Appraiser's Liability For False Or Negligently Prepared Appraisal

LAWRENCE H. JACOBSON AND LLOYD CHAPMAN

Mr. Jacobson is a Partner in the Woodland Hills, California law firm of Kindel & Anderson and practices in both the business and real estate areas. He has extensive experience with cases involving mortgage banking, real estate syndication, acquisition and development of real estate and real estate brokerage. He is a past president of the Association of Real Estate Attorneys and was Vice President of Legal Affairs of the California Association of Realtors.

Mr. Chapman is an associate at Kindel & Anderson with their litigation department. He also holds a degree in economics from UCLA and brings this expertise to his work in real estate related litigation.

Appraiser's Liability For False Or Negligently Prepared Appraisal

by
Lawrence H. Jacobson and Lloyd Chapman

THE BANKING CRISIS

THE banking and thrift industry is in serious trouble. Despite five years of expansion by the United States economy as a whole, many banks and savings and loan associations are racked by troubles in the farm belt, depressed conditions in the oil patch and unwise real estate ventures all over the country. Notwithstanding the Federal Home Loan Bank Board's recent mega-bailouts of insolvent thrifts, providing $1.3 billion in government assistance to take a dozen Texas thrifts off its hands, and the $565 million it took to merge two ailing California savings & loans, industry insiders continue to be concerned.

Approximately one-third of the nation's 3000-plus thrifts are losing money. More than 500 may be insolvent. The weakest institutions are in such bad shape that they threaten to exhaust the multi-billion dollar government insurance fund. Approximately 11% of the commercial banks in the United States are troubled. In fact, many of these are considered already doomed. The Federal Savings & Loan Insurance Corporation projects revenues of $42 billion over the next decade, but it anticipates the cost of cleaning up the thrift industry to be well in excess of $100 billion.

What happened to this industry? Where did it all go wrong? Where were the safety nets? Where were the procedures that would prevent this kind of mismanagement and improper loan practices? Deregulation and incompetent management certainly played their part. But one major contributing factor had not been identifies — until now.

THE APPRAISAL LINK

In 1981, Terry Barker borrowed $880,000 to buy State Savings & Loan in Lubbock, Texas. In 1987, Barker was convicted of fraud and is now serving five years in the federal penitentiary in Fort Worth. During those six years, Barker elevated age-old land flipping schemes into a finely-honed craft by getting appraisers to pin higher-than-market values on properties. Surprisingly, Barker had no problem arranging those

"The appraiser's part of this sad horror story reflects tragically on an industry which has long prided itself on accuracy, honesty and professionalism."

appraisals. Barker would then sell the property, at its artificially high appraisal value, to one of his network of financial institutions. The appraiser's part of this sad horror story reflects tragically on an industry which has long prided itself on accuracy, honesty and professionalism.

Not surprisingly, the reactions of these problems have triggered a frantic search for people to blame as well as quick solutions. Many lenders erroneously believe that since every lender has an appraisal which fixes with "absolute" certainty the value of the property, if the lender is unable to realize that value from the property, clearly the appraiser must be at fault.

Thus, an unbiased, accurate appraisal has become the cornerstone of a good real estate loan. It no longer is just an additional piece of paper for the file on a loan that is preordained. It must be a basis for deciding whether the loan is adequately secured. Although precision seemed less important in the 1970s when double-digit inflation boosted property values quickly, careful appraisals may very well be the key to lender survival in the 1990s. The appraisal, therefore, has become the pivotal document to justify the loan; as such, it has become more the focus of investigation when the loan goes bad and the REO value does not cover the loan.

The increased emphasis and focus on the quality of appraisals have had two impacts on the industry. The first was an extensive effort at updating and revising the manner in which appraisals were performed and in upgrading and professionalization of the industry. The second was the increased in malpractice lawsuits aimed at appraisers, accusing them of failure to adequately perform their appraisal duties.

UPGRADING INDUSTRY STANDARDS

In the area of regulation and professionalism there was, charitably speaking, a clean slate to start with. As a congressional report noted, there was an almost nonexistent level of regulation and grossly inadequate supervision of real estate appraisers. Congress found a pattern of rampant "client advocacy" appraising: providing the numbers necessary to make a deal work instead of an independent value estimate. When the Federal Deposit Insurance Corporation reappraised 21 properties acquired from the non-performing loan portfolio of Continental Illinois Bank, the appraisals indicated a total portfolio value 64% less than the originally appraised property values.

The investigators noted a tendency among lenders to consider the appraisal as simply an obstacle to overcome or a rubber stamp needed to establish the maximum amount of the loan. The congressional report concluded with a recommendation that the bank regulatory agencies place greater emphasis on lender accountability for appraisals and specific guidelines for compliance, called for Congress to give the bank regulatory agencies authority over appraisers, and recommended creating public-approved appraisal review by governmental insurers such as FHA.

A. Federal Regulations

The Federal Home Loan Bank Board issued first its memorandum R41B and then later its successor R41C containing guidelines to be used by the Federal Home Loan Bank Board examiners in determining an institution's regulatory compliance. Although R41C was later rescinded. it is an example of the type of regulation the federal government — and most states — are likely to enact.

