Why Do Claims Get Settled?

When an appraiser reports a new claim, one of the first questions he or she asks is, "What happens now?" After we explain how the litigation will be handled, and what will be expected of the appraiser during the course of the lawsuit, we inevitably get into a discussion about settlement. Many appraisers are afraid that the insurance company will pay to settle just because a claim has been made. That is not the case. There must always be a strong reason for settlement to be an option. Most of the time, a claim is settled because after careful analysis and review, it is determined that the appraisal in question cannot be supported. If that is the conclusion reached, then efforts from that point forward are designed to put the case into the best posture for settlement. Sometimes a case is settled for other reasons, such as economics or the personal desire or circumstances of the insured. In this article we will look at some actual claims from the LIA archives and discuss the facts and circumstances that made settlement the best, and sometimes only, option.

TELL TALE CLAIMS...

It Does Not Help When You Appraise The Wrong Property

In a Nevada case, the insured was asked to appraise 5.75 acres of vacant land. He estimated value to be $1.68 million "as is" in November of 2007. The bank agreed to loan $350,000 to the borrower to acquire the property. At the time, this same borrower was in default to the bank on another loan they had made to him in 2005. The bank agreed to loan this borrower another $850,000, secured by the subject property, in order to give him the capital necessary to repay the first delinquent loan.

Not surprisingly, the borrower defaulted on both new loans quickly. The bank foreclosed and determined that the value of the subject property was much less than the insured's estimate had been in 2007. The bank's expert did a retrospective review and determined that actual value, in November 2007, was only $350,000.

After some investigation by the defense, it was determined that plaintiff's expert was probably right. The insured was only given a few days to turn around this assignment. He went out to the general area where the subject property was supposedly located, but he was never quite sure where the boundaries were of the lot he was supposed to appraise. He looked at a lot that had paved road access and utilities. The subject lot had dirt road access and no utilities. The appraiser was in a rush, so he accepted comparable sales provided to him by the borrower and did not have the time to verify those sales or to look for any others.

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The property was resold in 2009 for $300,000, so the bank claimed a loss in excess of $850,000. The insured's policy had a limit of $300,000. This was a case where settlement was the only option. If the insurance company proceeded to defend the case there would have been little left on the policy to pay any judgment at trial.

The defense was able to negotiate a settlement for under $300,000, less than 1/3 of the bank's loss. It was pointed out that the bank loaned money to a borrower who was already in default on another loan. That was not a prudent lending decision and the bank had to accept a large percentage of responsibility for its own foolish lending decisions... but the insurance company also had to pay for the insured's mistakes.

Trainees Can Get You Into Trouble

An insured in North Carolina allowed a trainee to do a substantial amount of work on an appraisal of a single family home. The trainee went out to measure the property and found square footage to be 2,130 square feet. Her estimate of value was $350,000, as of May 2005. When the trainee went back to the office to prepare her report she "manipulated the software" so that the footprint of her sketch matched the square footage figures in her notes. While doing so, she inadvertently inserted an additional 10 feet of wall space into the program, which caused the overall square footage to be overstated. The trainee then apparently provided a copy of the appraisal directly to the borrowers during escrow, as was evidenced by a handwritten email address on a document found in the file.

In January of 2009 the homeowners had a refinance appraisal done. This new appraisal estimated value to be $250,000, based on 1875 square feet. The owners sued the insured seeking damages of over $102,000. When looking over the work file, the appraiser immediately saw her mistake. Liability was clear. The borrowers had gotten a copy of the appraisal prior to closing and said they relied on the appraised value to confirm they were not paying too much for the home.

The defense did have some arguments to make as to damages. The plaintiffs' own appraisal expert said that value of the home in May of 2005, assuming the lower square footage, would have been $335,000. That is only $15,000 less than the original appraised value and the actual purchase price. Plaintiffs were seeking to recover over $100,000 to compensate them for the general decline in the market since their 2005 purchase. During mediation, the mediator was able to convince the plaintiffs that their damage claims were unreasonable and the case was settled for $15,000.

You Can't Always Rely On The Work Done By Others

An appraiser in California was hired to do a review of an appraisal of vacant land zoned for multi family dwellings. The original appraisal had estimated value to be $2.5 million as of April 2006. The insured concurred with this value. Plaintiff was a private lender who agreed to loan $1,275,000 to a developer. There was a first payment default. Plaintiff got a new appraisal that said the value of the property was only $1 million. The property was ultimately resold in 2009 for only $250,000. Plaintiff sued both the original appraiser and the review appraiser seeking damages in excess of $1.2 million.

It quickly became obvious that neither the original appraisal nor the review could be supported. The original appraiser used superior comps and it was arguable that those were the best sales available at the time.

