Eight (or So) Appraiser Liability Parables

ACOW

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Purpose of Seminar

- Share eight different appraiser liability stories.
- Learn the lessons from each to help you avoid being the main character (*i.e.*, defendant) in another story.
- Assure you that despite these parables being both mostly true and scary, the liability risk for appraisers who take appropriate precautions is manageable.

Story #1: The Review Appraiser Gets Sued by the Appraiser Whose Work He Criticized

- Review appraiser retained by lender prepares review that is highly critical of another appraiser's work and also opines to a significantly lower value.
- Lender drops the appraiser from panel, costing the appraiser tens of thousands of dollars in lost work. Other lenders learn of the "blacklisting" and more work is lost.
- Reviewer on his own reports the appraiser to the state for USPAP violations and submits the review. However, the state finds no errors and actually disciplines the reviewer for a poorly supported review.
- In sum, the reviewer's review was negligent.
- Can the damaged appraiser who lost tens of thousands in income because of the negligent review sue the reviewer for damages? For negligence? For defamation?

Appraiser Liability Claims
What Are We Generally Talking About?

Elements of a professional negligence legal claim?

(1) a duty on the part of the defendant to conform his conduct to a standard of care arising from his relationship with the plaintiff,

(2) a failure of the defendant to conform his conduct to the requisite standard of care required by the relationship, and

(3) an injury to the plaintiff proximately caused by the breach.

Other legal claims commonly made against appraisers:

- Negligent Misrepresentation
- Fraud/conspiracy
- Libel/defamation
- Breach of contract

So Who Can Sue an Appraiser for Negligence? To Whom Does an Appraiser Owe a Legal Duty?

In most states, a professional may be liable to third parties for negligent misrepresentation despite the absence of “privity” . . . If the professional knew or reasonably expected that the third party would use or rely on the information being supplied.

Who Sues Appraisers over Lending Work?

- Borrowers/purchasers (>60%)
- Lenders (small v. big, bank v. alternative lenders)
- FDIC
- Sellers
- Other parties
  - Real estate agents and brokers
  - Random third parties
- Very few AMCs (so far)

So Who Can Sue an Appraiser for Negligence? To Whom Does an Appraiser Owe a Legal Duty?

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Story No. 2: The Washington Appraisers Who Used Good Intended User and Intended Use Language in their Reports

- 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**.

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- **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.

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- The developer received copies of the appraisals and showed them to prospective investors.
- Some of the investors received copies.
- 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.*"

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- 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.

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- 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, LLC 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.

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- 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:

[redacted] 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.

RockRock Group v. Value Logic, WA Court of Appeal Opinion Published July 7, 2016

- Value Logic moved for summary judgment, which was **granted** by the trial court on the basis that Value Logic did not owe the investors 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).

[redacted] 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.

“What Can I Do?”

Include a specific advisory in 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.”

- **Every report should be as clear and narrow as possible as to who the intended user is and what the intended use is.**

Story No. 3: The Appraiser Who Got His Legal Advice on the Internet

Yesterday at 12:28pm - [redacted] IL -

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.

[redacted] 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?

Like · Reply · 1 · Yesterday at 12:45pm

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.

Like · Reply · Yesterday at 1:49pm

[redacted] It would be on the supervisor that signed the report

Like · Reply · Yesterday at 2:40pm

Myths Based on Bad Advice From the Internet

“Since my firm is organized as a limited liability company, I don’t have personal liability for my appraisals.”

- Reasonable, but incorrect, understanding of the legal protections provided by limited liability forms of business.
- Choosing to operate your appraisal firm as a limited liability company (LLC), s-corporation or limited liability partnership (LLP) can be a smart business move for many owners.
- The legal reality is that LLCs, corporations and LLPs don’t insulate appraisers from liability for claims about their own alleged professional negligence.
- The appraiser carries the license; thus, the appraiser is personally responsible for their own work.
- The firm also has potential liability, but its liability stems vicariously from the work of its staff members. This is why in professional negligence lawsuits stemming from deficient appraisals, we most commonly see both the appraiser who performed the appraisal and the appraisal firm itself named as defendants.
- Choosing the right form may still offer other benefits and, moreover, when there are multiple appraisers working in a single firm, the limited liability business form will serve to insulate the appraiser-owners against personal liability for the professional negligence of the other appraisers’ work, as well as from other liabilities of the business.

