DIMINISHED VALUE CLAIMS, NOT JUST FOR CARS ANYMORE

By Tom Lacy and Randy Edwards

HISTORY

In *State Farm Mutual Automobile Insurance Co. v. Mabry,* 274 Ga. 498 (2001) the Georgia Supreme Court recognized that insureds were getting the shortchanged on their car wreck cases because even if the carrier "fixed" the car, the car was worth less due to it having been wrecked in the first place. "The documents from State Farm acknowledged that there is a common perception that a wrecked vehicle is worth less simply because it has been wrecked." Id at 503.This diminution in value was something the insurance industry was loath to pay because it thought that fixing the car was putting the insured into the position he or she was in prior to the wreck. The Court disagreed and defined this component of the loss as follows:

> "Having reviewed both Georgia law and that of other jurisdictions, we adhere to the long-standing contract interpretation set forth in the Georgia decisions discussed above. The rationale of those cases remains solid: the insurance policy, drafted by the insurer, promises to pay for the insured's loss; what is lost when physical damage occurs is both utility and value; therefore, the insurer's obligation to pay for the loss includes paying for any lost value. That has interpretation has stood for 75 years in Georgia and has become, therefore, part of the agreement between the parties when they enter into a contract of insurance which includes the promise to pay for the insured's loss." *Id.* at 508.

Policyholders and policyholder attorneys had thought for a long time that policyholders in first party property cases were also getting shortchanged in their claims for damage to real property. As one well respected public adjuster told me, an insured can get rid of the smell of the smoke after a fire loss but not the memory of it. That is particularly true in these days of more complete real estate disclosures where sellers are required to disclose certain types of losses. The Georgia Supreme Court again recognized the carrier's responsibility to pay for the entirety of the policyholder's loss in *Royal Capital Development, LLC v. Maryland Casualty Company*, 291 Ga. 262 (2012).

In *Royal Capital*, the court acknowledged that merely reconstructing a damaged building may not compensate the policyholder for the full loss. This is particularly true in fire or water losses that result in mold and in remediation techniques that give a potential subsequent purchaser pause. Royal Capital owned a commercial building in Buckhead which was damaged by some construction going on at an adjacent property. Royal Capital made a claim on its commercial property policy seeking both the costs of repair and any post repair diminution in value from the damage. The carrier paid over $1.1M in repair costs but refused to pay for any diminution in value claim. The Georgia Supreme Court quoted *Mabry* at length for the proposition that value not condition is the proper baseline for measuring damages when a carrier promises to pay for the policyholder's loss. *Royal Capital* at 264.

The Court also reviewed the historical decisions where Georgia courts had repeatedly considered diminution in value as an element of loss for damage to real property. While restating the prohibition on double recoveries, the Court held that the *Mabry* rule applied to real property losses as well. "We adhered in *Mabry* to the long-standing contract interpretation rule in Georgia that where '[an] insurance policy, drafted by the insurer, promises to pay for the insured's ***loss***; what is lost when physical damage occurs is both utility and ***value***; therefore, the insurer's obligation to pay for the ***loss*** includes paying for any lost ***value***.'"

In recent cases Randy and I have been involved in, some real estate appraisers put the value of the loss at up to 50% especially in high value homes where purchasers have the money to spend and no need to compromise for what they consider to be damaged goods despite an even exemplary repair job. For the sake of argument assume every first party property loss has some stigma or diminished value claim. Consider hiring an expert appraiser if the case warrants it. Look for the kinds of facts that would make you less interested in buying the house because chances are that is true of most potential purchasers and your clients have not been made whole by their carrier offering to pay for repairs.

The judicial reaction to *Royal* Capital has been almost uniformly positive as recent cases citing the decision show. Several cases have cited *Royal Capital* for the general proposition that diminution in value is an element of determining damages to real property. *Ingles Mkts., Inc. v. Kempler,* 317 Ga. App. 190 (2012); *Effingham County v. Roach*, 329 Ga. App. 805 (2014); and *Ridely v. Turner*, 335 Ga. App. 108 (2015). More importantly there is a recent ruling in the Middle District of Georgia holding that carriers have an affirmative duty to assess for diminished value in every loss to real property and failure to perform that duty creates a remedy. *Thompson v. State Farm Fire & Cas. Co.*, 2016 U.S. Dist LEXIS 30308. Judge Treadwell's decision certifies a class action for failure to assess after a very thorough examination of the importance of *Mabry* and *Royal Capital*. This decision should help all of you argue that by not affirmatively assessing this element of damages, a carrier may have handled the claim, or denied it, unreasonably and possibly in bad faith.

BURDEN OF PROOF

Under O.C.G.A. § 24-7-701(b), the owner is competent to testify as to value property. However, there must be a foundation that the witness "has some knowledge, experience or familiarity with the value of the property in question or similar property and he must give reasons for the value assessed and also must have had an opportunity for forming a correct opinion...."[1] While permissible, the better approach is to retain an appraiser to testify as an expert witness.

