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2016 E&O Insurance Update - where to get E&O, prior acts, state board complaints, E&O Myths

I have been writing this article annually since 1992 and have seen some big changes, mostly when the lender market is bad.

The number of claims are up this year because of Llano Financing. For more info google Llano or go to www.appraiserlawblog.com/ and search for Llano.

Complains by state boards are still up. Per Liability Insurance Administrators, 45% of their inquiries are about state board complaints. Your E&O does not cover this, but some insurers offer a $2,500 and help finding an attorney. If lenders and AMCs ever start complying with Dodd-Frank and turning in appraisals to state boards, this will go way up.

E&O Prices are stable to declining as we get farther from the big 2008 mortgage crash.

Almost all insurers offer no exclusions on prior acts now, but some may offer lower premiums if you don't get prior acts. Of course, this makes your insurance worthless for liability protection. In 2014, some only offered prior acts back to 1/1/08.

Overall, residential appraisal risk for lenders has declined. We are past a lot of the pre-2009 losses, prices are up, and there is much greater attention to quality control. Separation of the mortgage broker and the appraiser made a huge difference.

Buying appraiser E&O insurance is very different from auto or home insurance. There are relatively few brokers and insurance companies that handle appraiser E&O. Don't shop just for price. Shopping for price is not a good idea in today's changing liability problems for appraisers. Instead, you need to check out the exclusions, limits, etc. The cheapest is not always the best, especially when you have a claim.

A few years ago, shopping for E&O coverage was relatively simple. But now there are wide ranges in what is covered and what is excluded, assistance with state board complaints, prior acts coverage, etc.

Most of us hate dealing with insurance of any type, so we usually just stay with our current insurance company. There are some benefits to remaining with the same company, such as sometimes lower premiums, plus familiarity with the services they provide.

If you change insurers, be sure that prior acts are covered. E&O without prior acts isn't anything for liability protection, as you are typically sued up to 5 years after the event occurred. Coverage is not always offered in all states by insurance companies. Be sure to ask if your state is covered. Many thanks to Peter Christensen of Liability Insurance Administrators (www.liability.com) for the information he provided for this article.

Note: most of this article is reprinted/updated from last year's E&O update. But, we all need reminders of what we need to know about E&O insurance.

In This Issue

The Top Three Liability threats in the next 5 years (Peter Christensen, LIA)

1. Indemnity agreement enforcement. AMCs and lenders are not doing this at this time.
2. Mandatory reporting of "bad" appraisals - mandated by Dodd-Frank, but not being done.
3. Any type of a downturn in real estate.

What about appraisers who are thinking about quitting appraising or retiring?

If you qualify, you can get lifetime coverage for free from some E&O companies. Landy, LIA and Intercorp offer this. Requirements vary widely - number of years with company, years experience, etc. Check your E&O company.

5 Star Appraisers/Target Professional Programs offers tail coverage for only one year.

If you are not eligible for lifetime coverage, getting "tail coverage", which continues your E&O, is very important as the average time period for being sued, after you did the appraisal, is 2 to 5 years. There are still pending claims from pre-2008 appraisals. The cost is typically 3 times the price of your last year's coverage. Check with your E&O company.

Unfortunately, very few of the appraisers who are quitting the business because they can't make it financially get "tail coverage". They just let their insurance lapse. This means that they are self-insuring for all claims for appraisals done before they quit paying for insurance.

If an appraiser owns an appraisal company, retires, and the company keeps going, this coverage is not available.

Be Careful: The difference between "individual only" policies and regular coverage

Another good tip from Peter Christensen from their claims: "The "individual only" policies will not cover claims relating to appraisals signed as a supervisor or relating to claims by past or present contractors or employees."

"I see a fair number of claims denied based on that distinction. A typical example is: a long-term successful appraiser had a few employee or contractor appraisers in the past and always relied on those appraisers having their own coverage."

"Now, a claim comes in about one of those past employee's or contractor's appraisals. The appraisal firm/owner is sued and the appraiser is sued also. The employee/contractor appraiser is long gone and no longer has E&O and has no financial means."

"It's the appraisal firm/owner that gets stuck holding the liability bag, and if he or she has an "individual only" policy, he or she will have no coverage for the lawsuit. To make matters worse, as an employer of the appraiser, the firm/owner may have a legal duty to actually pay for the employee appraiser's defense (in addition to the firm/owner's defense). I've seen it happen a lot."

What if you're not renewing now?

The appraiser E&O market is fairly stable now, so much of the information will be useful until next year's update.

I only do this update once a year, but the phone numbers and Web site links should still be accurate.

It is also a useful source of information for topics such as what is a claim, how to handle communication with an upset borrower, tips on liability reduction, etc.

What are the cheapest policies?

No prior acts, low coverage limits, lots of exclusions, etc.

Do not shop only for the lowest price. Now that everyone is busy, there is no reason to do this. Just doing a few appraisals will pay for a year of E&O insurance and greatly reduce your risk.

Carefully evaluate low priced policies. For example, you choose the policy with the lowest price but do not notice that prior acts are excluded. Or, there are other items that are not insured that you would like to have.

Policies that do not cover prior acts, or only after a certain date, such as 1/1/08 are the lowest price as you are assuming the risk of those appraisals. THEY ARE WORTHLESS FOR LIABLITY COVERAGE.

45% of claims are from state appraisal boards. Your E&O policy does not cover this. Does the policy offer anything? Even $2,500 and a referral to an attorney is better than nothing.

Some states are more expensive, such as California and New York. Too many lawyers, I suppose.

Be Careful with short, online applications - prior acts

Navigators, General Star and Great American charge different rates based on prior acts. It's a higher rate if the appraiser wants prior acts coverage before 2008.

The application for these policies is a check box form and the appraiser can choose whether to get prior acts coverage or not (if the appraiser is qualified for prior acts). Some appraisers select no prior acts coverage the first year they apply to save the extra $200-$300.

That's a very bad mistake.

When do appraisers get sued?

1. If there is a buyer defect, with a couple of months.
2. Llano Financing starts about half of appraiser lawsuits now, and goes back to 2005, 2006 and 2007.
3. Some other lender claims have gone back as more than 10 years.

