CLAIM ALERT

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Three Easy Steps to Reduce Your Liability

Despite the large number of claims stemming from the mortgage crisis, the professional liability risk to appraisers remains manageable with prudent loss prevention. Most claims at this time – whether they are frivolous or have a justifiable basis – relate to appraisals completed during the real estate and mortgage bubble years of 2004-2007. An appraiser has little control now over whether a lender, borrower or other party will make a claim about work in the past.

Our single best piece of advice with respect to reducing your risk for prior work is to ***keep your reports and workfiles for longer than the minimum five years required by USPAP.*** We suggest keeping them for seven or eight, or even longer. USPAP has no relevance to any statute of limitations period and whether a plaintiff can sue you about an old appraisal. Given that we are seeing claims about appraisals dating back to 2004 and sometimes earlier, we think that keeping reports and workfiles, in paper or electronically, for seven or eight years provides a better margin of safety for appraisers.

Fortunately, there is much more that an appraiser can do to reduce the threat of liability from future work. You may have heard the following tips previously over the years, but they are more relevant now than ever. You'll find more information and more tips in the loss prevention section of our website at liability.com and available at our new resource readimember.org.

Appraise Your Client and the Assignment

Appraisers report hundreds of claims to us every year. Time and again, appraisers start the story about a claim with something like "I had a bad feeling about this client" or "I had a suspicious feeling about the transaction." Here's a recent example: an appraiser reviewed a sales contract in connection with a home purchase loan and accurately reported in her appraisal that the contract contained significant sales concessions. The concessions exceeded the limits in new lending guidelines. After the appraiser submitted her report, the lender's agent very quickly came back to the appraiser with a "new" sales contract with the same date, signatures and markings, but leaving out any concessions, and wanted the appraiser to prepare a new report. The appraiser declined. In other situations, we've heard appraisers basically say that they knew their client was going to use the appraisal report in a misleading way, but that they figured they could cover themselves with a disclaimer or other cleverness in the report.

Your knowledge – or even nothing more than a gut feeling – about a dishonest situation is your radar in avoiding lawsuits or disciplinary investigations. Many of these situations do produce claims and your best loss prevention strategy is to turn down the assignment if any part of, or any party to, the transaction "smells fishy".

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Check and Proofread Your Work

This is certainly obvious advice, but we have to say it because we receive too many claims that result from poor quality control. Indeed, we have had claims asserted against appraisers relating to plain old typographical errors. In one recent case, an appraiser delivered an appraisal report through a management company to a lender for its use in evaluating the sale of an REO property. In the report, the appraiser entered the wrong first digit in his opinion of value – *i.e.*, the appraiser keyed in $150,000 when the value in the report should have been $250,000. While any reasonable reader of the report should have recognized the obvious error because the number was outside the range of adjusted comparables and could not be reconciled with other data in the report, we still had to defend a claim by the management company because the lender allegedly agreed to sell the REO at a low price based on the appraiser's typographical error.

We also see too many lawsuits and disciplinary matters each year involving reports in which entire sections of data or information are copied over from another report and left unchanged. We see these problems from both residential and commercial appraisers. In residential reports, appraisers often carry over data and information that remains in the software template from a prior report in their system. In commercial narrative reports, we see appraisers borrowing sections written for other reports but then failing to update or revise the information to fit the new assignment. Claims about problems like this are even uglier when the data or information is copied from a report by a different appraiser.

These are usually embarrassing claims for the appraisers. Even if the affected data or information would have had no impact on the appraiser's opinion of value, this kind of carelessness provides fodder for the lender or borrower's attorney, and the appraiser is never anxious to have his or her deposition taken in a case like this or to take the stand in court. Accordingly, our simple advice is that a lot of liability risk can be avoided by taking the time to check and proofread your work.

Be Careful What You Promise

As the mortgage crisis has unfolded, businesses involved in lending, whether residential or commercial, have become more keenly aware of their potential liabilities. Overall litigation related to mortgage lending has increased more than tenfold (far more than appraisal related litigation). A visible result of all this litigation has been an increasing use of indemnification provisions in legal agreements, including appraiser engagement agreements and AMC independent contractor agreements.

Indemnification essentially means a promise to reimburse someone else for certain costs or expenses. Appraisers need to be careful about what they agree to in this regard because lenders, servicers and AMCs are now routinely demanding that appraisers promise more and more with respect to indemnification.

For example, a new independent contractor agreement used by a well-known AMC states, in part:

> Appraiser shall further indemnify, defend and hold [AMC] harmless from and against any and all claims, losses, liabilities, costs and expenses attributable to any allegation of intellectual property infringement arising out of this Agreement.

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Under this provision, the appraiser is agreeing to indemnify the AMC for liabilities for things like patent and copyright infringement in relation to any appraisals delivered by the appraiser – whether the alleged infringement is the fault of the appraiser, the AMC or some third party, such as a software provider. Another AMC's independent contractor agreement states, in part:

> Appraiser shall indemnify, defend, save and hold harmless [AMC] from and against any and all liability, claims, damages, losses, fines, judgments, suits, decrees, costs and expenses . . . in any way related to . . . any appraisal report submitted to [AMC] by Appraiser.

