The grass is not always greener

Appraiser liability in the US doesn’t look so bad when compared with other countries

by Peter T. Christensen

A trial court in 2014 awarded damages of $35 million to a commercial mortgage-backed securities issuer for alleged appraisal negligence by an international real estate firm’s valuation subsidiary.

The case involved the 2005 appraisal of a warehouse in which the originating lender made a $120 million loan based on the appraiser’s $148 million property valuation. The loan was then packaged into a CMBS offering.
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During the depths of the global financial crisis, both the warehouse owner and the tenant became insolvent. The CMBS issuer foreclosed in 2009, and the distressed property eventually sold for $25 million.

The CMBS issuer then sued the valuation subsidiary of the real estate firm, contending the property had been overvalued and blaming the firm for financial losses. A judge concluded that the “true value” of the property should have been $113 million, not $148 million, and based on that difference he found the firm negligent and liable. He ruled the recoverable damages to be $35 million.

Does it make you feel better knowing this terrifying case didn’t happen in the United States? It happened in a British court and concerned a German warehouse. The valuers were European, not American.

If you think appraisers have a tough time in the U.S., consider that liability can be worse in other parts of the world. Valuation firms in the U.K. and in Australia have far greater risk. Based on the severity of claims and insurance rates over the past decade, appraisers in the U.K. and Australia have faced liability risk two to three times worse than U.S. appraisers.

The same goes for Canada, where for the past decade appraisers have endured liability claims at a rate about 50 percent higher than in the U.S. The claims there tended to result in higher average damages, so Canadian appraisers pay about twice as much for professional liability insurance than do U.S. appraisers.

Before I go further, let me ease your concerns for the appraisers in the warehouse case (which was adjudicated in euros, not dollars). In November 2015, the U.K. Court of Appeal overturned the lower court’s decision. The Court of Appeal found that the “true value” of the warehouse was around 118 million euros (about $130 million) and that the appraiser’s valuation was within the “acceptable margin.” The lower court had previously established an acceptable margin of error of 15 percent, and because the valuation was within that range, the Court of Appeal absolved the appraisal firm of negligence.

How is it possible that the risk of appraiser liability is lower in the United States?

We are a notoriously litigious society, bogged down with multiple class actions and even lawsuits over hot coffee. Legal researchers have, in fact, confirmed that Americans file lawsuits more frequently than people in other
countries. A 2010 study by a Harvard University law professor and an Indiana University business school professor revealed that in the U.S. the number of lawsuits filed per 100,000 people in a single year was 5,806, compared with 3,681 per 100,000 people in the U.K. and only 1,542 in Australia. Canada had the fewest cases: 1,450 per 100,000 people.

When it comes to appraiser lawsuits, there’s something peculiar going on in the United States that allows appraisers to avoid litigation that ensnares their U.K., Australian and Canadian counterparts. How can this be explained?

**US appraisers produce better reports**

One possible explanation for why appraisers in America face lower liability risk is that they produce better appraisal reports. Now, let me explain before I spark an international incident. I can’t say which country’s appraisers actually produce more reliable valuations, but U.S. appraisers produce reports that are better at reducing the likelihood of legal claims being filed against them, and better at reducing the likelihood that filed claims will be successful. From a legal perspective, I believe that U.K. and Australian valuers (and, to a lesser extent, Canadian appraisers) can learn something from American appraisers about protecting themselves from liability.

Compared with the appraisal reports I’ve seen from the U.K. and Australia, U.S. reports contain more detail about both the property and the underlying valuation analysis. Appraisers in America typically show their work to a much greater extent by including in standard reports more information about how they arrived at their valuation. They also typically include detailed maps and more photographs of both the subject property and comparables. And they typically show their multistep process of adjusting sales comparables for different characteristics and conditions.

While some here bemoan the practice, the “thickness” of U.S. appraisal reports enables a reader or a reviewer to decipher whether an appraisal is generally a product of sound analysis backed up by relevant factual support. Very sloppy or incompetent work, therefore, is often disregarded or corrected before the user of the appraisal relies on it and potentially suffers harm. Despite serious legal claims in the U.K. and Australia, appraisal reports there often resemble letters (usually very well written letters) more so than presentations of detailed analysis supporting the value conclusion.

The additional content in U.S. reports also helps appraisers by serving as a form of disclosure. When defending a potential claim here, appraisers can usually point to something in the report (a photograph, a notation) that puts readers on notice of an alleged problem or condition that otherwise could serve as the foothold for a legal claim.