What about statute of limitations?

The statute of limitations laws start the day the problem is discovered, not the date of the appraisal. That is why banks sue for over-valuations longer than 5 years old. The older the appraisal, the harder it is to prove negligence. That is why lenders rushed to file claims during the mortgage meltdown. They are still filing them, but there are fewer discovered now.

In California, they have two years after discovery (finding out about the appraisal) to file a claim. States vary, so check your state's laws.

Damages vs. claims

Anyone can file a claim for any reason. Damages is when the person receives money. Few claims result in damages.

What is a claim?

A claim is any demand for money or services or a notice of breach of duty. What does "knowledge or information" mean? These terms are interpreted differently, state by state, but it is reasonable to assume that if you've been sent a letter about a possible claim, you've been informed.

If you want to change insurance companies, but think you may have a claim filed against you, check with your attorney or current insurance company. You will not be able to change insurance companies until your claim is resolved.

Who files claims?

Now, most are filed by borrowers who did not get their loans due to "low" appraisals. This has changed from a few years ago, when more were by lenders, FDIC, etc. for overvaluation during the boom years.

Damages for borrowers who did not get their refis could be as high as 30 years times the extra annual interest paid.

What total policy limit amount should you have?

For most appraisers, $300,000 is adequate. However, some lender/AMC clients require $1,000,000. If you are in a high cost area, consider at least $500,000.

For most appraisers, clients tell you how much insurance you must have to work for them.

Why have any type of insurance, including E&O?

The purpose of insurance is asset protection so that you don't lose your home, savings, etc. Plus the cost of defense, which can be substantial.

You decide which level of risk to take. For example, auto insurance with no deductible or a high deductible. For appraisers, E&O with minimal coverage and many exclusions would be a high risk.

Don't EVER let your E&O insurance lapse!!!

Claims made coverage is the only type of appraisal E&O insurance available now. In this type of coverage, the claim must occur while the policy is in effect. The error or omission causing the claim may occur during the policy period, or if "prior acts" coverage is applicable, prior to the policy period. If you don't have prior acts coverage, both the claim and the error or omission must occur when the policy is in effect.

In contrast, many types of insurance, such as fire insurance on your home, is made on an occurrence basis. In this type of policy, the insurance company covers any act or omission that occurred during the period the policy was in force - whenever the claim is filed. This type of coverage is not available for appraisers' E&O insurance.

For most appraisers, unless they're just starting self-employment, prior acts coverage is almost mandatory as claims are usually filed long after the alleged error or omission. According to Bob Wiley of LIA, a study he did showed that, on the average, you are sued 30 months after the appraisal is done.

Prior acts coverage cannot go further back than the last uninterrupted claims made policy. Remember, if you have had a lapse in coverage, you cannot get prior acts coverage for any appraisals done prior to that time.

What about having no E&O insurance?

The reason for having any type of insurance is risk reduction. The risk is losing your assets (house, stocks, savings, etc.), plus paying defense costs. E&O is the same. Without lenders' requirements, probably many appraisers would not have E&O insurance.

Some commercial appraisers don't have any, as few of their clients require it. If you don't have E&O coverage, I strongly recommend taking measures to protect your assets. Many appraisers say they don't have any assets. But, this applies to savings, retirement accounts, real estate, etc.

The best way to protect your assets is to put them all into a trust, managed by someone else, such as a spouse. You will need an attorney to set this up. Another option is to put all your personal assets in a spouse's name. Unfortunately, changes such as a divorce can make this messy.

Myth - "If I don't have E&O insurance, I won't get sued"

I have heard this from many commercial appraisers, as long as I have been an appraiser, 40 years now.

This is false.

Peter Christensen, before working for LIA, was a lawyer who sued people (probably few, if any, appraisers) for various reasons. These attorneys typically work on contingency. Below is his advice.

Attorneys that sue individuals often look to the assets of the person, not necessarily their E&O coverage. For example, you are in a lawsuit with a $100,000 claim and you have no insurance. It is much easier for an attorney to get the money if they don't have to hassle with an E&O insurance company. The appraiser can pay them off using home equity, savings, retirement accounts, borrowing from friends and relatives, etc.

Myth: "My business is incorporated, LLC, etc."

Incorporation and other business structures do not help reduce appraiser liability risk. You are sued directly as a professional appraiser.

Those structures can protect you from other types of lawsuits, but typically appraisers are sued because of an appraisal.

Commercial appraisals - the largest claims

Per LIA, last year, conservation easement claims were up, particularly by taxpayers when the IRS denied their deductions.

E&O premiums are higher than for residental. Dollar loss from claims is much higher than for residential. Commercial appraisers are much more likely than residential to not have E&O insurance, as only a few clients require it. Instead, they self insure.

Per John Torvi of Landy, the ratio of residential to commercial appraisal claims is 12:1. On the plus side, commercial owners, buyers and sellers are much more sophisticated than residential. They are not "emotional" and base their decisions on facts. Also, commercial properties are not subject to the strict protections of residential properties. Fees on commercial appraisals have been low for awhile after 2008. Some lenders allow more "minimal" appraisals, which can increase appraiser risk.

Especially risky are development loans made during the boom times. They are very risky for banks. For example, a developer has a construction loan or credit line for $8,000,000 that is up for extension or for a new loan. The developer can't get a loan and loses the development and sues the appraiser for $8,000,000, well over the appraiser's E&O limit.

Some E&O companies will not cover any commercial appraisals because of their high risk.

Commercial appraisals are risky because the dollar amounts of the properties are often significantly higher than for residential.

A recent trend is commercial lending is borrowers suing the appraiser for under-valuation when they don't get their loans.

E&O prices for commercial appraisals are higher than for residential, but not by that much. For example, I have a $1,000,000 policy (commercial and residential) that cost me $1,142 in 2012, down from $1,476 in 2010. My 2015 premium was 1,204, 2014 premium was $995. In contrast, a $1,000,000 residential policy is around $700.

If you do many appraisals for development loans, or other loans that are well over your policy limits, you will have to pay whatever is over your policy limit.