This provision similarly would enable the AMC to argue that the appraiser must indemnify the AMC for liabilities or damages and even fines assessed against the AMC relating in any way to appraisals delivered to the AMC by the appraiser – even if the alleged problems are the result of the AMC's own conduct.[1]

Indemnification provisions also appear in contracts for commercial appraisal work. Fortunately, commercial appraisers often have more leeway to negotiate different or more reasonable language. A reasonable indemnification provision – if one is going to be included in a contract at all – would ideally be two-sided, meaning that both parties have a mutual obligation to each other to indemnify the other party for liabilities arising from one side's negligence or errors or omissions.

Residential appraisers, on the other hand, often have limited ability to negotiate with lenders and AMCs, and often their only choice is to say "no" to the business relationship if the risk being shifted to them outweighs the benefit of doing business with the lender or AMC.

There are insurance concerns too with indemnification provisions. As to this issue, appraisers should understand that indemnification provisions such as the two from AMC agreements exemplified above do not change an appraiser's E&O insurance coverage or "void" the policy. The E&O policy will still provide the same degree of protection and coverage as if the indemnification agreement did not exist. However, under these types of indemnification provisions, appraisers are agreeing to pay losses, damages, attorneys' fees, etc. of the AMC even if the loss or damage results from the AMC's own errors or wrongdoing. Further, the appraiser is agreeing to indemnify the AMC for types of damages that are beyond the realm of E&O coverage, such as damages for patent infringement. Thus, the appraiser is agreeing to pay potential costs and damages that are broader than can be covered by the appraiser's insurance. An appraiser's E&O policy can only cover mistakes or damage caused by the insured appraiser (not a third party such as the AMC) and cannot cover liabilities forced on the appraiser by contract.

When appraisers are concerned about the nature of liabilities they may be assuming under an indemnification provision, we encourage them to discuss the relevant language with us. More information is also available on this topic in our loss prevention resources at <u>liability.com</u> and <u>readimember.org</u>.

[1] Some state AMC laws now prohibit such unreasonable indemnification clauses in AMC agreements. Utah's AMC law, for example, prohibits an AMC from requiring appraisers to indemnify the AMC for claims "*arising out of the services performed by the appraisal management company or its agents, employees or independent contractors and not the services performed by the appraiser*."

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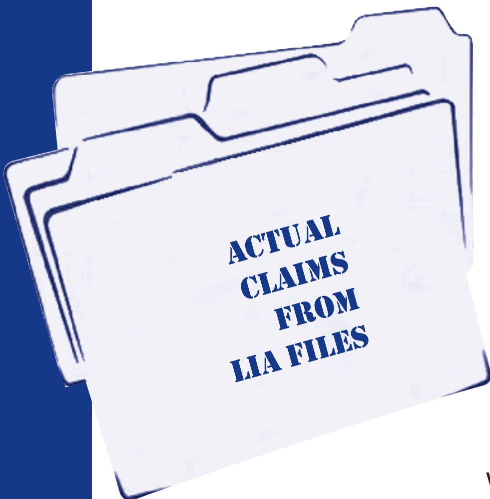

TELL TALE CLAIMS...

Over Her Head in Mold

An appraiser was asked to appraise a REO property in Florida. She was told by the client that a pipe had burst in the home, causing mold. When the appraiser got to the home, she was met by the mold inspector. He said he would leave his hazmat suit for her to put on before she went inside because the mold was intense. Rather than trusting her gut and walking away, and not wanting to disappoint the client, this appraiser donned the outfit and did an appraisal subject to the remediation of the mold.

The client came back later and asked for more work. They wanted an "as is" value and also a "cost to repair". It was at this point that the insured felt "over her head" and called to ask for advice. Perhaps she should have made that call prior to putting on the hazmat suit.

$4,600,000 - $3,100,000 = $400,000 Loss

A California appraiser prepared a narrative appraisal of a 34 vacant lot residential parcel. He estimated a value of $4.6 million. Almost one year later, after a loan of $3 million was made, the lender noticed a math error in the discounted cash flow analysis. Once this was pointed out to the appraiser he revised his value downward to $3.1 million. The loan defaulted and the lender made a claim for more than $1.5 million in damages. After a year of litigation, and due in large part to this error, the claim was settled with a payment of $400,000.

Trust but Verify

A Colorado appraiser assigned the appraisal of a mixed use building undergoing rehab to a trainee. The estimated value was $3.3 million. A year later, the appraisal was the subject of a lawsuit by the lender who had loaned $1.75 million. The lawsuit claimed the appraised value was overstated due to reliance on rental data provided by the developer/borrower and not verified by the appraiser and due to the use of comparable sales that were not truly comparable or that were out of the market area.

No expert could be located who could support the insured's value. The experts consulted by the defense could get no closer than $1 million less than the insured's value. Although a senior appraiser within the firm had signed off on the report, he later admitted that his other work and time commitments had really precluded him from doing much of a review. He trusted his trainee and admitted his review had only been "cursory". The case settled for over $250,000.