R41C imposed upon a lender's directors and senior management the obligation to ensure that the appraisal services they used supported the institution's lending posture and policies. The lender had to be prepared to demonstrate that the appraisers approved by the board of directors possessed prerequisite experience, education and facilities to perform.

In addition to requiring lenders to adequately review the performance of their appraisers on an ongoing basis, R41C then enumerated 19 items related to the preparation and use of appraisals, which management had to ensure. These included ensuring that appraisals reflected current conditions (to reduce the likelihood of material changes in market conditions upon which the loan was predicated); that appraisers were independent from the buyer and the seller of the real estate and approved by the institution's board of directors; that omission of any of the recognized methods of appraisal, market or comparable value, reproduction costs or income approval was justified; and that, in longer-term phase projects, where a portion of the property was to be sold to ultimate users over some future time, the appraisal reports the value of the project as if sold to a single purchaser at completion rather than the sale of the units individually. R41C also enumerated a new definition of market value as being the "most probable price which property should bring in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting independently, knowledgeably and assuming the price is not affected by undue stimulus" and unaffected by special or creative financing or sale concessions granted by anyone connected with the sale.

Of particular concern were sales of raw land. R41C required that the appraisal indicate the "as is" value of the property as of the date the appraisal was prepared. Obviously, the "as is" value could vary widely from the 'realizable" value of the property. For example, a difference in value for unimproved land to be re-zoned might vary between its value as raw acreage with an agricultural zoning at $1,000 per acre vs. $10,000 per acre when re-zoned for commercial and industrial use.

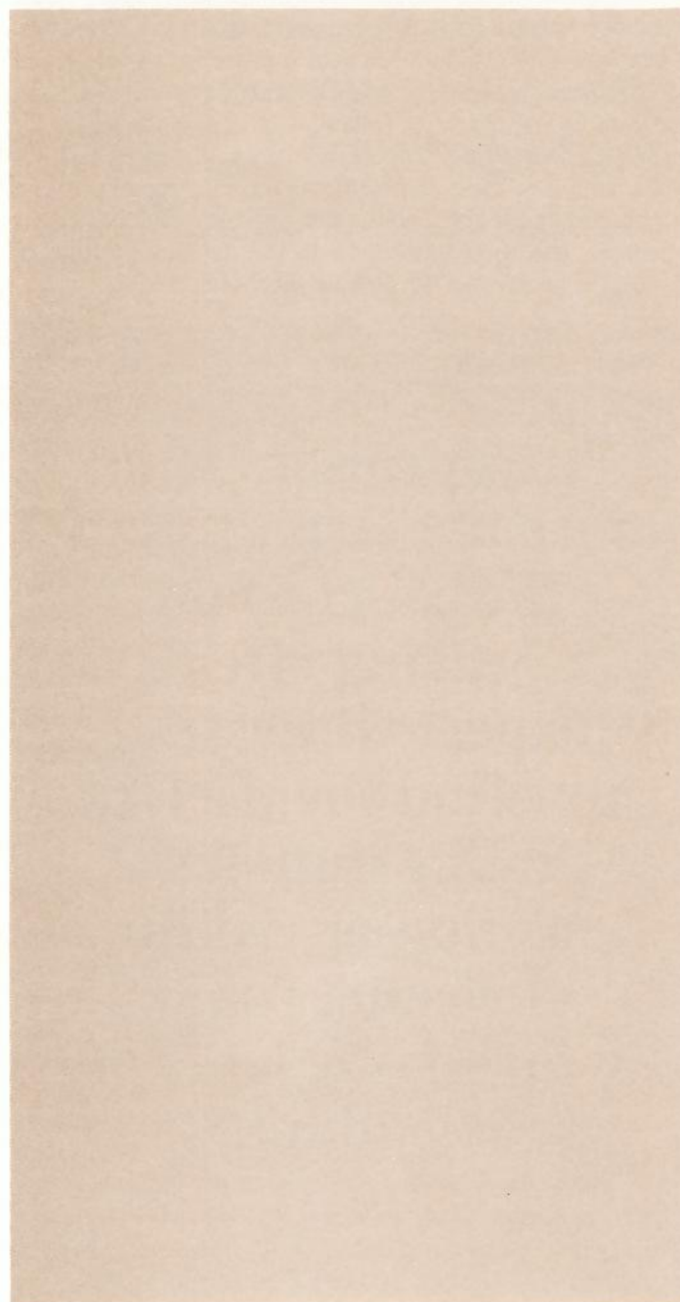
As far reaching as R41C was, it was questionable whether it was merely advisory or had the force of law. Shortly after memorandum R41B was issued, the U.S. District Court in the case of Haralson v. Federal Home Loan Bank Board, 837 F.2d 1123 (D.C.Cir. 1988) imposed limitations on the Federal Home Loan Bank Board's authority to regulate insured institutions through the agency's official appraisal guidelines. The Court ruled that memorandum R41B had no binding legal effect because of how it was promulgated.