FYI, commercial loans are typically for about 5 years, not 30 years. In my area, commercial properties declined about 40% from the peak in 2007 and started coming back up a few years ago.

What about AMC complaints?

Very few complaints, if any, are filed by AMCs. This may change in the future, if lenders decide to "go after" AMCs. FYI, AMC lender agreements are usually much more stringent than agreements between AMCs and appraisers.

What about Dodd-Frank's requirement for lenders/AMCs to turn in complaints on appraisers to state boards?

Very few lenders and AMCs are paying any attention to this requirement.

But, they tend to be like sheep. For example, one adds a requirement, then others follow. So far, the state board complaints and fines have focused on C&R fees.

If this ever starts happening, there will be many, many complaints filed against appraisers to their state boards.

This could be a big risk for AMCs as the state regulator could revoke their license and cause significant financial difficulty if a major client is lost. A few years ago, a large AMC purchased a smaller one whose state board license had lapsed in a state. The state suspended the large AMCs license for 2 weeks. Per the AMC they lost $10,000,000.

This is one of the major risks for appraisers in the future.

Policy exclusions

Check what your policy includes and what you can get for an additional fee.

Exclusions have been increasing. Before renewing or changing insurers be sure to carefully check the exclusions. All policies have exclusions.

Risky exclusions include claims for financial damage and prior acts.

Some companies are excluding FDIC claims, plus the typical new construction, etc.

Certain years may be excluded, such as 2005-2008.

Ask for a sample policy and carefully check the policy exclusions before renewing or changing companies. They all have exclusions.

Other types of exclusions are claims based on discrimination, pollutants, mold, or waste. Call the broker or insurance company and ask for an explanation of any exclusions not mentioned in the application.

Most exclude appraisals for certain types of development.

Don't ever lie or misrepresent on an E&O application

Why? They may not cover you if there is a claim.

It's never a good idea to lie or misrepresent on an application. If there's a question you don't understand, call and ask them what they mean and why they are asking the question. If the questions could cause you problems, look for another insurer who doesn't ask that question. But, they all ask if you've had any claims filed against you, or know of any circumstances which may cause a claim to be filed, or if you have been disciplined by any professional organization, agency,or court.

What about getting insurance with previous claims or damages?

A prior claim or damages does not mean automatic denial. The appraiser may not have been guilty and the suit was settled out of court. Most cases are settled. Very few cases go to trial.

What about trainees and independent contractors?

The supervisor who co-signed the report is equally liable. If your E&O did not include trainees, you will have to pay for their mistakes.

If you have an appraiser or trainee that you co-sign for, be sure they are covered under your policy. Or, get a copy of the appraiser's policy.

Most frequent reasons for claims today

1. Square footage
2. Over-valuation (Lenders from the boom years)
3. Under-valuation (Borrower doesn't get the loan.)
4. If there is a buyer defect, within a couple of months. Both the agent and the appraiser are sued.
5. Septic vs. sewer (Borrower failure to disclose) Unfortunately, some appraisers don't check for this. It can occur in urban areas. Be very careful to check if this is an issue in your area.

State appraisal board cases

Per LIA, about 45% of their inquiries from appraisers are about state board complaints.

RELS has been sending appraisal complaints to state boards, both staff and independent contractor appraisals. They have many more than any other complaint source. Dodd-Frank did require mandatory reporting, but very few lenders are doing it.

Just like all claims, appraisal board complaints are from dissatisfied borrowers. Lawyers are becoming more savvy about filing complaints with state boards.

This type of coverage is becoming more important.

Check to see what your E&O provider offers.

Coverage for state board complaints is very limited, as compared with other features of appraiser E&O policies. It only applies to attorney costs. You will need to hire your own attorney. Your E&O company hopefully can advise you on who to hire.

State board complaints

Although states were expecting many complaints due to Dodd-Frank mandatory reporting, it did not happen. Few complaints are from lenders. A slight majority are from homeowners, with about 50% about low values.

However, state board complaints and penalties are an increasing problem for appraisers. I always strongly advise getting an attorney to help you. Don't reply without one. Don't argue with the borrower or your state regulator. Penalties are a bigger problem as they must be reported when you fill out an E&O application.

State Appraisal Board cases

Several companies provide from $2,500 to $5,000 to its insureds if a complaint is filed by their state boards, and offer to find attorneys to help with the state board complaints. The number of complaints varies widely among the states, primarily depending on the state regulator.

There is concern about increases in state board cases due to the "mandatory reporting" requirement of appraiser "problems" in Dodd-Frank. But not much has happened yet.

If the Consumer Financial Protection Agency starts auditing lenders, they may require that the lenders file complaints.

Some other insurers offer limited coverage and/or assistance if your state appraisal board challenges one of your appraisals.

LIA and OREP offer a free consultation to their insureds to evaluate your response to the state board complaint.

Number of claims stabilizing, except for Llano Financing

Most claims have stabilized and are at a much lower level than in the past. However, claims overall are increasing if you include Llano Financing.

LIA renewed all the appraisers who had Llano complaints. See what your E&O company says.

Estate and trust appraisals - IRS penalties

Appraisers can have penalty assessments, up to 125% of the appraisal fee, for undervaluation resulting in reduced estate taxes. Be careful. This is not covered by your E&O insurance.

How many claims go to court?

The vast majority just go away as they are not valid. For example, the value was too low and they didn't get their loan. Most are dismissed, some settle and under 5% go to court.

Almost all lawsuits, whatever they are for, get settled before trial, often just before the trial starts.

Appraisers who do litigation work see this regularly.

Many appraisers think that the E&O companies want to settle to avoid litigation costs. This may happen sometimes, but many appraisers just don't want to go to court and prefer to settle and "get on with their lives", so they agree to settle, typically after 1.5 years.

Some appraisers are unwilling to admit they made a mistake and are hard to defend.

What about FDIC coverage?

FDIC complaints are less common now, but do occur. There are relatively few from residential appraisals.

Complaints can come from any government regulator, not just FDIC.

Why do appraisers get sued?

