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The mortgage crisis and errors & omissions insurance

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The declining real estate market and mortgage crisis are headline news everyday, and having a major impact on the liability exposure of real estate appraisers. Lenders, borrowers and sellers are filing lawsuits and disciplinary complaints with unprecedented frequency against appraisers. One particular sub-prime lender even appears to employ a dedicated staff whose only job is to assert claims against appraisers on its rotten loans and hound the appraisers with calls, emails and letters sometimes demanding several hundred thousand dollars. With claims coming from all angles, our claims activity in 2007 increased 50% over 2006, and the trend is continuing in 2008.

Most claims that we see against our appraisers have no merit - but unfortunately they all cost money to defend. Many are filed as knee-jerk reactions to a loss or drag the appraiser into a lawsuit in a long list of more culpable defendants. Usually, the opinion of value in an appraisal is entirely defensible. An experienced and competent errors and omissions (E&O) program and its defense counsel can defend these kinds of claims successfully and efficiently, often without payment of damages to the complaining lender, borrower or seller. Without E&O insurance, an appraiser might manage a successful resolution if the appraiser locates legal counsel knowledgeable about the appraisal field, but the cost of that legal defense then falls entirely on the appraiser.

As in previous downturns, the media, elected representatives and some prosecutors are focusing attention at times on the actions of real estate appraisers as an ingredient in this mortgage crisis. This only precipitates more claims. Similar blame was placed in the late 1980s in response to the S&L crisis - as a result, appraisers doing federally-related work had to become state licensed. We disagree with blaming appraisers. Mainly, appraisers did their jobs and appraised in accordance with the professional standards and rules that applied. Appraisers simply are not predictors or insurers of value. The roots of the present crisis lay in the extension of loans to borrowers without appropriate credit (at rates that did not reflect the risk), a Wall St. financial machine that ignored common sense and pretended these credit risks would disappear by repackaging loans into fancy securities, and a huge deflation in property prices. The fact that appraisers generally do not deserve blame is further suggested by the fact that much of the worst lending - the riskiest 100% LTV and subprime lending - was done on the basis of AVMs, not human appraisals.

From what I have seen in claims these past 28 years appraisal fraud is not a big issue. The relatively few appraisers who delve into outright fraud typically also do not worry about obtaining insurance. When fraud is a factor in our claims, it is almost always fraud by other parties - a crooked mortgage broker who alters an appraisal, a developer hiding material facts, or a borrower who lies to obtain credit.

Of course, appraisers are not always blameless. We do see cases where the appraiser received

comps or other information from an interested party without verifying the information. Other common errors are the appraiser cutting corners to get the job done faster, ill-managed trainees or signing off on incorrect appraisals without proper review. This isn't usually fraud - it's just the type of negligence that can be found in a small percentage of appraisals. These mistakes are easily exposed when loans are foreclosed and attorneys for lenders and borrowers are looking to make up their losses. Commercial appraisers are not immune from the fallout of this crisis either. Commercial claims have not only increased in frequency but also in severity. Investors and commercial developers have been hit by a tightening economy and have seen their investments and developments suffer or even aborted mid-project. Blame may be cast at the appraiser when a commercial venture doesn't succeed. Appraisers with advanced commercial designations are also sought for complex and unique assignments and this work imposes more risk than normal assignments. As you can imagine, the higher value of a commercial property also makes for a higher loss.

In this environment, an appraiser should take steps to assure their legal protection. First, do not let your E&O insurance lapse. Many appraisers put off the renewal process until the last moment. At that point, there is no guarantee renewal will be approved, especially when some insurance underwriters are having to scrutinize their risks more closely. Second, make sure your policy covers the types of assignments you perform. Read your policy and examine the exclusions. Lastly, if you do receive notice of a lawsuit or even a potential lawsuit, report it immediately to your E&O program.

Some appraisers have lost coverage for a claim when they failed to give timely notice to their agent, thinking the claim would go away or they could handle it themselves.

Liability Insurance Administrators (LIA) administer the Appraisers Liability Insurance Trust E&O Insurance program. LIA has been offering E&O insurance and Loss Prevention information to the appraisal profession nationally since 1977. Go to www.liability.com for more information.

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