Although the Haralson decision involved a challenge to R41B, R41C, which was not in effect when Haralson was decided, was apparently subject to the same Court-imposed limitation since it was adopted in the same manner as its predecessor. However, the Court's ruling does not prevent the Bank Board from using regulations like R41C as a guideline so long as it is not imposed in a mandatory fashion. Of more concern from a litigation standpoint, whether it carries the force of law or not, this "guideline" may well set a standard for establishing negligence in private litigation.

B. State Legislation

States have also begun legislating real estate appraisals. A typical example is the Lancaster-Montoyo Appraisal Act which became operative January 1, 1988, in California. This statute defines a "certified appraisal report" and sets forth specific standards to be followed. The Act distinguishes certified appraisals from "opinions of value" or "analysis" or "Opinions" which are not to be considered certified appraisals. The Act requires that for an appraisal to be called a "certified appraisal", the appraiser must use methods and techniques which are necessary to produce a creditable appraisal and base anticipated future income and expenses on reasonably clear and appropriate evidence and reasonable projections in the marketplace.

California has also recently considered legislation requiring appraisers to be licensed, by taking minimum education standards and then passing a state-administered exam. A licensed appraiser could become "certified" by taking more classes,



passing a more difficult test, and having at least two years of recent appraisal experience. Like many states, California took these steps in response to the OMB's statement that all properties financed under federal loan programs must be appraised by either a licensed or certified appraiser.

In organized real estate, the National Association of Realtors has made it clear that real estate brokers giving curbside appraisals and estimates of value should not refer to these as appraisals. The National Association of Realtors has indicated that the only document that should be called an appraisal is the one prepared by a professional appraiser, not one prepared by a real estate broker estimating property value for a client.

APPRAISER "MALPRACTICE"

The impact of this increased professionalism has effected a dramatic improvement in the quality and accuracy of appraisals. It has, however, also brought with it increased exposure and liability for appraisers. Having set a standard of professionalism and care for appraisers to follow, it is now much easier for plaintiffs' attorneys to impose liability upon appraisers for failure to follow these standards. As a result, appraisers who were not strangers to the court room appearing often as expert witnesses, now find themselves in the dubious position of visiting the court room wearing the label of defendant.

"...appraisers who were not strangers to the court room appearing often as expert witnesses, now find themselves in the dubious position of visiting the court room wearing the label of defendant."

A. Standards of Appraisal Liability

The job of the appraiser is to prepare an unbiased estimate of the nature, quality, value or utility of an interest in or aspect of identified real estate. It is not uncommon in a buy-sell agreement to provide that an item's value be based on an appraisal. The method quite frequently involves selecting three appraisers and averaging their appraisals. It is almost as if the parties expect and anticipate that appraisers will differ as to the value of the property. How, then, is it possible to determine if an appraiser has been negligent in preparing an appraisal if the parties anticipate that it is not an exact indication of value?

Several factors determine whether an appraiser is liable for a negligently-prepared appraisal. First, what is the extent to which a real estate appraiser is considered a "professional"? "Professionals" are those who undertake any work calling for a special skill. A professional is required not only to exercise reasonable care in what he does, but also to possess a minimum standard of special knowledge and ability. Most cases involving professionals have dealt with physicians and surgeons. But the same standard applies to dentists, pharmacists, psychiatrists, attorneys, architects, engineers, accountants and even many skill trades. There is a growing tendency in the law to require those who practice in the real estate industry to adhere to the professional's standard of care.

An example of this expanding application of the professional standard of care is the current status of real estate brokers, since it may well be a precursor to the standard imposed upon appraisers. In Easton v. Strassburger, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984), decided several years ago in California, the court imposed upon real estate licensees the duties of a professional. The real estate licensee sold property to a buyer. The property had serious geologic problems, of which the licensee was not aware. The court noted that the driveway was cracked and admitted that a lay person such as the buyer would not be expected to know that the cracks could indicate a problem. However, the real estate licensee, being a professional, should have recognized this "red flag" (an indication that something was wrong), called the potential problem to the buyer's attention, and requested appropriate geologic surveys which would have uncovered the problem. The court imposed upon this real estate licensee the high duty required of a professional, upon whom members of the public rely for advice and information.

As a result of this California decision, real estate licensees now are held to a much higher standard of care than ever before, It is not enough that they be aware of market value and obtain the best negotiated price for the seller or buyer; licensees must also be sufficiently familiar with construction and geologic conditions to recognize problems that the lay person would not.

We may assume that this standard of professionalism will be extended as well to appraisers and, in fact, it may already have been so extended. Just as the court in Easton said that the public

has a right to rely on the real estate licensee as a professional, the court likely would determine that the public has a right to rely on the real estate appraiser to the same degree. Given the increasingly litigious nature of society, and the overall increase in malpractice cases in all professions, it is clear that this is a trend which will soon engulf appraisers.

It is said that bad facts make bad laws. Unlike doctors or attorneys who have structured educational requirements, there are generally no similar requirements for appraisers. In a majority of states, there is no appraisal bar to join or state appraisal examination to pass. Most states require no license other than perhaps a general real estate license. Thus, the likelihood of a poorly-trained appraiser creating a bad factual situation which creates bad law for good appraisers is high.

