

Appraiser Liability

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Where Are We Going This Morning?

We are going to talk about real-world liability and disciplinary risks:

1. Status of claims.
2. Overview of most common allegations in negligence lawsuits
3. Most important strategy to reduce liability risk.
4. Hybrid appraisals.
5. Marijuana cultivation activities.

How Are Claims Now?

- Low -- but appraisals performed now will be the subject of future claims.
- Watch for complacency.
- When do claims increase?

The Most Common Bases of Legal Claims Against Appraisers

In any presentation about liability issues, most appraisers want to know “what do appraisers get sued for?”

What are the most common alleged mistakes that lead to lawsuits against appraisers?

Here are the answers – based on 8,200 claims:

The Most Common Bases of Legal Claims Against Appraisers

The most common alleged mistakes at the core of professional liability lawsuits concerning appraisals for mortgage lending (either residential or commercial) are:

1. **Value.** The appraiser's opinion of value allegedly was too high or too low because the appraiser used incorrect information about the subject property, selected inappropriate comparable sales or made inappropriate adjustments.
2. **Measurement.** The appraiser made an error in determining or reporting the square footage of a structure or the land area of the subject property.

The Most Common Bases of Legal Claims Against Appraisers

- 3. Property condition/characteristics.** The appraiser failed to discover or report a unique issue or problem with the subject property. The most common alleged issues and problems include:
 - The property suffers from a condition problem such as leaky roof, mold, foundation settlement, vermin infestation or unrepaired damage from fire or flood.
 - Structures on the property were built without proper permits or in violation of zoning.

The Most Common Bases of Legal Claims Against Appraisers

- The appraiser misreported that the property is served by public sewer, when, in fact, the property is served by a septic system (or a pipe running to a creek) and that system has failed.
- Vacant land or other property for development was not developable in the manner stated in the appraiser's report or underlying the appraiser's valuation.

The Most Common Bases of Legal Claims Against Appraisers

4. **Income approach.** In an income approach, the appraiser developed or used faulty information overstating revenue or understating expenses (mainly multi-family and commercial appraisals).
5. **Construction progress reports.** In a construction progress report for loan disbursement, the appraiser overstated the degree of completion or failed to identify problems with the construction.

The Most Common Bases of Legal Claims Against Appraisers

The most common alleged mistakes at the core of professional liability lawsuits concerning appraisal work for non-lending purposes such as litigation or tax are:

- 1. Outright errors and miscalculations.** The appraiser made an outright error or computational mistake in a valuation used for litigation or tax and the appraiser's client suffered a bad outcome as a result.

The Most Common Bases of Legal Claims Against Appraisers

- 2. Failing to meet technical requirements.** The appraiser failed to produce admissible expert testimony or failed to meet the minimum technical requirements for the appraisal or report – for example: the appraiser failed to apply legally acceptable methods or analyses in a condemnation case or failed to produce a “qualified appraisal” meeting IRS requirements.
- 3. Overreaching.** The appraiser overreached in his or her testimony or expert report with the result being that the testimony or report was not credible and was rejected by the court or taxing authority.

The Most Common Bases of Legal Claims Against Appraisers

- 4. Failing to disclose.** The appraiser failed to disclose alleged conflicts of interest or other matters that made his or her testimony or valuation unusable or less credible.
- 5. Licensing.** If necessary to the assignment, the appraiser was not appropriately licensed in the relevant jurisdiction.

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

- In March 2005, the plaintiff borrowed money to purchase a property located on Camano Island.
- A staff appraiser employed by LandSafe Appraisal performed the appraisal.
- More than three years later, in July 2008, the plaintiff was having problems with the property's waste system and hired a contractor to investigate the issue.
- The contractor determined that the existing septic system was not operable and had not been operable since before 2005.

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

- The system had caused serious damage to the home's foundation.
- The county public health department prohibited any further occupancy of the property until installation of an approved functional septic system and repair of the foundation.
- With repair costs estimated in the hundreds of thousands of dollars, the plaintiff determined that the property was essentially worthless and stopped making payments on the loan.

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

- The borrower then sued the bank and appraisal firm for negligent misrepresentation, alleging that the firm's appraiser reported in the appraisal that the property was served by a working septic system and failed to identify or report any deficiency.
- The borrower filed this lawsuit in June 2011, more than six years after the original appraisal.

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

- LandSafe Appraisal moved to dismiss the case based on Washington's three-year statute of limitations period.
- The court hearing the motion pointed out that Washington follows the discovery rule and that the statute of limitations begins to run when the plaintiff "discovered or, in the exercise of due diligence, should have discovered the misrepresentation."