Also, the perceived litigiousness of American society has predisposed appraisers to include more disclaimer-type language in their reports than what is typically found in reports produced in other countries. While we might hear complaints about all the statements and limiting conditions in U.S. reports, the practice does help achieve a somewhat fairer economic balance between appraisal compensation and monetary risk in this country.

**Courts in other countries are less favorable to appraisers**

In discussing the German warehouse case, I noted how the British court applied an acceptable margin of error to determine whether the appraiser was negligent. This application is partly responsible for why appraisers there have bigger liability problems.

To evaluate appraisal negligence, U.K. courts have established the following general guidelines for acceptable margins of error:

- 5 percent for a standard residential appraisal.
- 10 percent for an appraisal of a more complex property or a commercial property.
- 15 percent — or higher — for a special property (such as a warehouse).

I’m simplifying it a bit, but when an appraisal falls outside these margins, a presumption is made that the appraiser was negligent and it is the appraiser’s responsibility to show how and why the opinion of value was developed. It’s difficult for an appraiser in the U.K. (or in Aus-
tralia, where similar rules exist) to overcome the presumption that the appraisal was negligent.

That difficulty is compounded by two other facets of the U.K. and Australian legal systems: First, judges in those countries focus less on sympathy for a defendant and more on the facts of the alleged negligence. If they find fault with a defendant appraiser, they expect the appraiser to pay for the loss. Second, in the U.K. and in Australia, an entity that wins a lawsuit usually is entitled to recover legal fees from the loser, which is not typically the case in American courts. The chance of such recovery means that a party with a valid claim against an appraiser is more likely to file a claim.

Canada, on the other hand, does not have a court-established margin of error analysis embedded in its legal decisions, but its judges certainly seem to share the no-nonsense approach to a defendant appraiser’s liability. With talk of real estate bubbles forming in both Vancouver and Toronto, we may have more opportunity to observe Canadian appraiser liability issues in the near future.

**How bad can it get for appraisers outside the US?**

Let’s take a deeper look at how scary it can be for appraisers working outside the United States. In 2011, a British court decided a case filed on behalf of investors against an appraisal/real estate services firm then called Drivers Jonas (now Drivers Jonas Deloitte). The venerable firm traces its roots to the middle of the 18th century. Through an investment trust set up in 2001, the investors had acquired the remainder of a 155-year lease to a historic building for redevelopment into a factory outlet center. Drivers Jonas valued the property at 48 million pounds (nearly $59 million), and at 63 million pounds ($77.3 million) when certain tax advantages were factored in — and that’s the amount the investors paid.

The factory outlet center was not commercially successful, never reaching more than 80 percent tenant occupancy, and the managers of the investor trust sued Drivers Jonas for overvaluing the property. The central allegation of negligence was that the firm had not commissioned a study of projected consumer spending at the center and therefore did not discover that rent projections were unrealistic.

The trial court found that a competent valuation of the factory outlet center would have fallen within a range between 31.9 million pounds ($39.1 million) and 36.8 million pounds ($45.1 million) without the tax allowances. At 48 million pounds, the Drivers Jonas valuation fell outside the acceptable margin of error. Accordingly, the court found Drivers Jonas negligent and awarded damages against the firm in the amount of 18 million pounds ($22 million), plus interest totaling 8.5 million pounds ($10.4 million).

The damages award was later cut by approximately 6 million pounds ($7.3 million) because the Court of Appeal concluded that certain tax benefits received by the investors should have been subtracted, but the appraisal firm remained on the hook for the rest.

It can get worse. Earlier this year, Australian business news sources reported on a large lawsuit by a bank against a commercial appraisal firm (a subsidiary of an international company). The bank reportedly was seeking more than 100 million Australian dollars ($76.6 million) in damages based on an allegedly inflated appraisal for a loan for a large-scale development. In the midst of the lawsuit, the firm had filed for the Australian version of receivership. The news sources suggested that the firm’s shutdown resulted from loss of appraisal work due to the lawsuit and the firm’s inability to obtain new professional liability insurance — a necessity for practicing in Australia — after holding discussions with more than a dozen potential insurers.

A cautionary note, then, for appraisers contemplating assignments outside the United States or for foreign clients: Pay heed to potential risks and your client’s views on appraiser liability.

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**About the Author**

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