Although an individual appraiser may have no required methodology and the appraisal conclusion may depend on many factors, the appraiser's commitment to professional standards enhances the appraisal report and the overall discipline of the appraisal. It is this utilization of high standards of competence in a specialty, a distinct and growing body of knowledge, and a code of ethics that serve to identify an appraiser as a professional. As such, he will be judged by the court not by the standard of a reasonably prudent man utilizing the skills of everyday experience, but rather by the experience of skill and learning.

A professional is not judged by the standard of the reasonably prudent man of the community-at-large. Rather, he is judged by the average of professionally-accepted conduct. This is the minimum standard measured by the learning and skill ordinarily possessed and exercised by the profession. Thus it is not enough that your appraisal was done with more care than a lay person would do it; it must be done with at least the minimum standard of care expected of a real estate professional.

In view of the relatively few cases involving appraisers, the courts have not had an opportunity to set forth judicially-derived standards of conduct. Thus, the courts are more likely to draw on standards formulated by professional societies and regulators in determining whether a particular act or omission falls below the level of skill ordinarily possessed and exercised by the profession. As indicated earlier, the R41C appraisal may not have had the binding force of law; however, it may very well be used by a court in setting a standard of conduct required of the appraiser.

FACT OR OPINION?

Another factor which impacts upon the potential liability of appraisers is that the results of their work are more easily questioned than those of other professionals. While the average person can't evaluate whether a doctor has taken the right course of treatment or whether the lawyer has properly drafted the document, everyone has an opinion as to the value of his own property. Thus, it is more likely that an appraiser's work may be called into question than those of other professionals, simply because most people would defer to other professionals' expertise.

"The appraisal, therefore, has become the pivotal document to justify the loan; as such, it has become more the focus of investigation when the loan goes bad..."

"Another factor which impacts upon the potential liability of appraisers is that the results of their work are more easily questioned than those of other professionals."

Whether the appraiser is a professional or not, it is well argued that the appraisal should not be considered a representation of fact; it is merely a statement of opinion. Even so, as noted in the Restatement of Torts, a representation made with an honest belief in its truth may still be negligent because of lack of reasonable care in ascertaining the facts or in the manner of expression of absence of the skill and confidence required by a particular business or profession.

Certainly no one has any trouble with the proposition that an appraisal fraudulently prepared with the intent to deceive by misstating the value should expose the appraiser to liability. Likewise, an ambiguous, misleading appraisal should expose the appraiser to liability to any injured party, possibly even where the appraiser believes in its truthfulness. Cases, however, generally have been unclear as to what happens when the estimate of value in an appraisal report is in the form of an opinion.

One reason why appraisers have not been the targets of malpractice litigation until recently is that the public and the users of appraisers have generally regarded the appraisal as being merely an opinion, not a statement of fact. The difference among appraisal reports could be attributed to differences of opinion just as easily as to negligence. A client dissatisfied with an appraisal must show more than a difference of opinion as to value. A successful lawsuit against an appraiser for negligence is one in which the plaintiff proves that there was no reasonable basis for the appraiser's opinion,as in a drive-by appraisal.

As was noted earlier, litigation involving real estate brokers has tightened up the traditional view that salespersons are expected to do occasional puffing as to value and that it was all right to give an opinion without basis in fact. Just as such opinions offered by brokers may be classified as representations of fact, this stricter view of opinion would likely be followed when the representation is made by an appraiser.

The appraiser is also less able to argue that his appraisal is a mere statement of opinion because of the new appraisal format. By statute and regulation, the format of the appraisal is now regulated, with guidelines as to what may be required to go into an appraisal. Following those guidelines makes it much more difficult to argue that you have given a mere opinion. Effectively, the appraisal implies that the maker knows of facts that justify his opinion and that it is reasonable to rely on that opinion.

The appraiser is an independent expert. The appraiser's objectivity supports reliance upon the appraisal. When such reliance is regarded as reasonable and permissible, the misstatement of opinion may be sufficient basis for liability.

In a recent Wisconsin case,Costa v. Niemon, 366 N.W. 2d 896, 897, 900 (1985), the court ruled that a real estate appraiser who represented that a particular property had a fair market value of $21,500 was making a representation of fact. In this case, the buyers applied to a mortgage company for a VA loan on a single-family residence. The mortgage company engaged Niemon to appraise the home and he reported that the property had a fair market value of $21,500. The Costas were not given a copy of the appraisal, nor did they ever see it.

Shortly after moving in, the Costa's decided to relocate and sought a copy of the appraisal. Neither the appraiser nor the lender would give them a copy. (In California, statutes would require compliance with such a request). Unable to get the existing appraisal, the Costas hired their own appraiser who found that the value of the property was only $13,000. They sued the first appraiser for negligent misrepresentation.

The defendant appraiser responded by stating that his appraisal was a mere opinion not a representation of fact. The court disagreed, and held that a real estate appraiser gathers and assesses facts such as a property's square footage, improvements, costs to rebuild, depreciation and sales of comparable properties in the marketplace. The jury was entitled to determine that the appraiser, in stating an appraisal value, made a statement

of opinion carrying with it the implied assertion that he knew the facts which supported his opinion. The evidence supported a finding that the appraiser had made a representation of fact for which he was liable.

