

# Fact vs. fiction

Don't let these four appraiser liability myths trip you up

by Peter T. Christensen

**I**worry that some myths about appraiser liability will never go away. These myths are repeated to the point that they're basically accepted as fact. Here, I've collected four of the most common myths concerning appraiser liability in an attempt to bust them once and for all.

## Myth No. 1

**I don't have personal liability for my appraisals because I organized my firm as a limited liability company.**

**Truth:** While that sounds like a reasonable understanding of the legal protections that come from forming a limited liability business, the statement is incorrect.

Operating a valuation firm as a limited liability company, an S-corporation or a limited liability partnership can be a smart business move. Selecting the right business form depends on individual personal and business circumstances, with each form presenting advantages and disadvantages related to taxation, retirement planning, outside investment and financial liability.

However, forming an LLC, an S-corporation or an LLP doesn't insulate appraisers from liability for claims about their own alleged professional negligence. The appraiser carries the license; therefore, the appraiser personally is responsible for the work and liable for professional errors. The firm itself also has potential liability, but it's vicarious through the work of its staff, which is why it's common to see both the appraiser who performed the appraisal and the appraisal firm named as defendants in professional negligence lawsuits stemming from deficient appraisals.

This hard truth doesn't mean appraisers should avoid organizing their firms using limited liability business forms. Choosing the right form can offer tax, retirement and other benefits, as previously noted. Additionally, when there are multiple appraisers working in a single firm, a limited liability business form will serve to insulate the appraiser-owner

against personal liability for the professional negligence of another appraiser's work, as well as from other business liabilities.

## **Myth No. 2**

**Lenders require appraisers to carry E&O insurance because they routinely seek to hold appraisers responsible for loan losses.**

**Truth:** A few lenders and servicers have experimented with systematically suing appraisers over loan losses, but they failed in their efforts and discovered it's not a good business plan. The most spectacular failed experiment was backed by Impac Mortgage Holdings, which authorized third-party collectors like Llano Financing Group to sue more than 500 appraisers between 2014 and 2016.

The fact is, lenders only account for about 30 percent of claims filed against appraisers. Lenders typically don't sue appraisers to make up for loan losses; they sue when they believe an appraiser's negligence was particularly egregious and clearly caused a loss. Therefore, appraisers who perform residential and commercial appraisals for lenders mainly have E&O insurance to protect against claims filed by aggrieved borrowers and property purchasers, who account for 60 to 65 percent of current claims.

## **Myth No. 3**

**The only appraisers who get sued are those performing appraisals for mortgage lending.**

**Truth:** The origin of this myth most likely correlates with the significant amount of valuation work performed for lending purposes — the more lending work, the greater the liability risk, the thinking goes. However, 20-plus years of appraiser claim records in LIA's insurance program disproves this myth. Expert witness work, tax work, estate work and arbitration work all produce liability claims against appraisers.

In one case, an appraiser serving as an expert was sued by his client because the client's win wasn't financially rewarding enough. The client claimed in a subsequent professional liability lawsuit that the appraiser wasn't suitably persuasive as a testifying expert.

Appraisers should recognize there is potential liability risk for non-lending work because failing to do so actually increases their risk.

## **Myth No. 4**

**Liability risk for appraisers is out of control.**

**Truth:** Some appraisers see potential liability risk at every turn, but the reality is, lenders and mortgage investors sue appraisers in small numbers — even at the height of the most recent recession and mortgage crisis. For the most part, lenders and investors eat their losses or sue each other.

There also are appraisers who believe that valuation work for litigation purposes must be filled with liability risk — a line of thought not unlike those who believe lending work results in copious claims.

For example, appraisers who perform appraisals for condemnation cases may have liability fears rooted in a belief that they will be sued if they serve as an expert witness for a government agency and the property owner whose land is being condemned is unhappy with the valuation. While these lawsuits happen — and appraisers are right to exercise caution and protect themselves — the reality is that these types of claims are not and never have been out of control.

Are some appraisal assignments riskier than others? Certainly. There are three areas that generate an inordinate number of claims (relative to the volume of assignments):

1. Appraisals used in offering statements, sales documents or prospectuses for equity investments in the subject property.
2. Appraisals used to support federal income tax deductions for conservation and building façade easements.
3. The reporting of construction progress by appraisers for purposes of construction loan disbursements.

If you work in any of these three areas, take heed and know your risks. However, overall liability risk for appraisers is manageable, and liability fears should not discourage you from taking an assignment for which you are qualified.