

# THE REAL ESTATE APPRAISER AS A DEFENDANT

By Lawrence H. Jacobson

Part of the fallout from the crisis in the savings and loan industry has been the search for additional potential defendants who, it can be argued, share in the liability. The latest group to join attorneys, accountants and savings and loan executives has been real estate appraisers.

The typical layperson would assume that an appraisal is perhaps the single most important document a lender considers in making a loan. The same layperson would be surprised to learn that until recently there were no educational or regulatory requirements to be a real estate appraiser. No college or high school degree was required, nor was a license from the Department of Real Estate, or any other agency, required. As one congressional report noted, there was an almost nonexistent level of regulation and grossly inadequate supervision of real estate appraisers with a pattern of rampant client advocacy.

When the Federal Deposit Insurance Corporation reappraised twenty-one properties acquired from the non-performing loan portfolio of Continental Illinois Bank, the appraisals indicated a total portfolio value of 64% less than the original appraised property values.

Traditionally, appraisers have not been considered as potential defendants because their appraisals are viewed as mere opinions, not representations of fact, and they have not been held to professional standards. In recent years, however, these two defenses have been substantially eroded. Extending the concept of what is a professional far beyond the traditional occupations of attorney, doctor and accountant, in 1984 the California courts in *Easten v. Strassburger* imposed upon real estate licensees the obligation of a professional and held licensees to a high standard set by the experience of his or her skill and learning, rather than the skills of a reasonably prudent person.

In addition, the old concept that an appraisal is a mere opinion has been discarded. By virtue of new statutes and regulations, the formats of appraisals are now more structured, requiring use of methods and techniques necessary to produce a credible appraisal, thereby making it more difficult to argue that an appraisal is an opinion of value and not a representation of fact.

Courts continue to struggle with the problem of who may or may not rely upon the appraisal and who may or may not sue the appraiser for a negligently prepared appraisal. While traditionally appraisers have been viewed as agents of the lender and, therefore, liable only to the lender, the right to sue has recently been extended to include borrowers who rely on the appraisal.

In the Wisconsin case of *Coast v. Neimon*,

the borrower was allowed to sue the appraiser for an overvaluation based on an appraisal which the borrower had never seen (the court noted that the borrower was aware the bank would not make the loan unless the appraisal came in at a specific number; since the bank made the loan, the court felt the borrower was justified in assuming that the appraisal reflected that value).

In *Gay v. Broder*, however, the court held that a veteran applying for a Veteran Administration loan could not sue the appraiser for having negligently under-appraised the property, even though the appraisal resulted in the veteran not being able to obtain a Veteran Administration loan. The court reasoned that allowing the veteran to recover would put the appraiser in a conflict of interest with the bank. If the negligently performed appraisal resulted in a higher appraised value, rather than a lower appraised value, one would expect the borrower, as well as the lender, to be able to sue, as was the case in *Costa*; see also *Larson v. United Federal Savings and Loan Association* (Iowa) for a similar result. However, one appellate court in California has recently declined to do so. In *Nymark v. Heart Federal Savings and Loan Association*, June, 1991, the Court of Appeals held that the lender did not owe a duty of care to a borrower in appraising the borrower's property to determine if it is adequate security for the loan; rejecting the reasoning in both *Costa* and *Larson*.

Courts appear also to be expanding the duty of care required of an appraiser by increasing the obligation to inspect the property and confirm the facts upon which the appraisal is based. Appraisers may likewise be expected to be more sensitive to environmental hazards which may affect the value of the property. As evidenced by the recent United States District Court opinion in *Federal Deposit Insurance Company v. Joe Baker*, establishing negligence on the part of an appraiser will not be inexpensive. The courts have made it clear that expert testimony is essential to establishing that an appraiser did not meet the appropriate standard of care.

On the regulatory level, both the federal and state governments have implemented substantial licensing and educational requirements. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) provides for sweeping regulatory reforms in the thrift industry. FIRREA includes within its reforms a substantial change in the way appraisers will be able to do business in the years to come and significantly increases the exposure of appraisers as well as attorneys, accountants and other independent contractors

providing services to financial institutions.

Not only is the scope of the regulatory agencies increased under FIRREA, their enforcement powers and the scope and severity of the sanctions has likewise been significantly increased. Liability may be imposed on those appraisers who knowingly or recklessly participate in any violation of FIRREA's regulations, or any breach of fiduciary duty, or any unsafe or unsound practice which caused or is likely to cause more than a minimal financial loss to or significant adverse affect on the insured depository institution. Penalties include permanent and temporary cease and desist orders, prohibition from participating further in the affairs of the insured institution, and substantial civil monetary penalties and criminal penalties.

Rather than directly licensing appraisers, FIRREA has delegated this task to the individual states. California has recently enacted the Real Estate Appraisers Licensing and Certification Law which was effective December 31, 1991. The law provides for the adoption of licensing and certification standards for appraisers which standards will at least meet the licensing requirements for real estate appraisers established by FIRREA.

The law requires that an appraiser must be licensed if he or she is preparing a real estate appraisal for financial transaction in which a federal financial institution regulatory agency is involved. Such agencies include, but are not limited to, the Federal Deposit Insurance Corporation, the Resolution Trust Corporation and the Federal Reserve Board.

With both the increasing liability being imposed by the courts, as well as the increasingly higher standard of care required by statute and regulation, appraisers must be significantly more careful in the manner in which they prepare their appraisals and will become increasingly more frequently named as defendants when the appraisal does not reflect the fair market value of the property.

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