

## Liability Issues and Prevention for Real Estate Appraisers

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## Purpose of Seminar

- Update you on the most common liability issues that affect good appraisers -- so that you know the higher risk areas that actually cause claims
- Make you more defensible in court
- Leave you with the understanding that using plain English addressing property issues is very important, even more important than "boilerplate"
- Explain that liability for good appraisers is not out of control.



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## Some Basic Pieces of Loss Prevention Advice

- Be vigilant in identifying your clients, intended users and uses in your reports and cover letters
- Proofread reports
- Keep strong workfiles
- Keep workfiles well beyond USPAP's minimum
- Use plain English in your report to describe special conditions and issues affecting the property
- Follow your gut instinct about clients or situations that pose a high risk



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### Increase in Appraiser Claims 2006-2013

- Overall claims have increased about 95% since prior to the mortgage crisis.
- For residential appraisers, the odds are currently about 1 in 30 each year that the appraiser will receive a demand for damages, lawsuit or disciplinary complaint.
- The odds are better for commercial appraisers but the damages defense costs are more severe on average.
- Valuation losses and liability risks have increased *far more* for lenders and investors but most of that liability actually does not trickle down to individual appraisers.



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### Why So Many Claims?

- Declining real estate prices, record levels of mortgage defaults and weak economic conditions – have a direct relationship to the volume of appraisal-related lawsuits
- Greater social acceptance for filing lawsuits relating to mortgage issues
- Appraiser and appraisal are more visible
- More liability shifting in the mortgage business – mortgage repurchases, mortgage insurance denials
- Erosion of concepts of client and intended use



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### Who Sues Appraisers?

- Borrowers/purchasers (>50%)
- Lenders (small v. big, bank v. alternative lenders)
- FDIC
- Sellers
- Other parties
  - Real estate agents and brokers
  - Random third parties
  - Litigants (expert witness work)
- Very few AMCs (so far)



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## Allegations from "Typical" Buyer's Remorse Case

22. On or around October 2009, Plaintiffs obtained a forensic appraisal of the Subject Property. The appraisal verified that Defendants' representations regarding the fair market value of the Subject Property when it was purchased in 2002 had been significantly overstated. The forensic appraisal indicated in pertinent part as follows:

It is our opinion that the market value of the Leased Fee Interest in the subject property, as of October 20, 2002, should fall within a value range of \$680,000 to \$720,000. This range of value has been based on a review and analysis of numerous sales and rent comparables of auto-service related facilities in the Northern California marketing area which had closing dates between 2000 and early 2003 (and also included an analysis of the four sales and four rent comparables utilized in the original appraisal report—which were represented by the same four properties). It appears that the original appraised value of \$920,000 and contract sales price of \$935,000 were substantially above market value. This may have occurred for a number of reasons from both an appraisal perspective, but also from a lack of fiduciary responsibility on the part of the other real estate professionals involved in the transaction.

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## "Wait . . . What About the Statute of Limitations? That appraisal was 8 years old."

Statutes of limitation for claims against appraisers:

- Have no relationship to USPAP's 5-year recordkeeping requirement
- May be subject to the "discovery rule"
- Are extended for the FDIC and some others
- Vary by the type of claim
- Vary by state

So how long is it in Kentucky?

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## "Wait . . . What About the Statute of Limitations? That appraisal was 8 years old."

Statute of limitation for claims against appraisers in Kentucky: 1 year, with a "discovery rule"

KRS 413.140 "Actions to be brought within one year."

Includes, at subparagraph (f) "[a] civil action, arising out of any act or omission in rendering, or failing to render, professional services for others, whether brought in tort or contract, against a real estate appraiser holding a certificate or license issued under KRS Chapter 324A[.]"

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## Statute of Limitations Example



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## Statute of Limitations Example



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## Statute of Limitations Example



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## Kentucky Statute of Limitations One Year from the Date of Damages:

In the case of *Mahaffy Land Services, Inc., v. Gretna Park, LLC*, in support of the contention that the statute of limitations should have begun to run when [redacted] discovered the fraudulent construction progress reports. 230 S.W.3d 586 (Ky. 2007). However, the *Mahaffy* case is factually distinguishable from the present action. *Mahaffy* involved an action by a developer against a contractor for damages resulting from a failure to perform. There is no dispute that the contractor's actions caused the developer's loss of the property. [redacted] was sold, there was a possibility, however remote as a practical matter, that [redacted] would suffer no damages from Defendants' actions, and the amount of damages was purely speculative. Thus, the Court cannot find a factual or legal basis for distinguishing the *Mahaffy* case. The facts are virtually identical, and the Supreme Court recognized that even a theoretical possibility that no damages would be suffered is sufficient to toll the statute of limitations until the foreclosure sale.

