



CONSTRUCTION PROGRESS REPORTS:

Don't Get Hammered

It is commonplace for appraisers to receive construction progress report assignments from lenders. Lenders use these reports in making loan disbursements, also known as construction draws. Suits against appraisers involving construction progress inspections have consistently been a basis for litigation, and appraisers should consider this fact before agreeing to such an assignment.

In a typical scenario, a homebuyer decides to build his dream home. His selection of a contractor is motivated by price alone, and little care is taken to check the contractor's references or to stipulate the type and quality of materials to be used in the construction of his home. After construction begins, the relationship between the contractor and the homebuyer deteriorates. The contractor claims that the homebuyer keeps making demands that are not provided for in the original contract, and the homebuyer claims that the contractor is taking too long and is cutting corners.

The usual outcome of such a dispute is that the contractor is either dismissed or he walks off the job, and that leaves the homebuyer with a partially finished home. The homebuyer, after his unpleasant experience with the 'best-priced' contractor, decides to hire a top-notch contractor to complete the job. The new contractor informs the homebuyer that the previous contractor's workmanship is flawed and that he used sub-standard materials, and therefore much of the construction will have to be re-done. Ultimately, the amount of money needed to finish constructing the dream home is far more than the amount remaining from the original construction loan. When the homebuyer is unable to collect monetary reimbursement from the original contractor he pursues his claim against the appraiser. After all, the appraiser certified the percentage of construction completed and should have noticed poor workmanship or cheap materials!



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In another scenario, the homebuyer simply walks away from the unfinished home and the mortgage obligation. The lender is then faced with the decision whether to finish construction before selling the home, or selling the home in its unfinished state so the new owner has the opportunity to finish the home to his liking. Inevitably, the lender sues the appraiser, arguing that the company suffered a loss on the resale due to the appraiser's misjudgment of construction completion.

Many appraisers decline construction progress assignments because they don't think they are qualified or the fees are too little. Some appraisers accept these assignments simply to maintain the business relationship they have with their client/s. Appraisers who do perform construction progress inspections should consider the following suggestions to reduce their liability exposure:

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Use additional language

The majority of lenders have pre-printed forms for the appraiser's completion in construction progress inspections. The forms have a list of specific items and the appraiser must estimate a percentage of completion for each item. Our Claims Counsel recommends that you consider adding the following additional language to the prepared form:

"This report is prepared for the benefit of the lender to assist in making loan disbursements. It is not prepared for the benefit of the borrower."

Although we always argue that the appraiser owes no duty to the borrower, adding language similar to the above on the progress inspection report will assist us in asserting that position. Other language to be added might include:

"The purpose of this inspection is to determine an approximate degree of completion based on the appraiser's limited knowledge of basic construction."

"The appraiser is not a contractor and does not have the expertise to evaluate the quality of construction, workmanship or materials."

Adding the language above is helpful in the defense of claims made by lenders who expect the appraiser to exceed the scope of their professional expertise because they are unwilling to pay a contractor to perform the construction progress inspection.

Take as many photographs as possible

Photographs should be taken during each inspection and attached to your progress inspection report. If the lender does not want photographs, retain them in your file or on your computer. The photographs give the lender a chance to compare images of the construction progress with your estimated percentage of completion and allows them an opportunity to voice any concerns they may have with your estimation before they make a further disbursement to the contractor.

Insist that the lender have the borrower sign off on your reports and on disbursement requests

Once a borrower signs off on your construction progress report and approves the disbursement to the contractor it becomes more difficult for him to argue later that he disagreed with your percentage of completion. If the borrower disputes the findings in your construction progress report, the disagreement should be resolved before the lender makes any further disbursements.

Be careful when estimating costs of completion

If asked to provide an estimate of "cost to complete", clearly indicate that it is simply an estimate, not a guarantee. Make sure you fully understand the work that needs to be done and the materials to be used. Stress that you are not a contractor and that a more accurate estimate should be sought from a qualified contractor. You do not want financial disbursements being made based upon what you merely consider to be a "ballpark" estimate.

Don't report that work is complete unless and until it is actually finished

Only report construction that has been completed at the time of your construction progress inspection. Just because the materials are on site and the contractor assures you that the construction will be finalized does not guarantee that the work will be finished. Materials can be removed and promises can be broken. Even if it means you have to go back to do an additional inspection, don't report that anything is complete when you know that it is not finished.

SUMMARY

Even though appraisers are aware of the increased risk with construction progress reports, they often accept such assignments to please a client or preserve an existing business relationship. By following some of the suggested loss prevention ideas, you may avoid being cast as the "villain" when the buyer's dream home becomes a "nightmare".





TELL TALE CLAIMS...

If you masquerade as an expert, be prepared to be judged as one

A Montana appraiser accepted a lender's assignment to perform a "subject to completion" appraisal of a new construction, and also agreed to perform periodic construction progress inspections. During construction a disagreement started between the contractor and the borrowers about the manner in which the home was being finished, resulting in the contractor walking off the job.