Shift from over-valuation (lenders) to under-valuation (borrowers). As the claims from lenders against appraisers for over-valuation during the boom years winds down, it is being replaced by property owners saying the appraisal was too low and they didn't get their refi or purchase.

How to handle the first contact from a borrower

Sometimes it can start with a phone call, such as a nice or nasty borrower. Keep your composure. Your client is the lender. Don't say "Sorry, I made a mistake. How do we fix it?" You may not have caused the problem, such as a trashed foreclosure. Don't "do a favor" and offer to pay for the damage.

Your first contact can also be a letter.

Be sure to contact your E&O company. Don't ever try to handle it yourself.

Recent claims from LIA files

Editor's note: None of these are new topics.

- Accepting an appraisal and turning it in late or not at all.
- Expert witness appraiser turning in complaint on appraiser for the other side.

Unpermitted additions

There are claims on this, usually by the buyer. Information is much more easily available online, from local jurisdictions or online services that compile and sell the data.

When I started appraising in the mid-1980s, most of my lender clients said to not go to city hall to verify permits, because the borrower "may get into trouble." But, now lots of permit info is available online. When I get permit info at a building department I just get the records and look to see if a permit was taken out and finaled.

Whether or not an appraiser is liable is somewhat controversial, but be sure to prominently disclose what you did, or did not do, in your report. Peter Christensen advises:

- If you see poor quality construction, beware
- State in your report what you saw and did. For example, the addition appears to be lower quality (include photos). Per the owner, no permits were obtained. I did (or did not) check permits at the local building department.

Attic and basement conversions

State "in plain English" what you saw and determined. For example, public records has 5 bedrooms, but two of the bedrooms were in the basement, which is not included in the GLA. It was in a college town and was purchased by an investor. The number of bedrooms made a big difference.

Assessors and lenders can have different ways to evaluate finished basements. Also, lender requirements (and local preferences) can change over time. With the wide availability of free public records online, lenders and lots of other people, unfortunately, think they are correct.

What if you do 1-4 unit residential plus sometimes land or small commercial?

Be sure to check to see if the policies cover these additional property types. Some don't.

What about deductibles?

Look for no deductible for defense (see above), minimal deductible for damages, which applies only if you lose the case.

If you have a claim will your E&O get cancelled?

"It depends" per LIA. The farther back in the past, the better. Whether or not you were at fault, and how you were at fault also matter, i.e., a mistake vs. intentional deception.

Typically, they don't immediately stop your coverage. Instead, they won't renew your policy. You must find another company, which can be tough if you have had a claim that resulted in damages. You may have to go to a high cost policy with a company that has them available at $5,000 or more per year.

Another major factor is if the claim is still open. Insurance companies don't know what they will be getting into if they insure an appraiser. So, you won't be able to change insurance companies until it is resolved.

If none of the regular appraiser E&O insurance companies will insure you, there are companies of the last resort that will insure appraisers who have had a claim. The annual cost? One appraiser reported getting a policy for $5,000 a year.

Intercorp and Liability Insurance Administrators have a special program for appraisers with claims. The cost is high, typically $2,500 to over $10,000, but it is available.

How can you reduce your risk?

• Check out your clients, particularly their financial health. You don't want to be dragged into a lawsuit.

• Adequate supervision of less experienced appraisers.

• Not relying on information provided by the owner, Realtor, or developer. Check it out.

• Document, document, document. Put it in writing. Take photographs. Otherwise, you won't be able to remember, or prove, something that happened several years ago. Keep your photo negatives and digital images. Keep a diary of who you've called and what they said.

• Document all property deficiencies in your report.

• Don't attempt an assignment beyond your expertise. Split the fee with a more experienced appraiser.

• Investigate the qualifications and experience of a potential new hire or independent contractor. Be sure they're not in a lawsuit.

• Check for clerical errors. They can be very expensive. Flood zone, and as is/as completed boxes are a common source of errors.

• If you are unable to inspect something, such as the type of foundation or insulation, put down "unknown".

•Turn down high risk appraisal assignments.

• Carefully screen new clients.

• You get a "feeling" about a prospective assignment or client. Most appraisers have them. I learned the hard way to just say no, after getting badly burned a few times.

For example, I took an estate assignment from the person handling the sale of her grandfather's home. They needed a value for when he died. The pre-screening with the granddaughter went fine over the phone, so I accepted the assignment. When I got to the property, a man was there. I identified myself and asked who he was. His name was on the front of his shirt, the same last name as the person who called me. So I asked if he was her husband. He started asking me a lot of questions about my qualifications I had already answered with his wife.

Then his wife showed up and he kept saying he needed a low value and wanted to know what it would be. I explained that I could not provide it and that it would be very difficult to determine as the home was a major fixer upper.

Plus, it would enter escrow as soon as it was listed with multiple offers in early June, so this would have to be explained in the report since it is for estate purposes to establish a new basis.

I said the January 2013 value would be less that the June sales price as prices were increasing about 3-4% per month in 2013. Then I asked if they wanted an appraisal and they said no.

As I was driving back to my office, I got paranoid about state board complaints, lawsuits, etc. I was writing up this article at that time and was very, very glad the appraisal was cancelled.

What should you look for in a policy?

If you're a solo residential appraiser, price shopping is easy. Often, the rates our posted on the insurance broker's web site. Don't select the company on price alone. Be sure to evaluate the company as well as the policy.

Also check out:

• Prior acts coverage for as long as you have had continuous coverage without any lapse.

• Deductible, per occurrence, and aggregate dollar limits. Most policies lump together the defense and loss into one total dollar limit. For example, the first $2,500 is paid by you. Or, the policy does not apply for defense, only for 75% of the damages.

• Coverage for both the claim and the legal defense.

• Any exclusions. Be sure to investigate both the application, and the policy itself.

• Assistance if you have a question. This is the main reason why I have stayed with LIA. I have only called them a few times over the past 25 years, but I will never forget that they advised me on what to do. They also help with state board problems and have a full time attorney on staff, Claudia Gaglione, to help. She has many years of appraisal liability experience. I also knew they would not cancel my policy if I called.

• No deductible on defense expense ("First dollar defense")

• Coverage appropriate for your past and current business. For example, covering trainees who used to sign on reports that you co-signed. There are still claims being filed for appraisals done during the "boom years" when there were lots of trainees.

