Double trouble

IN SECTION: LEGAL MATTERS — PROTECTING YOUR BUSINESS AND YOURSELF

How risky are hybrid appraisals, and where do the hazards lurk?

by Peter T. Christensen

Lawsuits related to hybrid appraisals have been filed against appraisers for years. By hybrid appraisals, I mean assignments in which appraisers forgo their own inspection of a property and instead provide an opinion of value utilizing a third-party property condition inspection.

There are various hybrid products available for residential lending, but I haven't seen many significant claims in that context. That's because it's still early in their adoption and hybrids typically haven't been used for extending credit until recently; when they have, it's been for low-risk lending within the relatively safe environment of a rising real estate market in which few new loans have defaulted.

Why then did I announce that I've seen claims against hybrids for years? Because hybrids performed outside the residential lending sector have generated their share of professional negligence claims.

For example, an appraiser was retained to appraise a large property with diverse uses and resources. Part of the property held significant timber, and a forester was engaged to provide a timber cruise — a sample measurement used to estimate the amount of standing timber in a forest and its characteristics, condition and value. The appraiser included this third-party inspection in his report and arrived at his opinion of value in part based on the timber cruise.

Unfortunately, one of the users of the appraisal later alleged that the value was inflated because the condition of the timber was inaccurate and sued the appraiser (and the forester) for negligence. The appraiser asserted that the timber cruise was not his work product and that fact was clearly stated in the report. The plaintiff countered that because the timber cruise was included within the report, the appraiser was responsible for determining whether the information is reliable. The lawsuit is pending.

This case offers a glimpse of the potential liability risk for appraisers who perform hybrids for residential lending. I fully anticipate that plaintiffs will drag appraisers into lawsuits about property condition despite the fact that the appraisers did not perform the inspections. That's because plaintiffs and their attorneys see appraisers as being responsible for the appraisal and everything included in the report.

That’s not a huge leap from the lawsuits we currently see against residential appraisers who misidentify flood zones based on third-party flood mapping, for example.

When assessing liability risk related to hybrids for residential lending clients, it’s important to know how the appraisal will be used and to whom it may be supplied. There’s a big difference in risk between an appraisal that’s used internally by a lender or mortgage investor for evaluating existing loans or real estate-owned properties, compared with one used to support an extension of credit — in this instance, the borrower likely will receive a copy of the report. However, risk multiplies when reports are exposed to borrowers. Currently, 60 to 70 percent of the legal claims we see against appraisers come from borrowers. Therefore, the appraiser’s risk is significantly diminished when a hybrid appraisal is only used internally by a lender, mortgage investor or other client.

The qualifications and the aptitude of the third parties providing property condition information can add risk to hybrids. There are no standards for the inspectors, and inspectors may or may not be named in the report. Third parties may or may not be insured. It’s my strong hunch that many inspectors won’t be helpful — or even present — if a borrower files a lawsuit. I suggest that appraisers research the third parties providing inspection data to make sure they’re reputable sources.

I also suggest that appraisers carefully review the proposed hybrid appraisal forms. Some of the new products are missing key liability prevention components. The worst forms just copy standard language from the Uniform Residential Appraisal Report forms developed by Fannie Mae and Freddie Mac. In particular, appraisers should review the intended user and intended use language and any wording about who may rely on the report. Particularly concerning is anything resembling the sloppy wording in Certification No. 23, which states, in part, "the borrower … may rely on this report."

Since there are no industry-entrenched hybrid appraisal forms yet, appraisers should consider them a blank canvas on which to include their own protective language. Consider adding to the form language along the lines of:

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, and the appraiser shall have no liability to any such parties or any other party not identified by the appraiser as an intended user. Parties other than the client and intended user(s) identified in this report 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 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 condition of the property or other matters reported by any third party.*

If hybrid appraisals take hold in the market, we will surely see claims about them in the future — as we do all types of appraisal work — and I will update advice and suggestions accordingly.