

Mold Growth Threatens Property Values

By Richard Barrett-Cuatara and Raymund King

Much has been written about the difficulty of overcoming the hurdles associated with mold claims asserting physical injury or damages. Less attention has been paid to the effect such claims have on property values.

Recently, Hilton Hotels filed a lawsuit regarding the Kalia Tower of its Hilton Hawaiian Village Hotel. The suit involved 453 guestrooms and a 42,000-square-foot spa and fitness center. In late 2002, Hilton closed the guestrooms at the \$95-million tower due to mold contamination. Reports indicate Hilton spent \$55 million to fix the problem.

The revenue lost from the guestroom closure represents a claim for damages. More importantly, the lost income reduced the value of the hotel to its owner—from an appraisal standpoint, a direct hit on the reversion value of the hotel. For example, the lost net income for a given year could be \$500,000, but from an appraisal stand point, that lost income could result in a reduction in the hotel's value by \$5 million, assuming a 10-percent capitalization rate.

Mold claims are vigorously litigated because the problem can be difficult and costly to fix. Inspectors have to punch holes in walls and rip up floors to determine the extent of the infestation. It is not unusual to see remediation costs double or triple the fair market value of the property.

To date, there is no well-supported scientific evidence proving mold exposure can cause brain damage or birth defects, as has been claimed by some websites and other media sources. Typically, individuals with significantly weakened immune systems, such as HIV/AIDS patients or people taking anti-cancer medication, can acquire pneumonia or other systemic infections from mold exposure.

In severe injury cases, some insurance companies so fear the "uncertainty factor" about juries on these claims that quick settlements may come about even without thorough medical investigations. Depending on the evidentiary standards of the jurisdiction and the causation evidence available, the plaintiff may have an uphill climb if the only damages asserted are



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physical. On the other hand, theories of liability that are easier to quantify will often lead to more predictable recovery.

In mold litigation, the value of real estate is often reduced secondary to the perceived mold contamination and the remediation process. When the mold is remediated, the real estate will be reduced in value.

This "diminution in value" measure of damages applies in commercial and residential real estate. In commercial, the result will remain the same: If remediation of toxic mold requires closing the property during remediation, the entity will have lost income during that period. So from an appraisal context, the asset value will be reduced in a discounted cash flow analysis.

A critical question is, how much is the property really worth? No matter whether it's plaintiff, owner or insurance company, each must be able to appraise the property logically to quantify damages accurately.

The appraisal process, an elaborate blend of finance, accounting and mathematics, is not an exact science. There are three methods to value real estate: the sales comparison approach, the income capitalization approach and the cost approach. In valuing commercial real estate, all three are used. Once they are finalized, the commercial real estate appraiser will reconcile them to determine the final value.

When dealing with a toxic mold claim asserting physical injury (disregarding bad faith or construction defect), two components should be considered: physical injury and "diminution in value" to the real estate. If a plaintiff fails to establish a physical injury and the real estate value was reduced due to the mold infestation, the "diminution in value" may provide irrefutable evidence of damage.

In the real world, perception is all, and the mental and physical frustrations associated with management and remediation of a mold infestation compound the problem of plummeting property values.

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has wood or natural fiber could be prone" to mold and mildew, Yoder says.

If construction materials and coverings are critical, so is environmental control, where Onity comes in. Its Sensor-Stat DDC (direct digital control) thermostat aims to use the existing room air conditioner to balance temperature and humidity. "While mold and mold spores cannot be entirely eliminated from indoor environments, their growth

can certainly be halted through proactive, preprogrammed moisture control systems," says Larry Gomez, vice president of sales for Onity's Senercomm division.

INSURANCE AND INSPECTION

Traditional underwriters exclude mold coverage, says Joseph M. Wilson, executive vice president, real estate/hospitality practices leader, Willis of New York.