Price, of course, is also a consideration. Be sure to get several quotes, especially for firm and commercial coverage, as there can be wide variations.

What insurance brokers should you use for E&O?

All the companies listed in this article are insurance brokers who work with two or more insurance companies. Typically they have one, or a few, insurance companies that they use for most appraisal polices. They have other companies they use for states where those companies don't cover appraisers, there are multiple appraisers in the appraisal company, or other issues the appraiser has.

I always recommend using a company that specializes in appraiser E&O insurance. Most, if not all, advertise in appraisal publications.

Brokers who insure real estate agents and related professionals can also work. However, they are not always the best choice as they are not familiar with appraisal issues, which are very different than real estate agent issues.

A general insurance broker, who handles your auto, home, general liability, etc. is not a good choice, as they are not familiar with the issues. Of course, they could place your coverage with one of these insurance companies, but they would not be able to help you with questions and give advice on issues that come up when doing appraisals, such as strange AMC requests.

What is a Program Administrator?

Last year I spoke with Peter Christensen, an attorney with Liability Insurance Administrators. He mentioned that he was working on an appraiser insurance policy. LIA is a program administrator for their primary carrier, Aspen Insurance Holdings, Limited.

Program administrators can also handle claims, so they are able to provide much more information than the other brokers.

Intercorp and Landy are also program administrators for their primary insurance companies.

Per Peter Christensen of Liability Insurance Administrators, "There is no bright line between broker and program administrator, but some of the defining characteristics are that a program administrator is more like a wholesale source (because it might sell through retail agents also as well as direct), a program administrator will usually have authority from the insurer to underwrite and bind policies, a program administrator will usually issue the policies (not the insurer), and a program administrator may be the one to whom claims are reported (as we are at LIA). We do all of these functions. The other companies you name perform at least some of the program administrator functions and I would consider them program administrators. But, note program administrators are always also brokers too (they must be licensed as brokers to sell insurance)."

What does this mean for you? I prefer a program administrator as they are very familiar with the policies and procedures of the insurers they represent. I also like that they receive the claim requests.

My E&O insurance

When I started my appraisal company in 1986 I used Liability Insurance Administrators. A few years later, they were not active in this market, so I went with an insurance broker affiliated with NAREA, which had a great "occurrence" insurance policy which was similar to car or fire insurance - if you had it, you were covered for any claims at any time. When they shifted to claims made in 1991, I switched back to LIA.

I stayed with LIA because I knew if I had a claim, they would not cancel on renewal. Also, they gave good advice when I had a question, from an attorney very familiar with appraiser E&O issues.

They were never the cheapest, but the prices were reasonable for me as I do both commercial and residential. Their prices went up and down over the years.

I also like the state board complaint assistance and the $2,500 coverage.

My E&O insurance with LIA ($1,000,000 - commercial and residential) has been stable over the few years. 2015 was $1,204, 2014 was $1,199, 2013 was $1,181, 2012 was $1,181. However, 2011 was $1,446.

E&O Insurance Companies

Note on broker contacts: I have listed brokers who work with appraisers all over the country.

I don't recommend using your local insurance agent for appraiser coverage as they can't help you if you have a claim. They are unfamiliar with the market.

Most brokers that offer appraiser E&O also offer coverage for other professionals, such as real estate agents and home inspectors.

For appraiser E&O some brokers offer coverage from a primary carrier with secondary carriers for appraisers who have had claims that resulted in damages. Others offer coverage from multiple insurers and can shop around for you.

For example, Lloyds of London is an insurance company. Landy is an insurance broker.

5 Star Appraisers/Target Professional Programs

Note: 5 Star is now affliated with Target Professional Programs and has been advertising under that name.

All states through Lloyds of London.
Only offers prior acts back to 1-1-10.
Offers 1-4 unit residential coverage, light commercial property (less than 50,000 sq.ft./maximum 4 stories), and agricultural property. Only offers tail coverage back 1 year.

Contact:
5 Star Appraisers/Target Professional Programs
1230 East Diehl Road, Suite 350
Naperville, IL 60563
800-497-4644
www.targetappraisers.com

Alia

Coverage through Lexington, Navigators, and Genstar.
E&O insurance was split off from FREA several years ago to provide only insurance.
Contact:

2645 Financial Ct., Suite A
San Diego, CA 92117
800.882.4410
www.aliains.com

CRES Insurance Services
Coverage through QBE Insurance Co.
Contact:
CRES Insurance Services
15010 Avenue of Science #100
San Diego, CA 92128
P: 858.618.1648
F: 858.618.1655
www.cresinsurance.com

Intercorp Insurance Program Managers
Coverage through Lexington.
Contact:
Intercorp Insurance Program Managers
1438-F West Main Street
Ephrata, PA 17522-1345
Phone: 800.640.7601
www.intercorpinc.net

Landy Insurance Agency
Coverage through Great American Insurance Company in all states except possibly LA.
Contact:
Herbert L. Landy Insurance Agency, Inc.
75 2nd Ave. Suite 410
Needham, MA 02494-2876
800-336-5422
www.landy.com

Liability Insurance Administrators
Coverage through Aspen Insurance Holdings Limited. They previously offered insurance through Liberty. They changed to get lower rates.
Contact:
1600 Anacapa St.
Santa Barbara, CA 93102-1319
800-334-0652
www.liability.com

Mercer (formerly Marsh) Affinity Group Services
Coverage through Genstar
Contact:
Mercer (formerly Marsh) Affinity Group Services
P.O. Box 8146
Des Moines, IA 50301-8146
Phone: 800-367-7950
Fax 515-365-3043
www.proliability.com

OREP (Organization of Real Estate Professionals)
Insurance though about 4-5 difference insurers
Contact:
OREP (Organization of Real Estate Professionals)
6760 University Ave. #250
San Diego, CA 92115
Phone: 888-347-5273
www.orep.org

John Pearl & Associates
Coverage through Intercorp, Lexington and other insurers.
Contact:
John Pearl & Associates
1200 East Glen Ave., Peoria Heights, IL 61614
Phone: (309) 688-9000.
Fax: (309) 688-5444.
www.pearlins.com

J.A. Price Agency, Inc.
Coverage through Mercer (formerly Marsh) Affinity Group Services.
Lexington, Genstar and Navigators
6640 Shady Oak Road, Suite 500
Eden Prairie, MN 55344
Phone: 952-944-8790
Toll Free: 800-279-1623
Fax: 952-944-0097
www.japrice.com

Victor O. Schinnerer
Coverage through CNA (Continental Casualty Company) insurance company.
Contact:
Victor O. Schinnerer
Two Wisconsin Circle
Chevy Chase, MD 20815
301-961-9800
www.schinnerer.com

How do upgrades affect UAD Condition and Quality ratings?