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

- The court ruled that the statute of limitations did not begin to run until June 2008 when the plaintiff first “had a reason to suspect that LandSafe’s appraisal was faulty.”
 - That date was within three years of when the borrower filed its lawsuit.
 - Accordingly, the motion to dismiss was denied and the case advanced toward trial.
- Lessons:
1. Keep your workfiles for longer than the minimum USPAP requires.
 2. Recognize how common septic/sewer errors are.

Two Lessons in One Case

Amini v. BAC Home Loans Servicing LP, LandSafe Appraisal Services, Inc.(2012)

That was an expensive septic system mistake. Bank of America and LandSafe Appraisal ultimately settled the case with the borrower – by agreeing to forgive the \$504,000 balance owed on the mortgage.

But What's Wrong with that Case?

What are the elements of a professional negligence legal claim?

1. Legal duty owed by the defendant appraiser to the plaintiff to follow a certain professional standard of care,
2. The defendant appraiser's breach of that standard of care, and
3. An injury to the plaintiff proximately caused by the breach.

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

The client, of course.

Other parties?

In most states (including Washington), the case law uses a test along the following lines: “Did the professional know or reasonably expect that the third party would use or rely on the information being supplied by the professional.”

An Interesting Case Illustrating the Importance of Intended Use and User Language

- The Resort at Squaw Creek is a high-end resort hotel adjacent to the slopes of the Squaw Valley ski area near Lake Tahoe.
- The hotel opened in 1990.
- After two years of poor performance, the owners sought to restructure \$53 million of debt with a regional bank. To consider the debt restructuring, the bank engaged an appraisal firm and its principal appraiser to perform an updated appraisal of the resort.
- The appraiser produced a 400-page report for his client.

An Interesting Case Illustrating the Importance of Intended Use and User Language

- In the report, the appraiser stated an opinion that part of the reason for the hotel's poor performance was that it was being mismanaged by Benchmark.
- He wrote in report that Benchmark was not a “competent manager of the subject ski resort” and further opined that the resort would be worth \$17.9 million more if managed properly.
- There was then meeting at the hotel with prospective new investors in the resort.
- Someone left the 400-page report in a vacated room.
- A housekeeper found the report and gave it to her supervisor.
- Eventually, a copy made its way to the manager.

An Interesting Case Illustrating the Importance of Intended Use and User Language

- The hotel was sold to the new investors.
- They demanded changes in the management agreement that deprived the Cabanas company (Benchmark) of significant revenue.
- Cabanas and Benchmark believed that the investors had received the report and that their decisions were made because of the appraiser's statements.
- Cabanas and Benchmark sued the appraiser and his firm for a variation of negligence called "negligent misrepresentation."

An Interesting Case Illustrating the Importance of Intended Use and User Language

- They alleged that the appraisal generally violated appraisal standards.
- They specifically alleged that “the comparables used were not true comparables” and that the defendant appraisal firm and appraiser did not conduct “a thorough evaluation of management's capabilities,” and that defendants did “not appear to have the proper qualifications.”
- How did the court rule?
- It dismissed the negligence claim. Why?
- Those key elements of a negligence claim.

An Interesting Case Illustrating the Importance of Intended Use and User Language

The court concluded the appraiser did not owe a legal duty to the management company or its president.

The appraisal was intended only for the benefit of the bank client; it was not intended to be used by, to benefit or to affect the hotel management company.

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



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

- **Appraisal 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.

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

- Developer Greg Jeffreys received copies of the appraisals and showed them to prospective investors.
- Some of the investors received copies.
- Statements were made by Jeffreys 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

- After acquiring their interests, the investors 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 2011, the investors sued Value Logic, LLC and two appraisers.
- The gravamen of the complaint was that Value Logic overvalued the properties in 2006 and that the LLCs would not have completed the purchases but for the overstated values.

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? The language about intended use and user was the key.

██████████ 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.

Significance of the Cases (and Similar Cases)?

- Intended use and user language in reports has paramount importance to the appraiser's ability to manage risk.
- Intended use and user language should be as precise and narrow as possible for any assignment.

What About the 1004? “What Can I Do?”

The biggest problem liability-wise with the URAR is certification #23:

The borrower, another lender at the request of the borrower, the mortgagee or its successors and assigns, mortgage insurers, government sponsored enterprises, and other secondary market participants may rely on this appraisal report as part of any mortgage finance transaction that involves any one or more of these parties.

What About the 1004? “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.”

Good Intended Use and User Language

If the appraisal is for a divorce, say something like this instead:

The intended use of this appraisal is to provide the client in this report with an opinion of the market value of the subject property for the client's sole use in contesting the division of assets in the client's marital dissolution proceeding. The appraiser does not intend, know of or authorize any other use of this appraisal or content in this report. The appraisal and content of this report should not be used for any other purpose.

