaining useful life of the major systems, equipment, structure, and finishes.

You Must Ask for a Home Inspection

A home inspection will only occur if you arrange for one. FHA does not perform a home inspection.

Decide early. You may be able to make your contract contingent on the results of the inspection.

Appraisals are Different from Home Inspections

An appraisal is different from a home inspection and does not replace a home inspection. Appraisals estimate the value of the property for lenders. An appraisal is required to ensure the property is marketable. Home inspections evaluate the condition of the home for buyers.

FHA Does Not Guarantee the Value or Condition of your Potential New Home

If you find problems with your new home after closing, FHA cannot give or lend you money for repairs, and FHA cannot buy the home back from you. Ask a qualified home inspector to inspect your potential new home and give you the information you need to make a wise decision.
#1 Point for FHA Liability Prevention: Use and Build on Guidance about Intended Use/User

In your report, be sure to use the express wording given to appraisers in the FHA handbook regarding intended use and user:

"The intended use of the appraisal is solely to assist FHA in assessing the risk of the Property securing the FHA-insured Mortgage (24 CFR § 200.145(b)). FHA and the Mortgagee are the intended users of the appraisal report. The FHA Appraiser does not guarantee that the Property is free from defects. The appraisal establishes the value of the Property for mortgage insurance purposes only."

Liability Insurance Administrators
#1 Point for FHA Liability Prevention:
Use and Build on Guidance about Intended Use/User

Include additional language further restating and clarifying these issues – my suggestion:

“Notwithstanding the pre-printed language on the fill-in form used to report this appraisal: (1) Pursuant to the requirements of HUD Handbook 4000.1, the intended use of this appraisal is solely to assist FHA in assessing the risk of the Property securing the FHA-insured mortgage; (2) FHA and the identified Lender/Client (the mortgagee) are the only intended users of the appraisal, and no borrower is intended to, or should, use or rely on the appraisal; (3) the appraisal establishes the value of the subject property for FHA’s and the Lender/Client’s mortgage underwriting only, (4) the appraisal is not a home inspection and does not replace the services of a home inspector, and (5) the appraiser does not guarantee that the subject property is free of defects.”
Myth: “Only Appraisers who work for lenders get sued.”
So, Who Sues Appraisers Engaged as “Experts” or Who Perform Other Non-Lending Work?

- **Client(s) of the Appraiser. Examples:**
  - Taxpayer who hired appraiser to provide value for return
  - Divorcing spouse who hired appraiser
  - Party to condemnation suit who hired appraiser as expert
  - Parties who jointly engaged appraiser to determine purchase price or a rental rate for a lease renewal

- **Opposing Parties. Examples:**
  - Divorcing spouse on the other side of the case
  - Opposing party who lost in litigation

- **Other Appraisers**
  - Defamation, malicious prosecution, etc.
What Are Your Getting Into? Divorce Appraisal Assignment Leads to RICO Lawsuit Against Appraiser

United States District Court
Middle District of Florida
Tampa Division
April 21, 2013

Robert C Courboin  Plaintiff

v

Candace Scott, Denise Wennogle, Scott and Daly, LLC,
Candace Scott, LLC, James Jensen,
Lauffer, Dalena, Cadicina, Jensen and Boyd, LLC,
Kalman A Barson, Barson Group,
Divorce Appraisal Assignment Leads to RICO Lawsuit Against Appraiser

4. (Attached – e) Invoice and appraisal from New Jersey Appraisals for $350 to also appraise marital residence at exact same time, 8-5-2009. Note that the forms (software) used: Fannie Mae Form 1004 March 2005. These are the only legal loan forms allowed since 2006. My cost. Negotiated----$350, for a modern, legal done by an appraiser who advertises and has a phone number on the appraisal. Note color pictures, modern mapping, etc.


My demands are simple,

1. I want the stolen $200,000 returned, three fold.
2. I want the entire Civil Law component of NJ Law looked at for anti-trust acts and criminal proceeding brought against any instances found which resemble my charges.
3. I want to be paid for my time fighting these thieves.
4. I demand damages under the Sherman Act, which doesn’t limit me to “treble damages”.
5. I would like the Court to find or appoint a local expert to examine the books of the named firms so that total independence could be assured. Named firms would be required to forward requested documents to Florida, instead of availability to a NJ accountant.
Case Example #1 – OR Tax Court, 2011
Wrong Form, Wrong Date

“Plaintiff did submit an appraisal report. However, the report indicates that the valuation date for the $500,000 value estimate is October 26, 2011, which is almost 22 months after the applicable assessment date. . . More importantly, there is no explanation for the appraiser's adjustments, and there is no statement as to the purpose for the appraisal or the scope of work other than standard boilerplate language indicating "[t]he scope of work is defined by the complexity of this appraisal assignment and the reporting requirements of this appraisal report form," and that the intended use "is for the lender/client to evaluate the property for a mortgage finance transaction."

Defendant's representative . . . noted that the appraisal form was a standard Fannie Mae document and asserted that the report appears to violate applicable USPAP requirements.”
8 Basic Liability Prevention Tips

1. “Appraise” clients, parties and assignments for unreasonable risk – follow your survival instinct.
2. Focus on precise, narrow descriptions of intended use and intended user – can a party who you really don’t intend to rely on your report (like a borrower) twist your language?
3. Include a more detailed scope of work statement – stating what was not done.
4. Proofread your reports – even better, have another person proof them.
5. Get square footage right.
6. Disclose special conditions in clear plain English – don’t rely on canned phrases to explain unique issues.
7. When you use your own engagement agreements, be sure to get them signed.
8. Keep good workfiles – for several years longer than required by USPAP.