By Rachel Massey, SRA, AI-RRS

The Uniform Appraisal Dataset (UAD) was designed to help bring some uniformity into the appraisal process related to mortgage work. After all, appraisers were not very uniform in the way they described condition and quality.

This applied not just to condition and quality ratings, but to a myriad of other factors such as view and location, down to how basement finish was identified. The Collateral Underwriter (CU) was designed in part to synthesize all of this information and also to identify areas where appraisers differed markedly from each other, as well as even within their own work product.

We had a lot of angst at the outset of CU related to reusing quality and condition ratings, and possibly changing them from one report to another. This was a valid concern because it is one of the factors that does get measured within the CU.

Since the UAD has been required since 2011 for mortgage related work intended for Fannie Mae or Freddie Mac, we would expect that, five years later, appraisers would be well versed with what the specific ratings entailed.

As both a reviewer and appraiser in the field, I find this is unfortunately far from the truth. The truth seems to be that confusion related to the requirements is still rampant.

My contention is that it is not the appraisers who are at fault, but the definitions themselves. There are simply too many grey areas. Either that, or educators have not done a sufficient job in helping appraisers understand what is expected, but it is a good possibility, based on the continued wide-spread variances, that the definitions themselves are too vague.

Q4 vs. Q5

Let us take a look at quality for a Q4 and a Q5 house. The ratings show:

Q4 Dwellings with this quality rating meet or exceed the requirements of applicable building codes. Standard or modified standard building plans are utilized and the design includes adequate fenestration and some exterior ornamentation and interior refinements. Materials, workmanship, finish, and equipment are of stock or builder grade and may feature some upgrades.

Q5 Dwellings with this quality rating feature economy of construction and basic functionality as main considerations. Such dwellings feature a plain design using readily available or basic floor plans featuring minimal fenestration and basic finishes with minimal exterior ornamentation and limited interior detail. These dwellings meet minimum building codes and are constructed with inexpensive, stock materials with limited refinements and upgrades.

Q4 indicates stock builder grade and may feature some upgrades. Q5 indicates basic finishes and inexpensive, stock materials with limited refinements and upgrades. Both say stock, but Q4 says it may feature some upgrades. What are these upgrades? Are they upgrades to cabinetry, or are they upgrades to the building itself? Does taking a standard high-volume production build quality for the starter market, but adding higher-end cabinetry bump the quality level up?

What about condition, C3 vs. C4?

Probably the two ratings that are utilized the most are C3 and C4, which are as follows:

C3 The improvements are well maintained and feature limited physical depreciation due to normal wear and tear. Some components, but not every major building component, may be updated or recently rehabilitated. The structure has been well maintained.

**Note: The improvement is in its first-cycle of replacing short-lived building components (appliances, floor coverings, HVAC, etc.) and is being well maintained. Its estimated effective age is less than its actual age. It also may reflect a property in which the majority of short-lived building components have been replaced but not to the level of a complete renovation.*

C4 The improvements feature some minor deferred maintenance and physical deterioration due to normal wear and tear. The dwelling has been adequately maintained and requires only minimal repairs to building components/mechanical systems and cosmetic repairs. All major building components have been adequately maintained and are functionally adequate.

*Note: The estimated effective age may be close to or equal to its actual age. It reflects a property in which some of the short-lived building components have been replaced, and some short-lived building components are at or near the end of their physical life expectancy; however, they still function adequately. Most minor repairs have been addressed on an ongoing basis resulting in an adequately maintained property.

Example: Remodeled kitchen and baths, C3 vs. C4 and Quality

Consider the scenario that follows, where the C3 and C4 ratings are most likely in play.

The difference between the two are that on C3, some components may be updated or recently rehabilitated and well maintained, and on C4 they are adequately maintained and functionally adequate.

Survey: What about quality ratings for this same property?

Because this is a question that seems to engender different answers,

I asked this question through SurveyMonkey:

"If the subject property is a solid Q5 or Q4 production house, but the owners have installed a new high quality kitchen and bathrooms, does the quality rating change? Figure about a 10-year old house and all sales were built the same initially."

I purposely limited the responses to three choices because I did not want to get too many options, or otherwise there would be little consensus from the respondents.

The choices included:

1) that recently installed new high-quality kitchen and bathroom changed the quality,
2) that it did not change the quality but changed condition, and
3) that it did not change quality but was addressed as a line item adjustment.

At this writing there were 438 responses, which is more than sufficient to have a good sense of appraiser's opinions.

Survey results:

• 20.55% of the respondents considered it an upgrade of quality

• 54.34% considered it a condition rating change

• 25.11% considered it a line item adjustment

In essence, 79% of the respondents considered it did not change quality but was either a condition change, or warranted a separate line-item adjustment.

So, what is the answer?

How does changing a kitchen and bathrooms affect the structure of the house? Does it do anything other than change condition? If it is condition, how is this different than installing a new kitchen and bathrooms of stock quality in the stock quality house?

Would it be best addressed as a condition item, but also as a line item because one aspect of the house is now atypical for the quality of the typical house by this production builder?

I don't have the answer and throw this out for discussion, because as proposed at the beginning of this article, the UAD ratings are too vague and open to interpretation. Perhaps now is the time to drill down to what is truly expected within the various ratings and start a discussion on how upgrades to some non-structural elements to a house could, or could not, affect the overall quality rating of the building.