Myths Based on Bad Advice From the Internet

“Lenders require appraisers to carry E&O insurance because they want to pass on their loan losses by blaming appraisers.”

- There are a few lenders and loan servicers over the years who have experimented with systematically suing appraisers over their losses but all have failed in that effort and discovered it’s not a good business plan – the most spectacular failed experiment was backed by Impac Mortgage Holdings who authorized third party collectors like Llano Financing Group to sue over 500 appraisers in 2014-2016.
- The fact is that except for a misguided few, lenders don’t sue appraisers in general to make up their loan losses.
- Most lenders only file lawsuits against appraisers when they believe that an appraiser’s negligence was particularly egregious and clearly caused a loss.
- For appraisers performing residential or commercial appraisals for lenders, the main risks that their E&O protects them against are lawsuits by aggrieved borrowers and property purchasers – these parties make up about 60-65% of current claims.

Myths Based on Bad Advice From the Internet

“Only appraisers who do appraisals for mortgage lending get sued.”

-
- Frequently repeated myth that probably has developed because most valuation work is performed for lending purposes, and therefore more professional liability cases arise from lending work.
- Expert witness work, tax work, estate work, and even assignments where the appraiser was serving as an arbitrator all produce liability claims against appraisers.
- We had one appraiser serving as expert who was sued by his client because the client didn’t win as much as they hoped for in the litigation and claimed in a subsequent professional liability lawsuit that the appraiser wasn’t persuasive enough as a testifying expert.

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 Really Bad Legal Advice From the Internet

- “Don’t report that disciplinary complaint to your E&O.”
- “Put your assets in your wife’s name.”

Story #5

The Appraiser Who Believed There Was No Risk With Hybrid Appraisals

Hybrid Appraisal Risks

- Appraisals that combine appraiser's valuation analysis with another party's inspection and/or with AVMs or automated tools.

- Main liability concerns:
  - Appraiser (and AMC) may be dragged into claim – typically by borrower – based on information supplied by the other parties.

    - Clarity of who provides and is responsible for particular information alleviates *some* of the liability risk.

Hybrid Appraisal Risks

- Main liability concerns (cont'd):
  - Some of the new products are missing liability prevention ingredients. Key examples:
    - No statements that the report is not a home inspection.
    - Weak wording on intended use and intended user.
  - The worst forms just copy 1004 language.
  - As a general matter, many form designers don't take advantage of their freedom from the 1004 – they are not doing a good job in reducing potential liability not only for the appraiser, but also for their own companies and inspectors.

Hybrid Appraisal Risks

- Main liability concerns (cont'd):
  - In performing certain hybrid appraisals, appraisers may:
    - Rely too heavily on automated tools built into the software platforms that create the reports.
    - Fail to create an adequate workfile with the required information and data to support (and perhaps later defend) their appraisal.
  - As far as liability and disciplinary risk, there is a big distinction between a hybrid valuation that a consumer may receive a copy of, versus one that will strictly be used internally.

Hybrid Appraisal Risks

- Problem: Inspectors vary widely in qualifications.
  - No standards for the inspectors.
  - May or may not be named in report.
  - May or may not be insured.
  - My observation is that inspection work for these purposes is usually a short term, non-career work experience and usually for pay below long term livability.

Example Hybrid Appraisal

APPRAISAL™

SUBJECT - SINGLE FAMILY HOME - 3BD / 2BA
411 S Schug St, Orange CA 92869

FILE NUMBER
#141110-2447-1

CLIENT FILE ID#
#7891665314-515

Appraisal Report

INSPECTION

Report Summary

OPINION OF MARKET VALUE

$651,000

1 YR RISK OF DECLINE - FORECAST

5.7% Very Low Risk

EXTERIOR PROPERTY CONDITIONS

Inspection provided by GUARDIAN Asset Management

C6	C5	C4	C3	C2	C1
Major Repairs Required	Repairs Needed	Worn but Adequate	Well Maintained	Like New	New

Hybrid Appraisal Risks

- Always pay close attention to intended user and intended use language.
- Don't trust form language.