In order to establish a cause of action for negligent misrepresentation, the Restatement of Torts set forth four requirements:

1) That the defendant made the alleged representation of fact;
2) That the representation was untrue;
3) That the defendant was negligent in making the representation; and
4) That the plaintiff believed the representation to be true and relied thereon to his or her damage.

In the Costa case, the appraiser argued that since the Costas had never seen his appraisal they could not have relied upon it to their detriment. This line of defense is not unusual. Quite frequently an appraisal report is prepared for the exclusive use of one party, is not shown to others, and is kept confidential. Where parties do not have an opportunity to see it, they obviously cannot rely on it. Likewise, there are cases such as Federal Savings & Loan Insurance Corporation v. Cook, 419 F.2d 1296 (7th Cir. 1969), where the court found that although the loan committee saw the appraisal, they gave it little credence and did not base their decision to make the loan upon the appraisal. Thus, there was no reliance.

The court in Costa, however, noted that the plaintiff understood that, in order to have the loan approved, the appraisal had to show a value of at least $21,500. The Costas got the loan they were applying for. Therefore, it was reasonable for them to assume that the appraisal did in fact show that value.

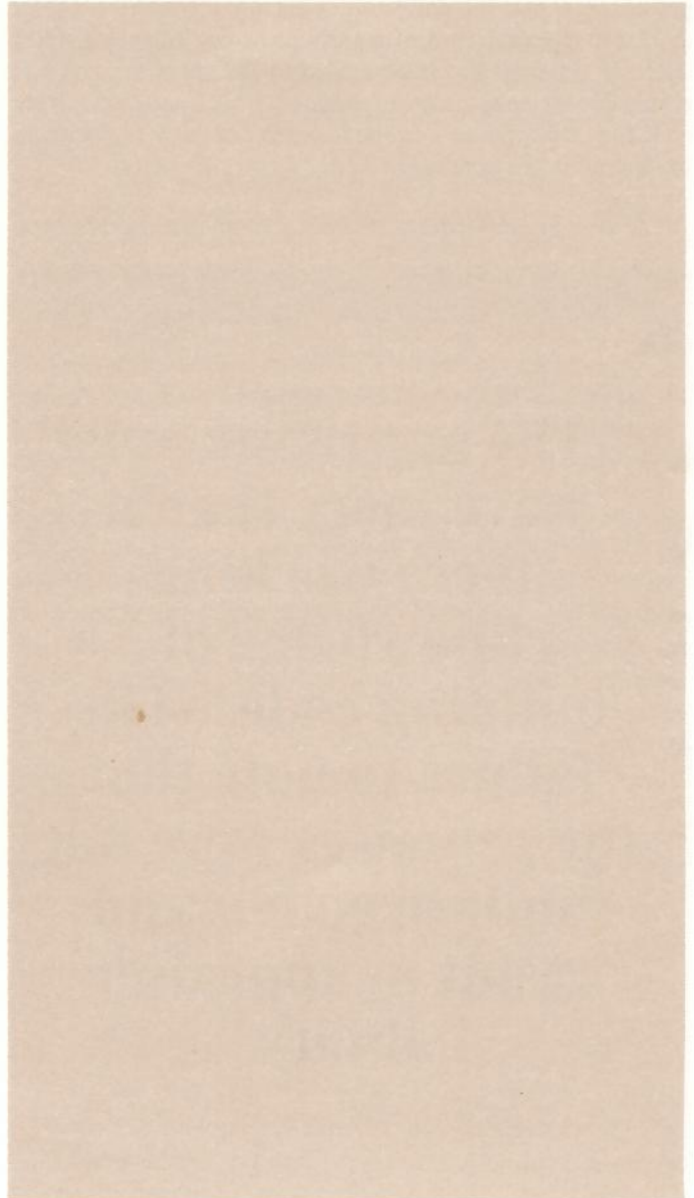
The court went on to note that limiting language in the appraisal would not be helpful to the appraiser. Since the buyers never saw the appraisal they obviously would never have seen the limiting language. The appraiser here was hoisted by his own petard: he was found liable for a negligently-prepared appraisal which was relied on by buyers who never saw it, but who likewise were not limited by any qualifying language it contained because they did not see it.

Although cases from one state are not binding on courts in other states, where a court is reviewing a case for which there is no relevant authority in that state, it may look outside of its state to see how other state courts have decided similar issues. It is to that extent, given the paucity of decisions involving appraisers, that one might anticipate that cases like Costa will be cited with great frequency by plaintiff's counsel seeking recovery for negligently-prepared appraisals. Thus, attorneys who are defending appraisers must not develop tunnel vision and look only to authority within their own state.

WHO MAY SUE

The appraiser by contract has agreed to render an appraisal for a specific party and quite often contractually provides that the appraisal is limited to the use of that party. Notwithstanding this, who can sue the appraiser, notwithstanding the lack of contractual relationship? The question revolves around a legal term called privity.