The borrowers and the contractor agreed to resolve the dispute by requesting the insured appraiser compile a list of incomplete items and estimate the cost to complete these items. The appraiser, with the consent of the lender, prepared his list and estimated the completion cost at \$34,000. The lender consequently withheld 1 1/2 times this amount and deposited it into an escrow account; the remaining loan funds were paid to the contractor as his final disbursement.

The borrowers then hired a new contractor to finish the construction; he estimated the cost to complete the home to be in excess of \$80,000. The insured appraiser allegedly failed to include numerous unfinished items on his list and further failed to disclose defects in workmanship and the cost of repair or replacement. The borrowers did not have sufficient financing left to complete the construction and filed a lawsuit against the original contractor (who was in bankruptcy at that time), the lender and the insured appraiser.

The court determined that the insured appraiser had assumed a duty to the borrowers when he agreed to prepare a list of items still needed to complete construction and the estimated cost of completion. This report did not contain any additional language that described his scope of work, that he did not have the expertise of a contractor, that he could only include items that were visually apparent and that the figures were only an estimate and not a guarantee. The borrowers testified that the appraiser represented himself as an expert and they therefore relied upon his opinion. We settled the case for about \$30,000, the difference between the loan funds held in escrow and the amount charged by the new contractor to complete construction.



Diligence equals liability protection

A similar case in South Carolina had a very different outcome. An insured appraiser agreed to perform a "subject to completion" appraisal of a new home, and also agreed to perform periodic construction progress inspections. The insured appraiser completed eight construction progress reports on pre-printed forms provided by the lender and attached a cover sheet to each report which stated in bold print that "The attached inspection report is prepared solely for the benefit of [lender] to assist with making loan disbursements. It is not prepared for the benefit and should not be relied upon by the borrowers or by any other party".

Further, the construction loan agreement clearly stated that the "inspector's" reports would be for the lender's use only and were not prepared for the benefit of the borrowers. In addition, each disbursement payment was made payable jointly to the contractor and to the borrowers, consequently the borrowers had to endorse the check before the contractor would be paid.



At the time of his last inspection, the insured appraiser opined that the property was 89% complete. The contractor and the borrowers got into a dispute about woodwork that still needed to be done and ultimately the contractor refused to finish the job. There was only \$26,500 of the original loan proceeds left to complete the construction and the new contractor opined it would cost much more than that to complete the home. The borrowers included the insured appraiser in a lawsuit to recover excess costs.

We filed a motion for summary judgment. The borrowers argued that none of the progress inspection reports they received from the lender had a cover page attached with the insured appraiser's additional language; however, the court agreed that no duty was owed to the borrowers by the insured appraiser, and granted our motion. The court based its decision on the language in the construction loan agreement and on the fact that the borrowers had agreed to all payments by endorsing the checks.

This experience showed the insured appraiser that it is better to include additional language on the report than on a separate page that could be detached.

Mistakes in the Land of 10,000 Lakes

After performing a "subject to completion" appraisal of a new townhouse in Minnesota, the insured appraiser was also retained to perform construction progress inspections. In his first construction progress report, conducted about thirty days after the "subject to completion" appraisal, the insured appraiser erroneously reported that construction was 85% complete. He meant to report that construction was 25% complete on the subject and 85% complete on the entire townhouse development. In the second construction progress report the insured appraiser stated that the exterior of the subject was 100% complete while the interior of the subject was only 50% complete.



More than one year later, the lender requested the insured appraiser do a third construction progress inspection. The insured appraiser reported that everything was the same as in his second construction progress report but added a comment that the subject showed signs of deterioration due to the property being left vacant and incomplete during the harsh Minnesota winter.

More than 3 $\frac{1}{2}$ years after the third construction progress report was completed the insured appraiser received a demand letter from the lender claiming that the insured appraiser had made a mistake in his first construction progress report. This was the first time the insured appraiser realized that he mistakenly stated 85% completion when he meant to report 25% completion, and the lender claimed to have relied on that report when they disbursed 85% of the loan funds to the contractor. The contractor diverted some of the money to other projects and never completed the construction, the borrower defaulted on the loan and the lender was unable to sell the property for the original appraised value.

The lender eventually filed a lawsuit against the insured appraiser and we defended the case for several years. We eventually settled the case to avoid a trial and since the insured appraiser made a mistake in his first construction progress report, however, the settlement amount was far less than the initial demand because the lender had to concede their contributory negligence.



It is not the intent of the article to establish an appraiser's standard of due care. Instead, the article makes suggestions about conduct that may be well above the standard of due care. This article is intended for general information purposes. It does not imply or warrant that implementation of suggestions will prevent claims. If you have specific questions after reading the article, you should consult an experienced local attorney to determine how applicable law relates to your specific facts or situation. No material contained herein may be reproduced in any manner without written permission.