

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /
Or Sponsoring Organization Is Missing

3. Development Topics

h. "Real Estate and Professional
Liability", no date

Real Estate and Professional Liability

- I. Real Estate is a generic term covering a multitude of sins; the real estate market which generates the need for professional services is the last of the great camel bazaars and the term professional needs to be applied with care. It is useful to divide the subject into categories.
 - A. Appraiser-Consultant
 - B. Brokers for real estate, mortgages, etc.
 - C. Builder-Contractor
 - D. Mortgage lenders
 - E. Investment Packagers

- II. Major lending institutions have provided an elaborate system for errors and omissions protection on each individual loan, for general administration, and ultimately, in the case of REIT's the ultimate defense of excessive cost of proof of malfeasance actions by an injured plaintiff.
 - A. Lawyers and engineers have defined exposures.
 - B. Builders have a significant product liability and consumer protection exposure for which they are dividing their own limited warranties, disclosure controls (Such as contract acknowledges, taped closings, and disclaimers).
 - C. Therefore today we will talk about the appraisers- Consultants, Brokers, and Investment Packagers.

- III. Until recently appraisers operated under case law analogous to that of accounting in the '40s and '50s.
 - A. Injured plaintiff must have privity of contract, must prove negligence was material and could have been avoided by due diligence.
 - B. Appraiser is generally paid by property owner even though the report is primarily for the benefit of third party such as lender, buyer, assessor, etc.
 - C. Appraiser traditionally defined procedures by approved professional format, disclaimed responsibility for sources, non-observable conditions and stylized the answer for a fictitious set of conditions.
 - D. A limited error and omission policy for typical graphical errors, report production flaws, etc. It does not cover the consequences for relying solely on the evidence.
 - E. However in the past five years three major extensions of exposure to litigation costs or real liability to third parties has appeared;
 1. Changing skill levels required relative to physical and environmental attributes of property and land use law.
 2. Real estate as a security and appraisal responsibility to SEC
 3. The era of consumerism and litigation
 - F. Recently an SRA advisor council recommended that the professional society:
 1. adopt an uniform contract for an appraisal assignment setting forth general assumptions, specific conditions, and limitations on liability where client refuses to employ environmental or engineering experts.
 2. define professional advantages of incorporating in a subchapter S corporation
 3. explore feasibility of obtaining a group type errors and omissions policy for professionally designated members
 4. national professional organization providing legal counsel for appeals
 - G. With increase in tax shelter investment deals, SEC intervenes and declare all partial interest in real estate to fall under Blue State State and Federal Blue State laws.

1. SEC makes all parties to a prospectus equally liable should a disgruntled investor prove a significant or material omission. Lawyer, Accountant, and Appraiser are all liable to third parties.
 2. Lawyers and accountants can obtain expenses liability coverage but appraisers cannot.
 3. Cost of insurance has concentrated legal and accounting business in a few firms; appraisers are now reluctant to appraise journals.
- H. Consumerism spawns litigation.
1. For example truth and lending provides appraisals to borrower. If appraiser is critical of contractor, home buyer may show appraisal to contractor who will then sue appraiser for disparagement.
 2. Unsatisfied investor may sue appraiser if forecast does not come true or property resales for more than appraised value to original buyer.
- IV Real Estate brokers have growing exposure for many of the same reasons as appraisers but their problems are compounded by having a double loyalty.
- A. The broker is the agent of the seller but has a responsibility under the licensing laws to protect the consumer in inverse proportion to consumer knowledge of the subject.
 - B. Some states like Wisc. place a specific burden on the broker to no zoning limitations, flood plains, and suitability soils. In addition some state courts hold realtors to high level of disclosure. (Proximity of airport case and soils case)
 - C. Projections about the future of real estate is a most difficult period.
 1. Some states like Oregon and Florida have rules that a real estate deal could be voided just because projections were mistaken "by almost 40%" even though in one case the investor still made money.
 2. For years the SEC banned projections for fear investors would take it as a promise but in Feb. 1973 it reversed its policy and permitted projections. Each state varies. Cal. requires projections for investment real estate while New York forbids it as case law states "it is impossible to predict future income".
 - D. As real estate brokerage becomes subject to more securities control, the broker becomes an investment type packager.
 - E. As brokers expand sales forces, control and quality of sales people declines. Brokers maintain sales people are independent contractors while law makes them agent of broker. Doctrine of vicarious liability is closing in on brokers.
 1. More control of real estate closings by separating the hostess whose shows the model but will not talk about sale and license salesman in bugged closing room.
 2. Increasing training session dignified by legal requirements to define level of training responsibility.
 3. Provision for contract rescission as liquidated damages.
- V. Until recently courts have held that a securities issuer was liable to the investor merely because projections may have widely missed the mark.
- A. Recently the Supreme court in Ernst and Ernst v. Hochfelder said that liability must be premised on an intent to deceive or fraud rather than because projections substantially exceeded actual results.
 - B. Lower federal courts have expanded the intentional deceit to reckless disregard of the truth.
 1. In short, knowing assumptions are unrealistic or negligence in research and assumptions leads to liability.
 2. Disclosure of projections selectively, whether in terms of who sees them or in terms of the information that is disclosed.
 3. The presentation of projections in a format that will mislead investors.
 4. The failure to disclose essential, but risk-inherent, assumptions which would not be obvious to investors.

- C. To avoid liability ofr projections about the future, the SEC recomende
 - 1. that the party responsible for making the projection disclosure have a reasonalbe basis for its results;
 - 2. that the projection be presented in an appropriate format;
 - 3. that the accompanying disclosures facilitate investor understanding of the basis for and limitations of the projection.
 - D. Other mehhods of limiting liability :
 - 1. disclaimers
 - 2. outside opinions and reviews
 - 3. seperating returns from the property from returens from the individual investor due to changing tax positions of investors
 - 4. presentation of alternative outcomes or arranges
 - 5. presentation of alternative investment so that investor makes the final decison or choice .
- VI. Consultant, appraisor, and packager may face a sliding scale of liability depending on previous credibility or failure to keep abreast of rapidly changing adminstrative rules of SEC, IRS, OILSR, or local land use control agencies.