Very Bad Intended *Use* Language

Never say something like this:

The intended use of this appraisal is to provide an opinion of market value.

Appraising After a Natural Disaster

- U.S. has experienced record-breaking weather-related disasters. In 2017, for example, 16 separate weather events each resulted in more than \$1 billion in losses.
- The monetary damages in 2018 caused by just two wildland fires in California – the Camp Fire in Northern California and the Woolsey Fire in Southern California – are estimated to exceed \$20 billion.
- Following a disaster, appraisal work is needed, and it is performed – are there any special liability issues to think about?

Appraising After a Natural Disaster

Are there claims and lawsuits against appraisers in relation to such events?

- We do **not** see appraisers face professional liability claims relating disaster-specific work in any significant volume.
- What we do sometimes see are liability claims relating to the “regular” appraisal work performed in the wake of a disaster:
 - Appraisal for a lender/client to appraise a property immediately after a disaster for new loan or for other lending purposes, or
 - Re-inspect or recertify the value of a property that was appraised before the disaster.

A Real-World Claim Situation: Accused of Failing to Detect Structural Damage Following a Flood

- In a recent claim situation, an appraiser originally had performed a purchase loan appraisal of a single-family residence for a regular client. This assignment had included customary interior and exterior inspections and was reported on a standard Uniform Residential Appraisal Report form.
- About a year later, the same lender called the appraiser back to do a drive-by appraisal for refinance.
- Within a few months, the area suffered severe flooding that damaged hundreds of homes. The borrower defaulted, and the lender foreclosed.
- The lender then asked the appraiser to do another drive-by appraisal for its use in the foreclosure.
- Given the recent flooding, the lender stated that it wanted the appraiser to comment, specifically, on whether the property showed "any evidence of exposure to recent flooding that affected the area."

A Real-World Claim Situation: Accused of Failing to Detect Structural Damage Following a Flood

- The appraiser was uncomfortable. The lender told the appraiser to "do his best."
- The lender was a long-time client, and the appraiser didn't want to walk away. However, he did not want to take on a needless liability exposure either.
- In this report, the appraiser took the time to add a brief description of the flooding in the area.
- He explained in the report that, while the property was located in an area impacted by flooding, there did not appear to be any visible, external evidence that flood water had actually touched the structure, such as visible mud or water stains.
- Though he only included the standard photos for this type of assignment in the report itself, he did take a few minutes extra to take some additional photos of the property – which he fortunately retained.

A Real-World Claim Situation: Accused of Failing to Detect Structural Damage Following a Flood

- Some months later, after completion of foreclosure, the lender's attorneys threatened the appraiser with a legal claim.
- The lender had acquired the property at the foreclosure auction for its loan amount, rather than let a bidder purchase it for less. Shortly thereafter, a major portion of the roof and ceiling had collapsed into the house.
- The lender demanded to know why the appraiser had failed to report the structural problems and demanded that the appraiser compensate the lender for the cost to repair.
- The appraiser was angry with the lender for trying to place blame on him, but still wanted to maintain the client relationship for the long term. He drafted a letter explaining his initial hesitancy to complete the assignment. He highlighted the language he had added to his report about only inspecting visible areas. He included copies of the extra photos he had taken which did not depict anything wrong with the structure or with the roof.

A Real-World Claim Situation: Accused of Failing to Detect Structural Damage Following a Flood

- After sending in this response, the appraiser heard nothing further from the lender until he later received an assignment to perform another new appraisal.
- The lender never officially abandoned the claim, but never mentioned anything further about it and never filed a lawsuit. (That's just the way some claims die – no climactic ending.)
- The appraiser continued to receive assignments and we closed the claim file.
- That's the power of plain English. Just say it in the report.

Key Liability Prevention Measures for Appraising After a Natural Disaster

- The appraiser in the flood related claim did everything right to avoid liability:
 - he took the time to take a few extra photos – which he retained for his own protection, and
 - he added a plain English description of the disaster in his report, included an advisement about the limits of his inspection.
- For other assignments that involve a fuller inspection, here is the type of language that we would recommend appraisers consider:

Appraiser is not a building inspector, contractor or engineer. Appraiser conducted a visual inspection of only the accessible areas. Appraiser makes no guarantees about the structural integrity of the property and assumes no adverse conditions exist. An expert should be consulted and further inspection conducted if there are any concerns about structural integrity.

Key Liability Prevention Measures for Appraising After a Natural Disaster

- If damage is detected during the inspection, the appraiser should:
 - specifically describe what they have observed,
 - consider whether the appraisal should be “subject to” repair, and
 - and take and provide extra photos.
- We’ve never defended a case against an appraiser in our insurance program in which we, the defense attorneys or the defense appraisal expert felt the appraiser took too many photos.