The Uniform Standards of Professional Appraisal (USPAP) provides a detailed framework for calculating DIV for environmentally contaminated properties.[2] USPAP defines Diminution in Value as "the difference between the unimpaired and impaired values of the property being appraised. This difference can be due to increased risk and/or costs attributable to the property's environmental condition." This involves calculation of the hypothetical value, assuming no impairment, and comparing it to the "as is" value. This is easier said than done, and will require more work on the part of the appraiser, and thus will cost more than a typical appraisal.

CALCULATION OF DAMAGES

The most common approach used by appraisers is the market approach, where sales or listings of comparable properties are used to calculate a value of the subject property. Usually, the three most important factors in appraisal are "location, location and location." However, these rules go out the window when appraising a contaminated property. The appraiser must locate properties that have sold or are on the market with the same or similar type of Stigma.

In simple terms, the appraiser will have to appraise at least two properties, the subject property and one or more comparison properties with a documented history of the same or similar type of contamination. Unless there is neighborhood wide contamination, this will likely require using comparison properties farther away from the subject property than would normally be used. In addition, the comps will likely have more differences in size, finishes and features as well. All will involve calculating the hypothetical value with no impairment. The hypothetical value will be considered the "baseline". Dividing the actual sales or listing price of the comparisons by their baselines will yield a percent "stigma factor." Multiplying the Stigma Factor by the baseline of the subject property will yield the Diminution in Value of the subject property.

Stigma is not a constant factor, meaning it may increase or decrease over time. For example, while a recently remediated house with a recent documented history of mold may

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[1] *Surman v. Blansett,* 246 Ga. App. 183, 186, 539 S.E.2d 890, 893 (2000).

[2] *See* USPAP Advisory Opinion 9; *see also* Guide Note 6: Consideration of Hazardous Substances in the Appraisal Process

have stigma factor of 25%, several years later, assuming the remediation was successful and no further mold exposures, that same house may have a stigma factor of just 5-10%. Conversely, if the mold continues or worsens, the stigma factor may rise to 50% or more. However, the measure of damages is the difference in value immediately before and after the loss.[3] Thus, the fact that the Stigma factor may decrease (or increase) over time, should be irrelevant in calculating the DIV immediately following the loss.

In addition to appraisers, you may want to talk to realtors who sold or listed the comparison properties. Given that realtors' commissions are tied directly to the sales price, the fact that they listed or sold the house for a substantial discount would support their credibility in front of a judge, jury and claims adjuster. Another way to enhance the credibility of the appraiser or broker, is to talk to real estate lenders and gauge their interest in lending to borrowers to finance their acquisition of the contaminated properties.

Another issue to consider is "betterment" from the repairs. Oftentimes, after a flood or fire, new drywall, cabinets, wiring and flooring is installed. Not only has the property been repaired, it has basically been remodeled. Failure to address betterment in the appraisal can result in the appraisal being inaccurate. Betterment needs to be addressed in some fashion.

Because the measure of damages is the difference in value immediately before the loss and immediately after the loss, one way to address betterment is to argue that it is irrelevant. The measure of damages immediately after the loss is the sum of the cost to repair and DIV, generally capped at the value immediately before the loss. Thus, any "betterment" weeks or months later is arguably irrelevant.

Another way, and we submit the better way, is to give credit for betterment in the appraisal process. This will involve a detailed analysis by the appraiser on a room by room basis of those items which arguably increase the value of the property. Thus, the total DIV will be the Stigma factor multiplied by the pre-loss value, less any betterment. For example, a $500,000 house, with a 25% stigma factor and $25,000 in betterment, would have a total DIV of $75,000.[4]

DEFENSES

The carriers have reacted swiftly and decisively to *Royal Indemnity*. Endorsements specifically excluding diminution in value for first party property losses have already been seen attached to the most recent property policies. In *Thompson* cited above State Farm asserted its new Endorsement FE-5621, Diminution in Value Loss Restriction, as a defense to the typicality prong of Rule 23 certification. In footnote 11 of the Order, the Court notes

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[33] *U.S. Fidelity & Guar. Co. v. Corbett,* 35 Ga. App. 606 (1926) ("the measure of liability would be the difference between the value of the property immediately before the injury and its value immediately afterwards….")

[4] $500,000 value x 25% stigma factor = $100,000 - $25,000 betterment = $75,000 DIV.

that State Farm claims that it began issuing the endorsement in all homeowners' policies issued after November 1, 2013 and all renewals issues after January 1, 2014. At this point it is unclear whether the Georgia Department of Insurance has approved of this endorsement but you can expect to see more of the like. As always, endorsements are to be strictly construed and any ambiguity should be construed against the carriers as drafters of the policy. None of these endorsements have made it up to the appellate level as of the date of this article but they will. Hopefully Georgia Courts will stick to the 75 years of consistent public policy and jurisprudence and strike down this endorsement as contrary to the established law of Georgia.