Hopefully this brief article spurs on discussion of these ratings, and helps ferment more consistency between appraisers who do mortgage related work, since we are all judged by the actions of our peers in our market and we want to be judged fairly.

As in all things appraisal, when in doubt, disclose. Write more, explain more. It certainly helps mitigate those grey areas to inform the intended users why one condition or quality rating was chosen over the other options.

What do you think?

Send your comments to Rachel Massey at rachmass@comcast.net.

About the author

Rachel Massey, SRA, AI-RRS has been in the real estate field in the Ann Arbor area since 1984, first in sales, and then as a full time appraiser since 1989. She has a Bachelor's degree from Siena Heights University with a real estate concentration, and is an AQB Certified USPAP instructor. Rachel was one of the original members of the Michigan Council of Real Estate Appraisers and has a passion for helping other appraisers through writing, teaching and with peer review.

She has expertise in lake appraisal, Relocation appraisal work and other residential work in Washtenaw County and surrounding communities. When not appraising or thinking about appraisal, she can be found enjoying sunsets, walking, and the occasional toss about the mat in aikido.

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Q&A -
FHA attic inspection requirements

By Doug Smith, SRA, AI-RRS

Editor's note on links: *Doug references long links to FHA documents below. Otherwise, this article would be way too long. Plus, it is always best to reference the original FHA document.*

If you are reading this on your computer or tablet, you can click on the links. If you printed it out to read, it will be easier to open the file on your computer and click on the links there.

Question:

I recently completed a FHA appraisal of a residential property. The underwriter asked me to state that I had fully entered the attic per the requirements found in the new FHA Handbook 4000.1. Just what are the new requirements for FHA attic inspections?

Answer:

At the onset of the release of the FHA Handbook 4000.1, appraisers were cautioned that the new Handbook was subject to change. A starting point for dealing with any requests from underwriters is to go to the latest FHA Handbook 4000.1 documentation.

This is easily done with two options.

1. Download the latest PDF copy or go to the searchable on-line version.
2. Bookmark the FHA site with the two options: Single Family Housing Policy Handbook (HUD Handbook 4000.1) Information Page: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_4000-1

The latest Handbook 4000.1 is dated 03/14/2016 and contains the following guidance:

k. Attic Observation Requirements (3/14/2016)

"The Appraiser must observe the interiors of all attic spaces."

"The Appraiser is not required to disturb insulation, move personal items, furniture, equipment or debris that obstructs access or visibility. If unable to view the area safely in their entirety, the Appraiser must contact the Mortgagee and reschedule a time when a complete visual observation can be performed, or complete the appraisal subject to inspection by a qualified third party. ***In cases where access through a scuttle is limited and the Appraiser cannot fully enter the attic, the insertion of at least the head and shoulders of the Appraiser will suffice****."*

"If there is evidence of a deficient condition (such as a water-stained ceiling, insufficient ventilation, or smell of mold), the Appraiser must report this condition, and render the appraisal subject to inspection and repairs if necessary."

"If there is no access or scuttle, the Appraiser must report the lack of accessibility to the area in the

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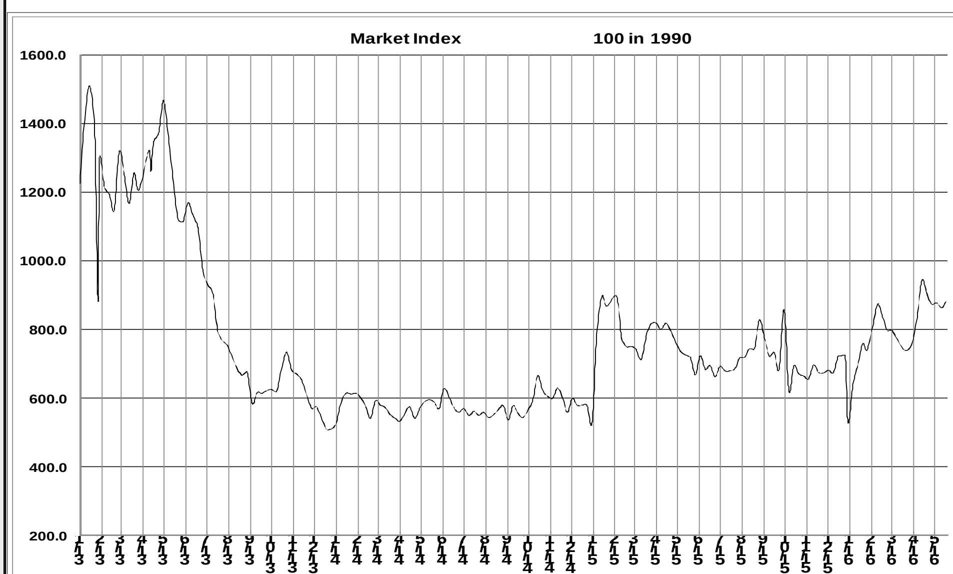
MBA Loan Volume Application Index – 1/13 to 6/16



appraisal report. There is no requirement to cut open walls, ceilings or floors."

"An observation performed in accordance with these guidelines is visual and is not technically exhaustive."

Before addressing the specifics of the FHA attic inspection, it might do well to back up and be reminded of the role of the appraiser in the appraisal process.

Appraiser Responsibility to Report Property Compliance

HUD is very specific as to the responsibilities of the appraiser
The Appraiser must observe, analyze and report that the Property meets HUD's MPR and MPS.

Minimum Property Requirements (MPR) refer to general requirements that all homes insured by FHA be safe, sound, and secure.
Minimum Property Standards (MPS) refer to regulatory requirements relating to the safety, soundness and security of New Construction.

"Every Property must be safe, sound, and secure so that the Mortgagee can determine eligibility. The Appraiser must note every instance where the Property is not safe, sound, and secure and does not comply with FHA's MPR and MPS. "

"Appraisers are reminded that FHA provides insurance to the lender that protects the lender in case of loan default. Loan defaults may have multiple causes. The specific reason for an observation of the attic is to identify deficient conditions such as a faulty, leaking roof, insufficient ventilation to prevent over-heating of the roof material or an unsafe presence of mold."