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 work file 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.

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 LIA (as an E&O provider) about hybrid valuations:

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

What about this situation?



What about this situation?

Informal poll:

- 1. In the last five years, who has ever appraised a marijuana-specific property (greenhouse, processing facility, distribution location, etc.) for the purpose of a loan?**
- 2. In the last five years, who has ever seen marijuana on a property while appraising a property of any type?**

What does that tell us?

Why Banks Generally Won't Bank with Marijuana Businesses

- **Under federal law, marijuana is still classified as a Schedule I controlled substance under the Controlled Substances Act (CSA).**
- **Classified as Schedule 1 under the following criteria:**
 1. The drug has a high potential for abuse.
 2. The drug has **no currently accepted medical** use in treatment in the United States.
 3. There is a lack of accepted safety for the use of the drug under medical supervision.
- Other Schedule I drugs: Heroin, LSD, Ecstasy.
- Schedule II Drugs: Cocaine, OxyContin, Methamphetamine, Morphine, Opium.

Why Banks Generally Won't Bank with Marijuana Businesses

- Banks do not want to be implicated as money-launderers.
- Required to file SAAR reports.
- In February 2014, the **Treasury Department and the DOJ** issued guidelines intended to increase financial services available to marijuana businesses.
- The banking industry didn't bite. They want an Act of Congress to pass legislation to provide certainty that financial institutions can engage with marijuana businesses

“While we appreciate the efforts by the Department of Justice and FinCEN, guidance or regulation doesn't alter the underlying challenge for banks. . . . As it stands, possession or distribution of marijuana violates federal law, and banks that provide support for those activities face the risk of prosecution and assorted sanctions.”

– Frank Keating, president, American Bankers Association.

Always Watch for Peak Prices in a Bubble

Many of the hardest appraisals to defend are those that appraisers did just after the peak of the bubble.

- Failing to react to the peak despite obvious signs.
- Using older and older comps, without time adjustment, to support the value.
- There have been some local bubbles in commercial real estate for marijuana facility use.
- Values crashed in micro-markets when land use plans changed in the local political environment.
 - Adjacent property owners pushing for change.
 - Different personalities on a county board of supervisors or city government.

Example of a Local Regulatory Disaster

- In 2016, thinking it was getting a jump on competition from other counties for future business, Calaveras County passed a local ordinance allowing marijuana growers to apply for permits in the county.
- County voters also approved Measure C, a cultivation tax.
- Growers flocked to the county, purchased the right properties in the permitted areas and made investments.
- Prices increased on certain types of properties.
- The county also collected nearly \$12 million in permit fees and taxes from growers.
- But when a shakeup of the Board of Supervisors occurred, the Board authorized that an Environmental Impact Report (EIR) be conducted and as a result of the EIR, the board summarily banned all commercial cannabis operations in the county.

**So, what about this situation?
What should the appraiser do on regular
lending appraisal?**



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.*”

An Unhappy Property Owner in a Condemnation Case Sues the State's Expert Witness Appraiser

- An experienced appraiser and his firm were hired by the state to value a largely undeveloped parcel for highway condemnation purposes.
- He appraised the property at approximately \$1,000,000.
- Property owner declined a pre-litigation offer based on that appraisal.
- The state then commenced an eminent domain proceeding.
- At trial, the state's appraiser testified to the same \$1m valuation, while the property owner's expert appraiser testified to a \$7m value.

An Unhappy Property Owner in a Condemnation Case Sues the State's Expert Witness Appraiser

- The jury split the difference and awarded approximately \$4m to the property owner.
- The property owner was not satisfied with that outcome.
- The owner then sued the state's expert appraiser, contending that his valuation was erroneously low and alleging various claims of negligence.
- The owner alleged that the condemnation award at trial would have been higher but for the allegedly erroneous low value and demanded damages from the state's expert and his firm for the difference.
- Who wins?

An Unhappy Property Owner in a Condemnation Case Sues the State's Expert Witness Appraiser

- The trial court dismissed the property owner's claims against the appraiser and his firm based on "witness immunity."
- New Hampshire's Supreme Court upheld that dismissal.
- The Court wrote in its opinion:

"The purpose of this privilege is to encourage witnesses to testify and to ensure that their testimony is not altered or distorted by the fear of potential liability."

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 – watch out for “reliance” language from clients that is overbroad or sloppily worded. Ask yourself can a party who you really don’t intend to rely on your report (like a borrower) twist the language?
3. Get square footage right.
4. Disclose special conditions in clear plain English.
5. Proofread your reports.

What To Do if It Happens to You?



- **With any legal threat or claim, don't ignore it.**
- **Report to E&O promptly.**
- **Get legal assistance.**
- **Handle the lawsuit appropriately if you are served.**