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The problem was that the appraiser then adjusted those sales in the wrong direction, thereby inflating his value. This mistake was not caught by the reviewer. In addition, it was discovered that the property had been "flipped". It had been purchased in February 2006 for $970,000 and then sold only two months later to the borrower for $2.5 million. Neither appraiser had found that prior sale. To further complicate matters, the original appraiser had retired in 2007, shortly after the appraisal was done. He had no insurance when the lawsuit was filed and threatened to file bankruptcy if he was not dismissed.

The defense argued that the proper measure of damages was the difference between the loan amount ($1,275,000) and the value at the time of foreclosure ($1 million). It was not the fault of the appraiser that the market for vacant land had plummeted and that the property could only be sold for $250,000. Further, the defense argued that the first payment default showed that the lender had done faulty underwriting, so the damages had to be reduced by some percentage of comparative fault. After lengthy negotiations, the case was settled for $150,000. The original appraiser paid $25,000 out of his pocket.

Settlement Is Not Always The Carrier's Idea

New York: Settlements are often instigated, encouraged and even demanded by an insured, even if the insurance company has other ideas and wants to defend. In one case from New York the insured did a very high dollar appraisal of commercial property. His value estimate was $8.6 million, as is, and $16.7 million, as complete. The bank loaned $11 million and claimed a loss of over $5 million. Before an answer had even been filed, the bank demanded that the company pay the insured's $1 million policy limit to settle. Before paying that amount, the defense did some investigation. While there were some problems with the appraisal, it became clear that the Bank had bigger problems and that their own loan officers had clearly been involved in a fraud.

Despite mounds of exculpatory evidence, the bank continued to demand policy limits to settle. The insured then jumped on the band wagon and demanded, in writing, that the insurance company pay up to $1 million so as to avoid him being exposed for anything beyond the limits of the policy. The insured even hired his own personal counsel and this attorney sent a letter demanding that the carrier pay. Defense counsel and the carrier believed in the merits of the defense. While settlement was not ruled out, the claim was not worth policy limits. All of the defense arguments were set out during mediation and the mediator agreed that the defense arguments had merit and that the bank had big problems with their case. The mediator placed the "value" of the case at $200,000. The carrier quickly agreed to pay that amount and the bank came on board soon thereafter. The carrier's patience and good defense work saved a great deal of money.

California: In California, a lawsuit was filed by some borrowers because they discovered that an addition to their home had been built without permits. The appraiser had photos of the addition attached to the appraisal. He commented that the additional square footage was finished in a quality manner so it was given value. "The appraiser went on to note... according to seller the addition was constructed with all necessary building permits and to code. The appraiser has not verified this information..." The defense did

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not think the appraiser had any liability in this case. The defense expert fully supported what had been done by the appraiser and supported the value stated in the report. It appeared that the buyers' motivation for bringing the lawsuit had to do with putting pressure on the seller to forgive a second/carry back loan that was soon coming due and payable. The appraiser sat on the sidelines hoping that the buyer and seller would work something out so that we would avoid the cost of trial. A short time before trial was to commence, the plaintiffs wanted to depose the insured. At this time the appraiser confessed that he had not done the inspection of the property. He had sent a trainee to do the inspection and had signed the report as if he had inspected. The trainee had not even been mentioned in the appraisal. The appraiser was desperate to settle so he did not have to admit this in his deposition. At a mediation that took place soon thereafter, the case did settle. The seller forgave part of the outstanding loan balance and the insurance company paid $7,500 to avoid the costs of completing discovery and proceeding to trial. The Release of All Claims signed by the plaintiffs included a promise they would not make any complaints to the state licensing board.

Colorado: A Colorado insured was involved in a large lawsuit involving 30 plaintiffs and more than 20 defendants. The plaintiffs had all bought second homes within the same subdivision. They claimed that the builder/developer fraudulently induced them to pay more for the homes than they were worth, that he falsified their loan applications and that he secured inflated appraisals to make the deals work. Throughout the course of the long and arduous discovery, we confirmed that the insured had only done one appraisal in this subdivision. His appraisal was done in connection with a sale that had fallen out of escrow. The appraisal done by this insured was not used in connection with any sale or with any loan.

Defense counsel tried for months to get a dismissal but plaintiffs' counsel was unwilling to agree. The insured was livid about the whole thing. He was ill and on oxygen. His appraisal business had fallen off due to the economy and to his illness and he was about to close his doors. Medical bills were piling up and he was speaking to counsel about possibly filing for bankruptcy.

This case was defensible and we likely could have filed a successful motion for summary judgment. However, the judge ordered that no such motions could be filed until discovery was complete and that day was a long way away. The carrier authorized settlement for $10,000 to avoid the cost of going forward to buy the insured the peace of mind that he was so desperately seeking.

Conclusion

The decision to settle any claim is never a decision made lightly. Only after careful consideration of all factors involved does the carrier agree to pay. If an appraiser has questions about settlement and why a case would or would not be settled, he or she needs to raise those questions with defense counsel.

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