"...even a theoretical possibility that no damages would be suffered is sufficient to toll the statute of limitations until the foreclosure sale."





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## "Wait . . . What About the Statute of Limitations? That appraisal was 8 years old."

How about in OH?

4 years, from the date appraisal performed.





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## Case Example Farmers & Merchants v. Putnam U.S. District Court, N.D. Ind. (2009)

"Plaintiff Farmers & Merchants Bank . . . filed this action on June 13, 2008, against Defendant Margaret Luanne Putnam, a licensed real estate appraiser, advancing claims of negligence, deception . . . and fraud on a financial institution . . . The claims arise out of an appraisal Putnam performed on September 13, 2001, on certain real estate purchased by David Schimmele, whom F & M Bank loaned \$200,000."





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**Case Example**  
**Farmers & Merchants v. Putnam**  
**U.S. District Court, N.D. Ind. (2009)**

"The statute of limitations in Indiana for claims based upon negligence. . . is two years. . . the two years begins to run when 'the plaintiff knows, or in the exercise of ordinary diligence could have discovered, that he had sustained an injury as the result of the tortious act of another.'"



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**Case Example**  
**Farmers & Merchants v. Putnam**  
**U.S. District Court, N.D. Ind. (2009)**

"Putnam first asserts that F & M Bank should have discovered that it had a potential claim against her for her appraisal on or before October 29, 2001, when it issued the loan to Schimmele allegedly without exercising reasonable diligence in accordance with its own lending policy and federal banking regulations. . .

Putnam also asserts that even if F & M Bank did not discover its potential claim in October 2001, it again received notice of the potential claim in 2004 and 2005 when it was issued subpoenas from the OCC concerning Schimmele's loan. . . ."



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**Case Example**  
**Farmers & Merchants v. Putnam**  
**U.S. District Court, N.D. Ind. (2009)**

"And finally, Putnam contends that there is absolutely 'no doubt' that as of April 27, 2006, F & M Bank had actual knowledge that it may have sustained damages as a result of Putnam's appraisal, because it made the following statement in its complaint against Schimmele filed in Allen Circuit Court: 'Schimmele knew that the real estate was worth less than the \$616,000 appraised value when he applied for the loan. Schimmele's statement concerning the value of the real estate was false when he made it.'"



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**Case Example**  
**Farmers & Merchants v. Putnam**  
**U.S. District Court, N.D. Ind. (2009)**

"In the face of that April 2006 statement, F & M Bank's current assertion that . . . it had no reason [at that time more than two years before filing its lawsuit against the appraiser] to question the accuracy, completeness or validity of the Putnam 2001 Appraisal or to question her competency, professional skills, integrity, or honesty is a bit hard to swallow."

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**What Happens When I Get Sued?**



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**Telltails of a Claim**

- Telephone call
- Requests for information
- Subpoena for deposition testimony or documents (appraisal, workfile)
- Administrative/licensing complaint
- Demand letter
- Served with a lawsuit

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The acts, errors, and omissions described above total a known and quantifiable loss to date of \$3. million, caused by 's negligent and grossly negligent performance of appraisal services, breaches of fiduciary duty, aiding and abetting, and breaches of contract. You may have insurance coverage available for some or all of these claims. We suggest that you report this claim to your insurer as soon as possible.



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### A Word on Subpoenas

US v. 2,091. 712 ACRES OF LAND, U.S. District Court, Eastern District North Carolina 2010

"The law does not afford an evidentiary privilege to professional appraisers. Moreover, the USPAP rules themselves explicitly contemplate the production of such documents to 'third parties as may be authorized by due process of law.'"