Privity is a mutual or successive relationship to the same right of property. It is based upon two concepts: 1) that legal protection of this kind of interest by third parties would lead to excessive and unlimited liability; and 2) if third persons could acquire a right in the contract in the nature of a duty to have it performed as contracted for, the parties would be deprived of control over their own contract. That is to say, you and I could enter into a contract and suddenly find that we have inadvertently contracted with a whole class of other people that we did not intend to contract with.



In the California case of Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958), the court said that "the determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree and certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to defendant's conduct and the policy of preventing future harm."

Many cases discussing the extension of the concept of privity can be found in litigation involving public accountancy. Courts have found that those third parties who could reasonably be known to the accountants at the time of their contract would be able to expect the same care as the original contracting party. Likewise, courts have held that an appraisal completed for the FHA was in fact performed for the benefit of a potential purchaser so that the purchaser could sue the appraiser for a defective appraisal.Thus, if a party providing financing relies upon the appraisal and is persuaded by the appraisal, and it is reasonable for the appraiser to assume that such party would rely on it, then the appraiser may be liable to that party even though the appraisal was not prepared for that specific party.

It must be stressed that it is not enough that one has been damaged and that there has been a faulty appraisal. There must be reliance upon the appraisal. However, as noted above, it is sometimes possible to rely on the appraisal without ever having seen it.

"The appraiser must have more than a mere working knowledge of building codes. The failure to note that the premises were not built to code... can result in appraiser liability."

The lack of certainty in this area is evidenced by the 1980 California case of Gay v. Broder, 109 Cal. App. 3d 66, 167 Cal. Rptr. 123 (1980), where a veteran applying for a VA loan was unable to recover against the appraiser for an appraisal done for the Veterans Administration. The court did not believe him to be third party beneficiary to the contract or that the appraiser had a duty of care to him.

This case obviously contradicts cases in other jurisdictions. There is some possibility that the overriding fact was that the party who ordered the appraisal was the government insurer, not an institutional lender. The court gave great weight to the fact that the statute governing the appraisal process for VA-insured loans is specifically designed to protect the Veterans Administration and not the veteran. If the court creates a duty to the borrower, the appraiser might be put into a conflict of interest between his paramount duty to the government to give an accurate appraisal and the desire to satisfy the borrower by setting as high an appraisal as possible. The extent to which the court went to protect the government leads one to believe that the same policy considerations might not affect its decision if it involved an institutional lender.

The opposite end of the spectrum is a case called Larson v. United Federal Savings & Loan Association, an Iowa case where the court stated that "even though the appraisal might be made primarily for the benefit of the lending institution, the appraiser should also reasonably expect the home purchaser, who pays for the appraisal and to whom the results are reported (and who has access to the written report on request), will rely on the appraisal to reaffirm his or her belief the home is worth the price he or she offered for it. The purchaser of the home should be among those entitled to rely on the accuracy of the report and therefore should be entitled to sue for damages resulting from a negligent appraisal."

The most recent California case on the subject is Christiansen v. Roddy, 186 Cal. App. 3d 780, 231 Cal. Rptr. 72 (1986), a California Court of Appeals decision in which investor-lenders brought an action for negligent misrepresentation of value on property used as security against the investment counselor and the appraiser. The Court held that the appraiser who performed appraisal services for the buyer and for the mortgage company for which the investment counsel worked, but not for the lenders, would not have intended that the lender rely on his appraisal and thus could not be liable to them. The Court held that the scope of liability for a negligent misrepresentation should not be broadened to provide for liability based on a theory that persons or a class of persons would communicate the representations to another. Foreseeability of harm extends towards those people who reasonably rely on the information. Even though the appraiser negligently misrepresented the value

of the property which was to serve as security for the loan, he was not liable to lenders for a negligent misrepresentation when, at the same time he performed the services, he did not know the lenders, did not know that there was a possibility that the loan was going to be made on reliance of the appraisal, and could not have intended that the lenders rely on his appraisal.

Once again extreme facts make for a somewhat unusual decision. Notwithstanding the California cases which seem to treat appraisers more favorably than other jurisdictions, these cases turn more on the privity issue than on the establishment of negligence or duty of care. Also, it must be remembered these are the same California courts that gave us Easton v. Strassburger.

