RELIANCE LETTERS: consider the risks

An adaptation of the *Professional Excellence Bulletin* by
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Appraisal Institute of Canada (AIC) Members are frequently asked to authorize by a party, other than the one(s) intended at the time of the completion of the assignment, to rely on their report. This can be a lender requesting authorization to use the appraisal for underwriting purposes, when the report had originally been prepared for the owner or a different lender; a report originally prepared for matrimonial purposes and a party wants to rely on it for refinancing (or vice versa); a report originally prepared for financing purposes being considered for estate settlement… the list of permutations is endless.

A reliance letter is an extension of the original report, and a report transferred to a third party carries the same pre-existing ability to attract a claim, not to mention the risk for a claim from the original client, in the event of breach of confidentiality. AIC Members can:

- issue in writing a reliance letter authorizing a third party to use/rely on the report, subject to consent from the original client and release from the original intended user;
- complete a new report for a new client and a new intended user, provided there is no conflict of interest, and that the intended use of the original report has been fulfilled; or
- decline the request (with no need to provide reasons since this could breach confidential information from the original assignment).

Issuing a new report may not be necessary in circumstances where the initial report meets the requirements of the new intended user. For example, a report prepared for a client (a property owner) for the intended use of securing first mortgage financing and no other use, may reasonably be expected to be used by a potential lender, identified by name, assuming the scope of the work of the original report meets the new intended user/lender's terms of reference. It is important to ensure that this new party is made aware of any special considerations, assumptions, etc., that entered into the value conclusion. Although these would be expected to be detailed in the report, there may be assumptions in the report that should be clearly outlined in the reliance letter.

SUGGESTED BEST PRACTICES: QUESTIONS TO ASK

- Who owns the original report? If the applicant or a third party paid for the report, but the bank is the client, who owns the report?
  ANSWER: If the bank is the client, then it owns the report, regardless of who paid for it. The client is the individual or organization for whom the Member renders professional services.
- Who was authorized to rely on the original report?
  ANSWER: The party identified by name in your report is the intended user. This could be your client, who is typically the intended user.
- Has your original client provided a copy of your report, without your authorization, to a new/different intended user?
  ANSWER: In this instance, you need to contact your client to find out if the original intended user is still relying on the original report. If they are, then the new party cannot be privy to the report nor can they rely on it. If they are not, then you need to confirm that the intended use of the original appraisal report has been completed as per Real Property Appraisal Standard Comment 7.2.1.1, i.e., obtain a release in writing from the client (and where appropriate/necessary for clarity purposes, from the original intended user) that the original intended user is no longer relying on the original report. This is to ensure that only one party/intended user is relying on the report. It is important for the appraiser to know where the risk lies.
- What is the date the original report was issued (report date)?
  ANSWER: Passage of time is a key consideration. Has the property condition, property use, market conditions, etc., changed since the report was completed? It is advisable to point out to the prospective new client the dates associated with the original report, whether it was last week, last month, last year, to ensure that it is understood that a value only applies as of the effective date and the value was determined within the context of data available as of the date of the report and in accordance with the client's terms of reference. Different assignments can dictate different effective dates, which can result in the original valuation

being irrelevant for the third party's requirements. Also, the older a report, the less relevant it will be to the third party, and it is not unreasonable for you to judge the relevancy and reliability of the report for the circumstances at hand. It should be clear to the prospective user that there may have been significant changes to the property since the time of report that would have a material impact on the current conclusions. ***As the author of the report, you have the right to decline to authorize reliance by a third party.***
- If prepared for financing purposes, why did the original lender/intended user turn down the mortgage request?
  ANSWER: If the property of the borrower represents a default risk in the eyes of one lender, then the report is at risk of attracting a claim from a less vigilant lender.
- Does the third party have a complete copy of the report?
  ANSWER: The best safeguard is for you to provide the third party with a copy of the report.

Many parties relying on reports have little understanding of the limitations on use and distribution of a report and that *only* the intended user identified in the report, or in a reliance letter, can rely on the conclusions.

Consider this:

Example 1:

A mortgage broker, the original client, contacts the appraiser for a reliance letter in respect to a property recently appraised. The mortgage broker indicates that he also wants the appraiser to comment on the increased market value due to additional lots having been developed, thus adding lots to the residential sub-division. "Please just indicate the higher value in the reliance report for the extra lots developed."

What should the appraiser do?

1. The first step is to get an understanding of the file and what has transpired since you completed the report. Where passage of time is a consideration, ask why the property is taking so long to get financed.
2. Ask your client to provide all relevant information regarding the changed scope of the development. New terms will alter the scope of the original assignment and would constitute a new assignment… therefore, a new report.
3. If your client consents to the release of the reliance letter, but you are not comfortable with the circumstances surrounding the matter, ***as the author and the person liable for the report, you have the right to decline the request.***
4. Document all exchanges (verbal and written) in your workfile (date and time-stamped), in the event that an unauthorized third party decides to rely on your report.

In this instance, the appraiser declined the request. The following week, a secondary lender called the appraiser with questions regarding the reliance letter received. The appraiser learned that the mortgage broker had fraudulently drafted a reliance letter, forged his signature and changed the value of the property. Due diligence by the unsuspecting lender resulted in the identification of a fraud scheme, the financing fell through and the appraiser reported the matter to the authorities.

Example 2:

Banker B, who was not the original client, calls the appraiser: "Can you send me a reliance letter on the recent acquisition of a property you appraised 1.5 years ago. We need it for financing for the new purchaser."

Facts:

- Original report: client is the former owner/seller; intended use was first mortgage financing.
- Ten months later, the property sells and the appraiser's friend is the purchaser.

What would you do?

The appraiser declined the issuance of the reliance letter due to the following:

- Market conditions changed since the original report.
- The use of the property in the original report was deemed to not be viable over time and the new report would have to address an alternative highest and best use.
- Different client.
- Different intended user.
- Conflict of interest or perception of conflict of interest may be a consideration.

It may seem that the only cost related to issuing a reliance letter is the clerical time associated with drafting the letter. However, the original report will now carry a greater claim risk due to the fact that a number of groups or individuals may have relied on the report. Consider the time involved in revisiting the file to assess the request, such as the review of the report and the work file, as well as time spent on the phone in relation to the request.

Liability risk has a cost that should be reflected in every professional service provided and to the risk associated with the work. If a 15-minute assignment comes back to haunt you as a liability claim, then the time involved with defending the claim will far outweigh the fee.

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Reference to Reliance Letters

- Qualifications (Ethics Standard Comment 5.5), Effective Date (Real Property Appraisal Standard Comment 7.6), Client and Intended User (Practice Notes 16.12.6, 16.12,8, 16.12.9)
- Sample Reliance Letter (Practice Note 16.12.9)

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