

# AZ | R E

ARIZONA COMMERCIAL REAL ESTATE

## 2010 Annual OUTLOOK



NAU's \$79.1M Health + Learning Center is being built by Mortenson Construction and designed by OWP/P and Cannon Design.

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## Appraisal Malpractice

### Who can sue and what other limits apply

Last year, the Arizona Court of Appeals issued a decision that some believe will open the floodgates of malpractice claims against real estate appraisers. While the court's opinion cleared the way for some new plaintiffs, there are still substantial barriers to successfully holding appraisers liable for negligently prepared mortgage appraisals.

#### → SAGE VS. BLAGG APPRAISAL COMPANY

In 2004, Ms. Sage executed a contract to purchase a home for \$605,200. The purchase was contingent on the home appraising for at least the sale price. The defendant appraisal company, hired by Sage's lender, appraised the property at \$620,000 based on 2,440 livable square feet. After the sale, Sage learned that the actual square footage was 1,871. She filed suit against the appraisal company alleging the appraiser should have valued the home at \$350,000, in which case she would have cancelled the sale. The trial court ruled that Sage could not maintain her lawsuit because the appraiser did not owe her a "duty" — which is the legal term for an obligation to act or refrain from acting in a particular manner. The Court of Appeals reversed.

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## → COURT ANALYSIS

The court framed its decision as an identification of the persons to whom an appraiser owes a duty and who, therefore, may sue for malpractice. Historically, the duty to appraise property in a non-negligent fashion was owed to the party who ordered the appraisal — typically the lender. The Sage Court acknowledged that, in the real world, buyers and borrowers often rely on the accuracy of the appraisal as well. Thus, the court held that the appraiser could also owe a duty to — and therefore be sued by — the buyer/borrower even though there is no direct contract or relationship between the two.

## → THE LIMITS

The court curtailed its expansion of potential malpractice plaintiffs by enunciating certain additional requirements. One significant requirement is that the plaintiff must prove that his loss was caused by his justifiable reliance on the appraiser's opinion. Ms. Sage met this requirement by showing that she had the contractual right to cancel the sale, but did not cancel because she relied on the accuracy of the appraisal.

While this analysis was favorable to Ms. Sage, the causation/reliance requirement poses problems for others. First, some contracts do not allow the buyer to cancel based on the outcome of the appraisal, which means the causation element cannot be satisfied. Also, many appraisers in the current market are being accused of undervaluing property, which results in a failed sale or refinance transaction. The Sage Court's analysis does not support a malpractice claim under

these facts, because the plaintiff's claim is that the transaction failed because of the appraiser's faulty opinion — not because the plaintiff relied on the accuracy of the opinion.

Another element of a successful malpractice claim is proof that the appraiser was negligent. The Sage defendant's failure to accurately calculate square footage is an objective example of appraiser negligence. However, other potential bases for malpractice claims — such as improper methodology, poor selection of data and negligent analysis — are subjective and therefore more difficult to prove.

## → CONCLUSION

Overall, the Sage case is important because the court recognized that appraisers play a critical role in real estate transactions, and their professional obligations should extend to those who rely on the accuracy of their work. However, the practical ramifications of Sage are fairly limited. Before Sage, appraisers owed a duty to their clients. After Sage, that duty is extended to parties who foreseeably rely upon their valuations. Even with duty established, to be successful a plaintiff must still prove negligence, reliance, causation and damage — each of which can pose challenges to malpractice recovery. ■■■

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