STANDARD OF CARE

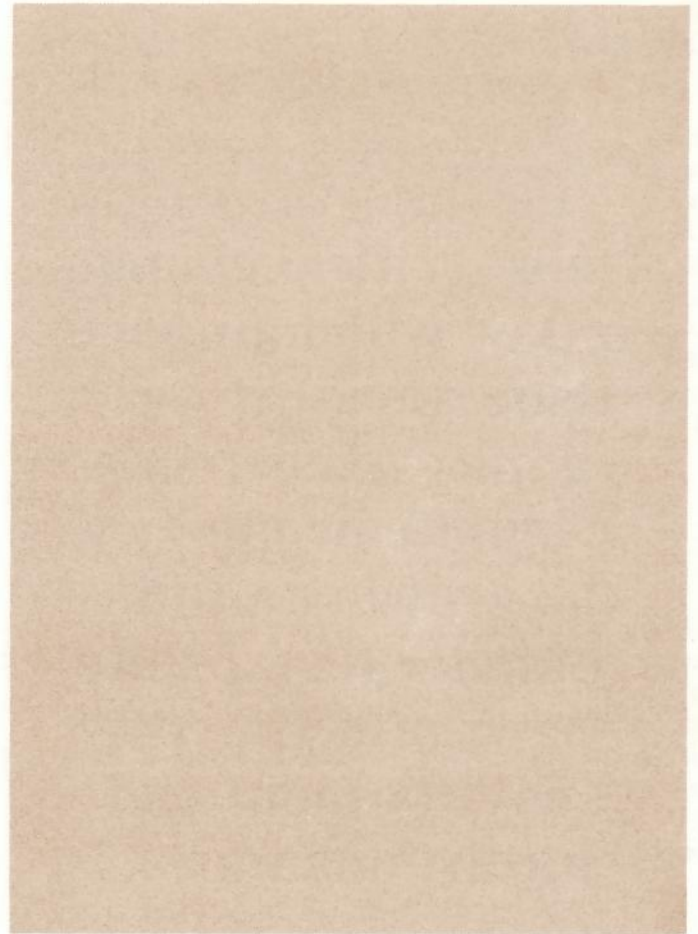
To this point, we have assumed that the appraiser has made a mistake intentionally or unintentionally that resulted in a faulty appraisal. We have not, however, discussed what acts or omissions constitute appraiser fraud, misrepresentation or negligence. What is the standard of care to which an appraiser should be held?

As discussed earlier, the trend in the law is to more and more regard appraisers as professionals and expect a higher level of expertise. If one goes to a pharmacist and complains of a bad headache and asks for his advice on a good headache remedy, it is unlikely that the heirs of that person could successfully prevail against the pharmacist if the man were to later die of a brain tumor. On the other hand, if he were to go to his physician and complain of a headache and ask for something to help, merely prescribing aspirin would not insulate the doctor from a malpractice action. We simply expect him to have greater expertise.

When one asks the local real estate broker for an evaluation of the value of a piece of commercial property, one does not expect that the number he comes up with will have the same degree of accuracy if an appraiser conducts a full-scale appraisal of the property. The fact that the real estate broker may not have gotten estoppel certificates from the tenants to confirm the existence of the leases and the lack of default would not necessarily excuse the appraiser from doing that. The fact that a real estate broker might have relied on a financial statement given him by an accountant for the borrower would not excuse the appraiser from independently verifying numbers. It is simply a different, higher standard.

What then is that standard? In United States v. Neustadt, 366 U.S. 696, 81 S.Ct. 1924, 6 L.Ed.2d 614 (1961), an appraiser was held liable for not discovering a latent defect in a property during his initial inspection of the house (a patent defect is readily observable, while a latent defect is not). The defect was discovered when a hole was drilled in the concrete basement floor. In this case, the court held that the appraiser should have conducted a core drilling.

In the case of Hardy v. Carmichael, 207 Cal. App. 2d 218, 24 Cal. Rptr. 475 (1962), a California case, the termite inspector



relied on a representation of the seller that the house was solid concrete. Of course, the house was infested with termites.

In Fusco v. Brennan, N.Y.L.J., July 30, 1979, a New York case, the appraiser relied on income projections rather than independent verification. One could almost excuse him for doing so since he was expressly told that the appraisal was for internal purposes only. Needless to say, the appraisal was presented to a bank for purposes of obtaining a loan. The court held that since the appraiser did not independently verify the accuracy of the income projections, relying instead on those provided by the client, and did not put the potential lender on notice of the limited scope of his analysis, he was guilty of negligence.

How, we may ask, could the appraiser have put the prospective lender on notice when he was not aware there was to be a prospective lender? What then is the appraiser expected to do?

1) The appraiser is expected to fully inspect the property, not relying on homeowners' mistaken statements of material facts. The appraiser cannot rely on a cursory inspection of the property. Don't do your client a favor and save him money by doing a cursory drive-by inspection. It is your liability, not his, that is on the line.
2) In new or proposed construction properties, the appraiser has a duty to correctly certify the specifications.

"Perhaps the single most critical change of law which impacts upon an appraiser's ability to correctly evaluate property is the growing number of federal and state laws affecting the environment and hazardous waste."

3) Political, social and economic factors which affect the property have an impact and must be investigated.
4) The appraiser must have sufficient knowledge and information about the values in the area in which the property is located.
5) Verify all data and second-hand information. a seller may puff; the appraiser may not.
6) The appraiser must appraise in strict adherence to the proper and appropriate definitions of market value with a reasonable basis for the method chosen to value the property.
7) The appraiser must be familiar with general rules of law which apply to the property which he is appraising.

It is in this last area that the appraiser must expend every effort to keep current with the rapidly changing areas of law. Five years ago an appraiser who appraised a piece of property might not have been negligent for failing to note the cottage cheese sprayed onto the ceiling or the cakey white substance wrapped around the insulation. Today the failure to flag the potential asbestos problem would be catastrophic.