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### Engagement Letter – Suggested Language Subpoenas and Testimony

*In the event that Appraiser is required by subpoena or other legal process to provide testimony or produce documents relating to Appraiser's services or report(s) prepared under this Agreement, whether in court, deposition, arbitration or in any other proceeding, and regardless of the identity of the party requiring such testimony or production of documents, Client agrees to compensate Appraiser for the time incurred by Appraiser in connection with preparation for and provision of such testimony and/or documents at Appraiser's hourly rate of \$ and to reimburse Appraiser's reasonable actual expenses.*



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### Engagement Letter – Suggested Language Confidentiality

*Client specifically consents to and authorizes Appraiser to disclose Appraiser's report(s) and other information relating to the appraisal assignment(s), including information which may be considered confidential, to third persons for the purpose of Appraiser's response to or defense of threatened or actual legal or regulatory actions and for the purpose of seeking insurance coverage.*



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### How To Respond to a Suit?

- **What to Do About It**



- Don't ignore it
- Do Not Delay
- Report it to E&O Carrier
- Never admit liability
- Think about potential informal resolutions



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### How to Turn a Potential Claim into an Actual Claim Part 1 – Chase "Quality Review" Letter

Dear Appraiser:

Your appraisal was selected for a quality review analysis by Chase Appraisal Panel Management. During the course of our review our analysis uncovered the following possible USPAP violations:

1. USPAP Standards 1-2(c)(i), 2-1(a), 2-2(b)(iii): The appraisal appears to be in violation of USPAP standard rules regarding proper identification and reporting of subject's property data and characteristics as well as reporting in a manner that will not be misleading.
  - a) In the neighborhood section on page one, no box is checked for subject location; however it is noted as rural per comments. It is noted to be built up "over 75%" yet comments state rural area with properties of 2-20 acres and satellite imagery shows a very sparsely populated area.
  - b) No zoning information is provided. Per public record, the subject is zoned LCA11 – residential with light agriculture and farm animals acceptable. However use code per public record indicates "quadplex". Public record living area is noted as 4,858sf with 12BR, 4 bath and 4 separate units. The report provides no discussion of this data.



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## How to Turn a Potential Claim into an Actual Claim

### Part 2 – Appraiser's Appeal

“Dear Appraisal Panel,

I would like to appeal your previous decision to place me on your Exclusionary list.

The appraisal in question was admittedly sketchy and very lacking in detail and clarity of presentation. I was truly appalled myself preparing the rebuttal to your review and I acknowledge that it did not meet the appropriate standards of reporting that it should have.

However, this was truly not representative of my work in 2007, nor does it have any similarity at all to the work that I do currently . . .”

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## How to Avoid a Potential Claim

1. The subject previously sold for \$77,000 on 10/09/2002. I appraised the property for \$85,000 on 04/13/2004. This means the review was \$10,000 under the original sales price. My notes reflect the property was in average condition with no deferred maintenance issues. At the time of the appraisal, real estate in Hamilton County was appreciating at a rate of at least 3% to 4% per year. Assuming 3%, the appreciation rate alone supports an \$85,000 value.
2. In addition, I do not believe the reviewer kept in mind the market conditions of the time. Even though there were, of course, some foreclosures and over-valued properties in the market area, there were also many homes in inventory and many properties available for investors. As an appraiser, my job was to estimate value based on the reactions of the typical buyer and seller. My opinion was that the subject's value based on the market conditions of the time.
3. The complainant alleges that I used comparables that were quite larger than the subject. My comparables were larger. However, I made an adjustment for the differences in the appraisal. The size issue was not ignored. My opinion was that the typical investor, and the owner of the property was an investor, was less interested in size than condition. All of my comparables were equal in condition, were closer to the subject in age than the reviewer's comparables, and were closer in location.

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## How to Avoid a Potential Claim

- Division of Real Estate  
March 3, 2010  
Page 2
4. In fact, the reviewer's comparables were substantially further in distance. The reviewer stated that it was necessary to use more distant comparables in order to have comparables equal in condition. I believe such a statement is inaccurate and misleading. My comparables were closer in distance and more comparable in age and condition as well.
  5. The reviewer's comparable sales #2 and #3 were a mile or more from the subject (the reviewer lists comparable sale #2 as 1.00 miles, but it is actually closer to 1.30 miles from the subject). At this distance, both of those sales which would have been outside my search parameters for comparable sales and would not have been considered because there were better and closer comparable sales, which were used in my appraisal.
  6. The MLS shows the reviewer's comparable sale #1 was "priced to move quickly" which suggests deferred maintenance, needed repairs, or other defects. At roughly half the age of the subject, however, I do not consider the reviewer's comparable sale #1 as a good comparable given the existence of the better comparables which were used.