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#141110-2447-1

CLIENT FILE ID#
#7891665314-515

INTENDED USER

The intended user of this report is the named Lender/Client. In some jurisdictions, e.g. Illinois, the AMC is considered an intended user.

It would be better to say: The intender user of this report is the named Lender/Client. Use of this report by other parties is not intended or authorized by the appraiser. No other parties should use or rely on the appraisal for any purpose.

INTENDED USE

The intended use of this appraisal report is to provide an opinion of the MARKET VALUE of the real property that is the subject of this report based on a sales comparison analysis, for the purposes as defined in this report.

It would be better to say: The intended use of this appraisal is for the named Lender/Client's evaluation of the subject property as collateral for a mortgage loan to the borrower identified in the report. No other use is intended or authorized by the appraiser.

Hybrid Appraisal Risks

Since there are no industry-entrenched hybrid appraisal forms yet, an appraiser might see each new hybrid form as a blank canvas on which to use his or her own protective language. In that regard, keeping in mind that 60+% of claims come from borrowers/purchasers, you might consider using language like this in the form:

The appraiser has not identified any borrower, purchaser 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 a valuation 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.

No information in this report or utilized by the appraiser about the characteristics or condition of the property should be considered a home or property inspection. Any party using or relying on this report, whether authorized or not by the appraiser, acknowledges and agrees that the appraiser has no liability or other responsibility for any matter relating to the characteristics or condition of the property or other matters reported by any third party.

Hybrid Appraisal Risks

The question most often posed by appraisers to us (as an E&O provider) about hybrid valuations:

- “Am I covered by my E&O policy for doing them?”

Story #6: The Appraiser Who Put His E&O Information on His Website and in Appraisal Reports

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 Renewal of Number:

1. **NAMED INSURED:** D
   STREET ADDRESS:
   ane
   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 "prior acts" or "retroactive" date on the appraiser's E&O policy does not cover the time when the appraisal was performed

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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.

Story #7: The Appraiser Who Did a Good Job Disclosing a Sewer Issue

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 might the appraiser say about this?

Use Plain English Disclosures

Example disclosure: "*The appraiser observed approximately 60 plants believed to be marijuana growing in the basement under lighting strung from bare wires suspended from ceiling. See photos from basement.*"

Story #8: The Appraiser Who Turned a Bad Situation into a Lawsuit

Dear Appraiser:

Your appraisal was selected for a quality review analysis by Chase Appraisal Panel Management. During the course of our review our analysis uncovered the following possible USPAP violations:

1. USPAP Standards 1-2(e)(i), 2-1(a), 2-2(b)(iii): The appraisal appears to be in violation of USPAP standard rules regarding proper identification and reporting of subject's property data and characteristics as well as reporting in a manner that will not be misleading.
    a) In the neighborhood section on page one, no box is checked for subject location; however it is noted as rural per comments. It is noted to be built up "over 75%" yet comments state rural area with properties of 2-20 acres and satellite imagery shows a very sparsely populated area.
    b) No zoning information is provided. Per public record, the subject is zoned LCA11 – residential with light agriculture and farm animals acceptable. However use code per public record indicates "quadruplex". Public record living area is noted as 4,858sf with 12BR, 4 bath and 4 separate units. The report provides no discussion of this data.

How to Turn a Potential Claim into an Actual Claim

Part 2 – Appraiser's Appeal

"Dear Appraisal Panel,

I would like to appeal your previous decision to place me on your Exclusionary list.

The appraisal in question was admittedly sketchy and very lacking in detail and clarity of presentation. I was truly appalled myself preparing the rebuttal to your review and I acknowledge that it did not meet the appropriate standards of reporting that it should have.

However, this was truly not representative of my work in 2007, nor does it have any similarity at all to the work that I do currently . . ."

7 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 – consider 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.