The appraiser must have more than a mere working knowledge of building codes. The failure to note that the premises were not built to code, the failure to check the building permits which would have led him to discover that there was no permit for the add-on, the failure to note that the toilets flushed into a septic tank rather than a sewer — all are in the nature of problems which today can result in appraiser liability.

Perhaps the single most critical change of law which impacts upon an appraiser's ability to correctly evaluate property is the growing number of federal and state laws affecting the environment and hazardous waste. 'Hazardous substance' is a phrase sweeping through the real estate industry and is becoming one of the single most important factors to be considered in the purchase and sale of real property. The mere fact that the buyers may not be aware of these circumstances does not immunize the appraiser from liability.

By way of example, recently some clients were contemplating buying a ranch property in San Diego County for development of a 500-acre piece of property with hills, a stream, ranch houses and stables. The property was well-suited to the proposed project which was to include a resort hotel, riding trails, a golf course and single-family residences. In connection with the due diligence to be performed for the purchase of the property, it was suggested that a hazardous waste study be made. The client questioned why one was needed; for 100 years the property was used only as a ranch. The red flags? The property was not connected to a sewer; it used a septic tank. Did the septic tank leak onto the property? Where did it come from? What was dumped upstream to be deposited on the subject property? What pesticides had been used?

This is not to say that an expert must look at every property to determine in advance if there is a problem. Like in buying a single-family residence, a termite inspection is done not with the expectation of finding termites, but for the comfort level of knowing they are not there. Likewise, an environmental survey should be made where conditions warrant.

Imagine for the moment that although sophisticated in development of property, the developer simply had not evaluated the rapid change in laws and had proceeded ahead and hired an appraiser to give him an appraisal to be utilized in connection with financing the acquisition of the property. Assume that the appraiser did not take these factors into consideration and that as a result a major hazardous waste problem which existed on the property was missed, rendering it valueless. How much of the $12 million purchase price of the property would be the lender or developer be able to obtain from the appraiser?

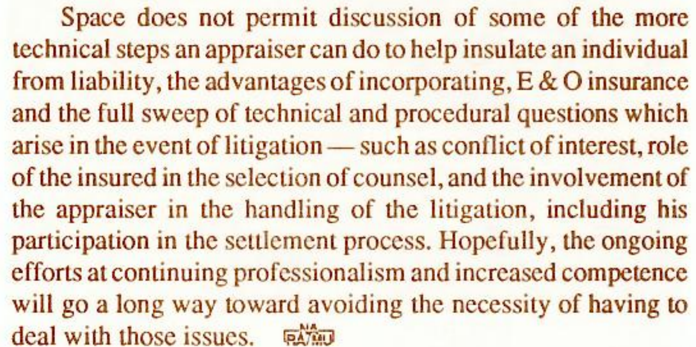
In the last six months, lenders have been routinely adding to their loan documents extensive documentation dealing with hazardous waste and representations from borrowers. Language dealing with hazardous waste is commonly found in purchase and sale agreements dealing with real property. Tenants must advise landlords of the existence of hazardous substances on

their property. Yet how many of us have a full and complete understanding and knowledge of what a hazardous substance is?

Every office has hazardous materials stored on its premises. A few examples include white-out to correct typewriter errors and Xerox toner. Your neighborhood supermarket is a repository of hazardous substances. Just walk down the automotive section and look at the cans of STP and motor oil. Go down the detergent section and look at the can of Drano, and when you leave the market look for the sign on the door — at least if you are in California — that warns the public there are hazardous substances there. These are critical factors that the appraiser must take into consideration in making his appraisal.

CONCLUSION

It is clear that the days of the old M.A.I. appraisal — one which was "Made as Instructed" — have long since passed. Certainly, the days are gone for those appraisers whose level of competence and professionalism will not permit them to do anything other than a first-class professional appraisal job. It is also clear that the present environment on the law is such that it is now significantly more difficult to do a competent professional appraisal. More care and more work needs to be done to ensure that adequate appraisal standards are adopted and adhered to by your companies. More educational programs should be provided to your appraisers to keep them current on the state of the law. More careful review of the work done by subordinate appraisers must be instituted. Remember that a negligent appraisal prepared by an employee is still a negligent appraisal by the company, and under the doctrine of respondeat superior it is the company's liability.



Space does not permit discussion of some of the more technical steps an appraiser can do to help insulate an individual from liability, the advantages of incorporating, E & O insurance and the full sweep of technical and procedural questions which arise in the event of litigation — such as conflict of interest, role of the insured in the selection of counsel, and the involvement of the appraiser in the handling of the litigation, including his participation in the settlement process. Hopefully, the ongoing efforts at continuing professionalism and increased competence will go a long way toward avoiding the necessity of having to deal with those issues.

Editor's Note:

This article is extremely factual and received exceptionally high praise from our editorial review board. However, it was written prior to the August dissolution of the Federal Savings and Loan Insurance Corporation. In all likelihood, references to the FSLIC can be inferred to reference the newly formed Resolution Trust Corporation, as the RTC will absorb many of the duties and functions of the RTC. As of press time, it is unknown, by the RTC itself, exactly which of the FSLIC functions the RTC will assume.