In conclusion, I think the main point is to consider the reactions of the typical buyer and seller on 04/13/2004, the effective date of the appraisal, and not to be swayed by the economic issues of the area after that date.

Please contact me if you need anything further, or more clarification on the complaint.

Thank you for your assistance in this matter.

Sincerely,

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## How to Avoid a Potential Claim

The Division of Real Estate & Professional Licensing has completed its investigation in the above-referenced matter. This investigation did not disclose reasonable and substantial evidence to prove a violation of Chapter 4763 of the Ohio Revised Code. Therefore, no further action will be taken on the complaint and the file will be closed.



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## The Progress of a Lawsuit

- Complaint – attorney representation
- Discovery – written and depositions
- Mediation/settlement
- Trial and appeal
- Toll of litigation
  - Financial and time burden
  - Emotional burden



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## Residential Appraisers

### Most Common Bases of Claims (Non-Value)

- Square footage errors
- Sewer vs. septic
- Construction progress report
- Property condition items:
  - Leaky roof
  - Foundation/structural problems
  - Mold




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### Kentucky Case Example Sued for Alleged Failure to Identify Termite Infestation

- Sparks v. RE/Max Realty, 55 S.W.3d 343 (2000).
  - The Sparks purchased a residence with an FHA loan.
  - Later discovered termite infestation.
  - Sued real estate brokerage, termite inspector and appraiser.
  - The Sparks had signed a special form, however, called "Important Notice to Purchasers Regarding the Property Which You Are Purchasing."




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### Kentucky Case Example

"Important Notice to Purchasers Regarding the Property Which You Are Purchasing."

"The undersigned purchasers hereby acknowledge that: ... Any appraisal made for the property which we are purchasing was made only for the benefit of Kentucky Mortgage Company, and should not be relied upon by any other party."

Court's decision: because the plaintiffs signed the disclosure acknowledging that they could not rely on the appraisal, the appraiser had no duty of care to them.




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### Commercial Appraisers

#### Most Common Bases of Claims (Non-Value)

- Square footage errors
- Zoning
- Special property issues
  - Inability to develop, wetlands, access
- Income analysis
  - Overstated revenue
  - Understated expenses




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### How Should the Appraiser Deal with This?



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### Use Plain English Disclosures

**Square Footage Issue:** "Appraiser notes that public building records, tax records and information supplied by the owner differ with respect to the square footage of the building structure. Floor plan is unique and difficult to measure. Appraiser's measurement is approximate."

**Septic/Sewer:** "Appraiser unable to verify whether property is serviced by sewer or septic due to inconsistent information provided in public records/data sources. Owner advises he thinks property is connected to public sewer. Further inspection recommended."

**Pet Feces Issue:** "The appraiser observed cat feces and kitty litter on every carpeted surface in the living area of the subject property."

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### Use Plain English Disclosures

- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are the appraisers personal, impartial, and unbiased professional analyses, opinions.

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## Use Plain English Disclosures

- The analyses, opinions, and conclusions are not facts; they are the appraiser's personal and professional opinions.



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## Use Plain English Disclosures

- The analyses, opinions, and conclusions in this report are exclusively for the use of the client and anyone other than the client cannot rely on them.



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## Use Plain English Disclosures

This is not a home inspection: "The appraiser is not a home inspector and the appraisal report is not a home inspection. The appraisal report does not guarantee or imply that the house is free of defects. The appraiser only performed a visual observation of accessible areas and the appraisal report cannot be relied upon to disclose conditions and/or defects in the property."



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## Confusion leads to problems and Lawsuits

- Based on the inspection and the estimated budget and expenditures to date...Building 5 is 85% complete and Building 6 is 80% complete, as of the date of inspection.



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## Confusion leads to problems and Lawsuits



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## Confusion leads to problems and lawsuits

- 15. Upon inquiry, the Defendants advised that the inspection reports provided to First Rock Bank referencing Buildings 5 and 6 only referenced the state of completion for Building 5.
- 16. The loan is currently in default.



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## What Kinds of Things Do Appraisers Get Sued For?

