

Why The Client Is Separate From Everybody Else

Those who do not remember the past are doomed to relive its failures.

FIRREA, and to a certain degree USPAP, came about due to the failures, within the banking and appraisal systems, that lead to the S&L Bailout of '80s.

Definitions that we use today for client, intended user, confidentiality and, "scope of work" were among several terms that were debated and defined during that time period. These definitions evolved out of past failures. They are the way they are, and the ordering systems we use today exist because the prior versions were failures.

Prior to the S&L bailout a borrower or property owner could order an appraisal, determine the scope of work and have the final report delivered to a bank, on a single piece of paper. The bank would use the single-page appraisal for lending purposes. Needless to say, some failures popped up with this process.

One of the more famous examples that was cited during the creation of FIRREA is that of an appraisal in West Texas.

The property owner hired an appraiser to provide an appraisal on his 5,000 acre parcel. The owner told the appraiser of his plans for a massive residential subdivision (think Sun City) with thousands of residential lots, golf course, recreational facilities, etc.. He asked the appraiser to tell him what the property would be worth when there were roads, water, sewer and electricity servicing the 5,000 acres.

The appraisal was completed and the property owner took it to a large bank in Phoenix. The bank read the appraisal and loaned millions, secured by a lien against the property. The owner/borrower picked up his check, thanked the bank, headed to the airport, and left the country, never to be seen again.

The loan went into default and sold at the foreclosure auction for pennies on the dollar. The bank lost millions and wanted their pound of flesh from the appraiser - the only person still around.

The appraiser's retort:

I prepared the appraisal for the property owner, using the owner's criteria, didn't you read the appraisal comment addendum? The appraisal was based on "IF" the subject property had roads, water, sewer, etc. I didn't say that it did have these components.

The property was miles from a paved road, had no electricity, water, or sewer systems. It was range land suitable for cattle ranching, not a residential subdivision. The actual value of the property was millions less than the theoretical value with improvements.

Because the bank was not the client, it was not aware of a) the instructions issued to the appraiser, b) the assignment conditions, c) the agreed upon scope of work, d) the amount of information that would be included or excluded from the report, nor e) the limitations or, g) assumptions. In short - the bank was out of the loop and was lending blind.

Stories like this are why we have special definitions of "client," "confidentiality," "intended use" and, most importantly that lenders are prohibited from relying upon an appraisal ordered by a borrower or their agent.

As a safety feature, when it comes to bank lending, the bank must be the "client," the entity that is fully aware of the instructions issued to the appraiser. This way, everyone who was not present at the meeting of the minds, between the appraiser and the client, are **forewarned** that the appraisal might have assignment conditions that are **unknown** to readers of the report. Anyone that is **not the client should not rely on the report information and conclusions**, since they do not know the circumstances behind their formulation. A report created without the lender being "present" is too risky to be used for lending purposes. Good banks and

regulators know this.

So here we are today, special interest groups trying to change the definition of “client” “intended user” what is confidential information and, who may issue instructions to the appraiser. If the user of the report isn’t present when there is a meeting of the minds between the appraiser and their client, then to be safe, a reader must question the appraisal process and conclusions. It’s a “Banking Safety and Soundness” thing. Making changes to “client” “confidentiality” or intended users is risky. This is also why **all** appraisals must be reviewed prior to a lender approving a loan on the property. President Reagan once said “Trust but verify.” The same should be said for **all** appraisals. Keep the current definitions, review appraisals and stop trying to make things easier for non-clients.

The retaining of “institutional memory” is a good thing. It helps prevent those who do not remember the past from reliving its failures.

I’m trying to keep you safe out there.
Richard Hagar, SRA