"All of these conditions could result in the homeowner sustaining post-sale expenses that may contribute of a financial hardship putting the repayment of the loan in jeopardy. Thus the appraiser must take into account the stakeholders in the loan process."

A Word about Equipment - ladder, flashlight, SelfieStick

Appraisers must have some means to observe the attic and therefore the basic equipment must include a ladder. The most common solution is to use a telescopic ladder. These have become much lighter and the locking mechanism has become much more reliable and safer protecting the user from pinched fingers.

A typical ladder extends to about 12.5 feet I use a Lenoxx Telescopic ladder that can be obtained from Amazon for under $125.00.

Along in my kit, I have a small terry towel to drape over the top of the ladder to prevent damage to walls.

I use a small LED flashlight with a fairly intense light. I also use a flashlight App on my smart phone.

A photo of the attic is required by FHA. The Handbook states, "The Appraiser must observe, analyze and report defective conditions and must also provide photographic documentation of those conditions in the appraisal report."

Therefore, appraisers may consider the efficiency of a "SelfieStick." The Sunpak Bluetooth SelfieStick is the most appropriate solution since it has a removable remote control for Apple ® and Android ™ Bluetooth devices.

What to look for in the Attic - How to use FHA web site

The most useful tool for appraisers is website guidance on filling out the appraisal forms. Click on the following:

Protocol and Tune-Up information - Requirements for Reporting: SF Housing Appraisal Report and Data Delivery Guide

From the HUD Single Family Housing Policy Handbook (HUD Handbook 4001.1) Information page, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_4000-1 There is a link to "List of Linked References."

Click on this page.
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/handbook_references

This useful website includes the full Protocols for filling out the following five forms:

- Uniform Residential Appraisal Report for one family residential properties
- Manufactured Home Appraisal Report
- Individual Condominium Appraisal Report
- Small Residential Income Property (Two to Four Units) Appraisal Report)
- Update of Appraisal (All Property Types)

The mechanics of the website is enhanced by the convention of instant search by clicking on the table of contents.

In the table of contents, for instance, for the Uniform Residential Appraisal Report, under Description of Improvements Section, item a. "Reporting Requirements for Attic," a left click will bring you to that section.

The protocol lists the following:
a. Reporting Requirements for Attic
The appraiser is required to inspect the attic. Enter the attic and observe the interior for insulation, ventilation (fan, vent, or window), and the condition of the roof structure. Note any deficient materials, leaks or readily observable evidence of significant water damage, structural problems, previous fire damage, exposed and frayed wiring, or any other health and safety deficiencies. If any deficiencies exist, condition the appraisal on their repair or inspection and prepare the appraisal as "subject to repairs" and/or "subject to inspection."

This narrative is followed by a

chart with the specific check mark protocol such as "Enter 'X' if this item exists.
The usefulness of the Guide lies in the completeness. It also includes the applicable Fannie Mae/Freddie Mac Uniform Appraisal Dataset (UAD) formats and report requirements such as a concise definition of the Condition Rating System, (C1-C6). In all cases, the instructions are consistent with the Fannie Mae Selling Guide.

Inspection Tips - Water Leaks

When completing an attic inspection, appraisers engage the five senses not only looking for water stains and other visible deficiencies, but also not ignoring odors that might suggest mold activity or listening for bird, bat or rodent intrusions.

Water stains may suggest a leaking roof. This may call for looking for freshly painted ceilings. Appraisers must be alert to the possibility that a fresh coat of paint may disguise an underlying problem with a leaking roof. Know that while the ceiling of a room may be painted, few will take the time to paint the ceiling in a closet.

A check of the closet ceiling may reveal a misguided attempt to cover up a leaking roof.

Inspection Tips - Insulation and attic access

When blown in insulation is added, the installer will often add an extension or dam to the scuttle that makes it difficult to fully observe the full attic.

Formerly, attics had walkways which when blown in insulation is applied, these walkways were covered with insulation.

If the scuttle is in a closet and closet shelves make it difficult to fully access the attic, the difficulty with attic must be reported and a photograph taken to demonstrate the difficulty with attic access.

However, if the access is blocked by personal possessions, it may be practical to enlist the help of the homeowner to make the attic or scuttle accessible. In the instant case of the underwriter stating that a full inspection is required, the underwriter is incorrect.

However, the appraiser must document why a full inspection was not performed when there is not an accessible attic. Suggested language might include: "A full attic inspection was not performed as the subject property does not have a readily accessible attic and only has scuttle access." Along with a photo of what can be seen from the scuttle, the appraiser might add that the appraiser completed a head and shoulders inspection of the attic.

Remember to check the block on page one of the form that the attic is accessed by a scuttle.

If the property has a full attic, note if a full inspection was performed and comment how access was gained either by stairway or drop stair.

Limiting Liability

FHA discourages appraisers from adopting language in an attempt to dodge liability. Appraisers often include language stating the obvious that appraisers are not home inspectors or that an "inspection" is an "observation." FHA includes this instruction in the Handbook:

Appraisers may not recommend inspections only as a means of limiting liability. The reason or indication of a particular problem must be given when requiring an inspection.

FHA depends on appraisers in the field to complete the work set out in the Handbook and if this task is seen to be too fraught with risk and uncertainty, then the appraiser must make the hard decision to not accept FHA assignments.

Additionally, FHA makes it clear that: ***"An observation performed in accordance with these guidelines is visual and is not technically exhaustive."***

Conclusion

The best way to handle the underwriter's concern is to quote from the actual Handbook:

In cases where access through a scuttle is limited and the Appraiser cannot fully enter the attic, the insertion of at least the head and shoulders of the Appraiser will suffice.

Include photos of the scuttle entrance as well as photos of what can be seen from a head and shoulders inspection. In the narrative section of the report include a clear detailed summary of the appraiser's inability to do a full attic inspection.

About the author

Doug Smith has an appraisal practice in Missoula, Montana, and is a certified general appraiser doing both residential and commercial appraising with a specialty in hotel appraising and feasibility studies. He has an MBA from the University of Montana and the SRA designation from the Appraisal Institute. He can be contacted at hotelman@montana.com.