- Overvaluation
  - "I borrowed too much money"
  - "We paid too much for the property"
  - "We lent too much money"




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### Typical Lender "Overvaluation" Lawsuit against a Residential Appraiser

**THE SUBJECT LOANS --**  
TRANS. NO. 1 -- THE ROGER [REDACTED] LOAN

41. On or about December 27, 2007, [REDACTED] lent \$405,000 to Roger [REDACTED] to refinance the property at [REDACTED] in Elk Grove, California, based upon the loan package BayCal prepared and submitted to [REDACTED]. (See the documents in Exhibit C).

42. BayCal chose Defendant Robert [REDACTED] to appraise the property, and he appraised it at \$540,000.

43. Based on that appraisal, [REDACTED] funded the loan and, subsequently, sold the loan to Fannie Mae.

44. But in July 2009, Fannie Mae demanded that [REDACTED] repurchase the Roger [REDACTED] loan package due to the Robert [REDACTED]'s negligent (or fraudulent) appraisal; the property's true market value at the time of the original appraisal was only \$370,000, as shown by a review appraisal. [REDACTED] had inflated the property's true value by \$170,000 or 46%.

45. As a direct result of his negligence (or fraud), [REDACTED] was forced to pay Fannie Mae \$185,372.00.




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### Typical Lender "Overvaluation" Lawsuit against a Residential Appraiser

157. Robert [REDACTED] failed to note in his appraisal that the property had been listed for \$519,000 and then reduced to \$484,000 between July 2060 and June 2007, and that the listing was withdrawn five months before his appraisal, after 354 days on the market.

158. Robert [REDACTED] knew, or should have known, that [REDACTED], or another lender, would rely upon his appraisal, since BayCal functioned as the mortgage broker and not as the ultimate buyer of the mortgage loan.

159. [REDACTED] has incurred damages proximately caused by the Robert Peterson's negligent appraisal in the amount of \$185,372.00, plus interest, attorney fees and costs.

WHEREFORE, [REDACTED] Bank, FSB respectfully requests that this Court enter judgment in its favor and against appraiser Robert [REDACTED] in the amount of at least \$185,372.00, together with costs, interest and attorneys fees.




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## High Risk Activities




- Flips
- Becoming more common again – with foreclosure and short sale properties being acquired by investors with cash and then flipped to purchasers using regular financing

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## Loss Prevention Advice

- Fully identify, disclose and analyze the prior sale
- Why was the prior sale lower? Explain.
- Is the present sale really a market sale? Undisclosed concessions or terms?

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## High Risk Activities




- Construction progress reports

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## High Risk Activities



As of the inspection date, the exterior of the building is nearly complete. The percentage of completion of the building is estimated to be approximately 89% to 90% complete.



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## High Risk Activities



- Appraising the amount to be paid under a lease or purchase option



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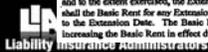
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## High Risk Activities



Extension Terms only (if exercised), Landlord will provide Tenant with its reasonable determination of the prevailing rent for similarly situated retail real estate and improvements in the North Columbus, Ohio area (the "Market Rent") within thirty (30) days of its receipt of the Extension Notice. In the event that Tenant objects in writing to Landlord's determination within ten (10) days of receipt of Landlord's determination, the parties shall, for a period of thirty (30) days after receipt of such notice (the "Negotiation Period"), negotiate in good faith to arrive at a Market Rent to apply during the applicable Extension Term, accessible to both parties. In the event that Landlord and Tenant are unable to agree on the Market Rent during the Negotiation Period, Landlord and Tenant shall each, at its own expense, engage an appraiser, qualified in the appraisal of retail properties in the North Columbus, Ohio, area within fifteen (15) days after the expiration of the Negotiation Period. The appraisers shall determine the Market Rent for the Demised Premises within thirty (30) days after being engaged. If the two appraisers agree or are within ten percent (10%) of each other, the Market Rent shall be the average of the two appraisals. If the two appraisers are further than ten (10%) apart, the two appraisers shall jointly appoint a third appraiser, similarly qualified, whose fee shall be shared equally by Landlord and Tenant. The two appraisers shall have fifteen (15) days after the submission of the later of the two appraisals to appoint the third appraiser. The third appraiser shall make its determination not later than twenty (20) days after being engaged. The Market Rent shall be the average of the three appraisals, ignoring, for the purpose of such averaging, any appraisal which is more than ten percent (10%) in excess or less than the middle appraisal. The determination of the Market Rent, whether agreed to by the parties or established by the appraisers, as provided herein, shall be the Basic Rent during the applicable Extension Term and shall be binding upon Landlord and Tenant. The "Demised Term" is hereby defined as the Initial Term collectively with, and to the extent exercised, the Extension Terms. Notwithstanding the above, however, in no event shall the Basic Rent for any Extension Term be less than the Basic Rent in effect immediately prior to the Extension Date. The Basic Rent for the second Extension Term shall be determined by increasing the Basic Rent in effect during the first Extension Term by fifteen percent (15%).



