Contamination- Valuing Detrimental Conditions

During recent years, the public has become increasingly aware of the extent of detrimental conditions that surround us, particularly contamination. As a result, much has been written about the labyrinthine issues involved in valuing their impact on real estate. For in depth presentations of the theoretical aspects, refer to various excellent articles in the Appraisal Journal by professionals in this field. And, don't miss other Appraisal Institute publications like Real Estate Damages: An Analysis of Detrimental Conditions; Environmental Site Assessments And Their Impact On Property Value, Real Estate Valuation In Litigation; and Appraising The Tough Ones. Doing research on line at the AI's LUM Library and on the internet via key words or phrases will yield hits and other links to a growing volume of research data and articles on the subject. Try "brownfields", "stigma" or "contamination" with a few of your favorite search engines, and see the results.

All types of valuation checklists, techniques and contamination event flow chart timelines have been created to help grasp the relevant issues and measure damages not only "before and after" the detrimental condition event, but also during remediation and after event termination and case closure. In his Appraisal Institute seminar Detrimental Conditions, Randall Bell, MAI, identifies no less than 255 different types of unfortunate conditions, followed by imaginative "Bell Chart" valuation models to grapple with ten different classifications of negative impact.

Is stigma real? At some point, it is highly likely that an appraiser, as planned or otherwise, will confront the need to evaluate the impact of some tangible or intangible detrimental condition. The valuation methodology is becoming more refined thanks to greater recognition of the negative impact of contamination on marketability, utility, financing, insurability, operating costs and liability to the public. We know that the impact on these components can often be measured with market data, paired or repeat sales or through income modeling using DCF analysis or direct capitalization. But, the remaining risk and uncertainty regarding success of the cleanup, possibility of reoccurrence, discovery of additional contamination, or new claims against the property can perpetuate the sometimes persistently lingering cloud of uncertainty over a property that “most” of us recognize as “stigma”. A property can often be adequately mitigated and “blessed” with a comfort letter from jurisdictional regulatory agencies, but those experienced in these matters know that the loss in value does not commonly or naively end there.

<u>Deferred marketability</u>. It is when the issue of stigma is raised that the storm clouds often roll in. I say “most” recognize it because during the course of carrying out many appraisals of properties suffering from a detrimental condition, I have been surprised to encounter a few knowledgeable individuals who question the validity of the concept. They seem to believe that a property, once mitigated, has recovered all of its market value, or that because it is difficult to quantify loss with paired sales, then no protracted value loss exists. This, of course, denies what can be a persistent, negative impact on marketability, the key component underlying the very definition of market value. The public perception of future risk after the physical remedy has been completed can thin the market, prolong marketability, and, therefore, diminish market value. A concern in litigation is the varying degree to which utility of the damaged property during and after mitigation can offset part or all of the damages driven by reduced marketability. The critical problem seems to be the challenging estimation of the prospective duration of the stigma.

<u>Alternative Valuation Dates?</u> Estimation of damages is further

obscured when a governmental agency with jurisdiction requires a valuation date on the date of the appraiser's inspection, *after* the date of contamination. The degree to which the cause has been identified, the remedy proposed and executed, and use of the property retained during the cure, affects the magnitude of impact on utility and deferred marketability as the property gradually recovers its "bundle of rights" and value. For a really implausible outcome, imagine estimating total damages suffered by the owner if the required valuation date is subsequent to event mitigation and return of the property to full use. It has been requested many times. Where, then, is the compensation for deferred or diminished marketability?

<u>Value In Use Or Market Value?</u> Some may accept the concept of stigma, but deny the negative impact on value if the owner or tenant of the property continues to occupy it during the remedy. This belief seems to confuse "value in use" with "market value", the latter of which is typically the basis for estimation of damages. We know that value in use can easily exceed or be less than market value depending on the owner's particular property requirements. For instance, does the property meet some unique requirements of the owner or tenant, or is it underutilized? This issue is similar to one that often arises in the valuation of vacant special purpose property for assessment purposes. Should its value be penalized as a distressed property or discounted for a longer marketing period, or should it be valued as available for immediate occupancy?

<u>Where is that elusive market data?</u> Concern about unwanted publicity and its impact on value makes most owners of contaminated properties understandably shy about discussing marketing obstacles or transactions details. And, it almost always makes their lawyers, insurers, lenders and other interested parties downright evasive. Excavation of data from

public documents reposing in regulatory agencies can be a long and tedious task. Non-disclosure agreements can silence other sources of data. As a result, discovery of market data to support quantification of that sometimes obscure and intangible stigma is usually a challenging exercise that requires dogged persistence.

<u>Which venue is appropriate for litigation?</u> It is also probably not too surprising how different a client's perspective can be regarding the different components of value diminution and the appropriate venue. The outcomes can be unforeseen. Juries can be emotional, empathetic with the injured party, less enthusiastic about exploring in detail the valuation concepts and their merits which support your conclusion, and …unpredictable. Binding arbitration forecloses appeal options. Mediation can be a less expensive and more efficient process for achieving a more timely result, but usually propels parties towards a compromise which may not be equitable. Case law is inconsistent, particularly with regard to recognition of stigma, and there seem to be a few prevailing judicial attitudes. As summarized in <u>City of Santa Fee V. Komis</u>, one proposes that it is "based on pure speculation by an ignorant public and will never be an element of damages even if it affects the market value of the land". Another holds that "while conjectural damages are non-compensable, if fear is shown to be reasonable, (or at least not wholly unreasonable) and in fact affects market value, the loss is compensable". Another suggests that "impact on market value caused by "fear" may be shown and compensated without proving the reasonableness of that fear". That is quite a range of interpretation. Some serious strategic planning by your client is in order, given the variety of attitudes and possible outcomes for your appraisal.

<u>What does the future hold?</u> The number of detrimental condition assignments is sure to increase as public awareness grows. Valuation of contamination does not lend itself to automated

valuation models or template approaches to appraising that are becoming more commonplace. Credible appraisals and supported recommendations in this specialty require extensive research, technical analysis and judgement based on considerable relevant education and experience. This interesting and challenging field continues to evolve rapidly and favors the professional appraiser.

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