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## Loss Prevention Advice

- Take photos
- Be accurate
- Clarify the scope with limiting language

*"This report is for the benefit of the lender to assist in making loan disbursements. It is not prepared for the benefit of the owner/borrower. The purpose of this inspection is to determine the degree of completion and not the quality of construction, workmanship, or compliance with technical specifications or requirements."*






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## The Best Defenses (Lending Appraisals)

- A Diligent Appraisal – and
- A Good Work File
  - Organization and appearance matter
  - Engagement letter
  - Photos, photos, photos
  - Documentation of anything out of the ordinary
  - Special instructions, responses to questions
  - Zoning issues
  - Blue prints or plans given to appraiser
  - Disregarded sales, evidence you didn't just search a narrow bracket of sales





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## Appraisal Firm Myth

"I don't have any personal liability because I have an LLC . . ."




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## If You Want Your Limiting Conditions to be More Effective, Include a Reference to Them in Your Terms of Engagement

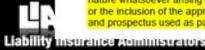
Kitsap Credit Union (KCU) asked Lauren Ellis to prepare an appraisal of a development project in Kitsap County. The record contains no information about the terms, payment, or expectations agreed to by the parties, but the parties do not dispute the existence of this initial contract. Ellis prepared the appraisal and submitted the completed appraisal report to KCU in January 2003. The parties do not dispute that KCU paid for and used the appraisal.

The appraisal summary included language limiting the use of the appraisal to "the sole and exclusive use of [KCU] for use only in "internal decision making regarding construction financing."

The clause further states that the appraisal "is not to be relied upon by any third parties for any purpose whatsoever" and limits Ellis's responsibility to KCU. KCU provided it's borrower with a copy of the appraisal.

In July 2007, several plaintiffs brought a lawsuit alleging a fraudulent investment scheme involving an agent of KCU's borrower. Ellis was named in the suit as having provided appraisals for use in valuing the project. The disagreement between KCU and Ellis arose when Ellis attempted to invoke the indemnification clause he had included on page twelve of the appraisal summary.

The client agrees to indemnify and hold harmless Ellis Consulting [sic], its officers, and employees from any and all claims for loss and liabilities of any nature whatsoever arising out of or related to this contract, the appraisal report, or the inclusion of the appraisal report as an exhibit to a registration statement and prospectus used as part of a real estate securities offering.



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## Engagement Letter Issues Reference Your Limiting Conditions

*"Appraiser's report(s) will be subject to the statements and limiting conditions set forth in the report(s). Appraiser's anticipated statements and limiting conditions are attached hereto as Exhibit [X]; additional statements and limiting conditions may be developed during performance of the appraisal assignment(s) and set forth in the report(s). All such statements and limiting conditions are incorporated into and form part of this Agreement. In addition, Client's use of the report(s) shall also confirm acceptance of the statements and limiting conditions in the report(s)."*



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## E&O Insurance

- Appropriate Limits of Liability
- Understand What "Claims Made" Means and the Importance of Maintaining Coverage for Prior Acts
- Most Relevant Exclusions in Some Policies (Not All)
  - Supervised Work, Subcontractors, Trainees
  - Fee Disputes
  - Mold
  - Construction Progress Reports
- Tail/Extending Reporting Coverage



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## Loss Prevention Overview

- Be vigilant in identifying your clients, intenders users and uses in your reports and cover letters.
- Use language to make reliance on your report unjustifiable by non-intended users or for unintended purposes.
- Keep a strong workfile.
- Keep the workfile well beyond the minimum required by USPAP



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