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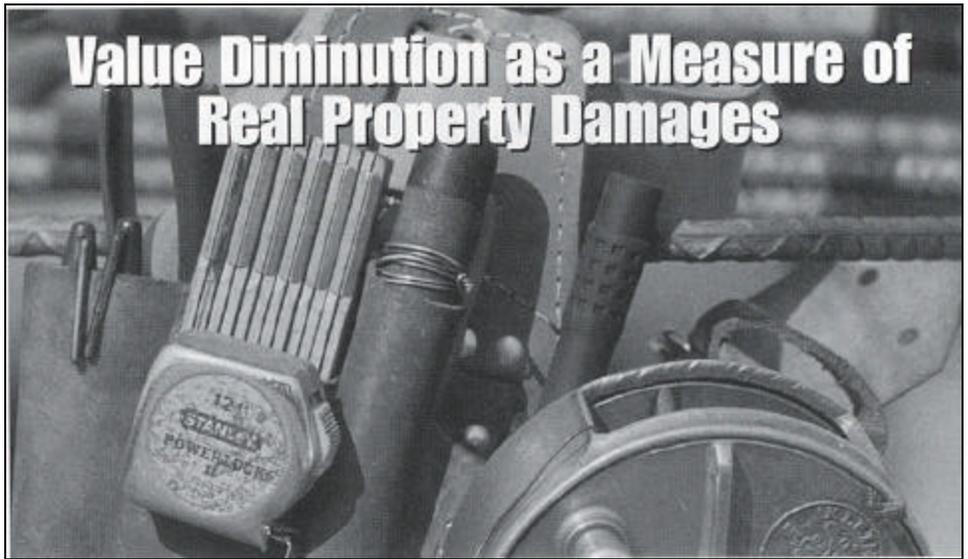
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By Michael V. Sanders

CASES INVOLVING DAMAGE to real estate often focus primarily on remediation or repair costs as the measure of damages. A construction defect case, for example, will entail considerable investigation to determine whether or not a particular component was built to code, and if proper standards of care were exercised in construction. If not, additional research will seek to determine responsibility, type and scope of repair, and ultimately, cost. Diminution in value is arguably the best measure of true economic loss, but its importance is often overlooked in real estate damage cases.

Legal Background

The idea of diminished property value as a limit to damages was articulated nearly a century ago in *Salstrom v. Orleans Bar Gold Mining Company*, 153 Cal. 551 (1908), where the court ruled that damages should be computed as the lesser of cost to repair or the value of the property before the injury. This rule was reiterated in a number of subsequent cases. For example, the concept was restated in *Mozzetti v. City of Brisbane*, 67 Cal.App.3d 565 (1977), creating the modern version of the "lesser of rule," limiting property damages to the lesser of diminution in value, or the cost of repairing the injury and restoring the premises to their original condition. In *Heninger v. Dunn*, 101 Cal.App.3d 858 (1980) and *Orndorff v. Christiana Community Builders*, 217 Cal.App.3d 683 (1990), courts in fact allowed

repair costs which exceeded lost value, creating the personal reason exception to the lesser of rule, where "there is a reason personal to the owner for restoring the original condition," provided there is a reasonable nexus between the repair costs, damage to the property, and value after repair (*Orndorff*, at 684).

In the area of construction defects, a very recent appellate decision, *Aas v. Superior Court of San Diego County*, 64 Cal.App.4th 916 (1998), denied recovery in negligence for economic losses absent personal injury or resultant damage—but this case is presently under review by the California Supreme Court. Whether or not value diminution is ultimately adopted as the measure of damages in a particular case, it is clear that this alternative should be considered carefully as part of overall case strategy.

Measuring Value Diminution

An appraiser is most often retained in real estate damage cases to assist in measuring value diminution. Undamaged value is often a starting point for this analysis, providing an upper limit to damage claims, and also a basis from which to apply percentage deductions for diminution, if applicable.

Property value diminution is frequently measured using case studies, where properties with a particular attribute (e.g., a history of geotechnical problems or environmental contamination) are compared with otherwise similar properties lacking such attribute.

Significant differences relative to price and/or marketability would tend to support the existence of a value impact, while lack of measurable differences might suggest little or no diminution. While case study properties need not be directly comparable to the subject, it is important that they bear some similarity with respect to the attribute under study. In some cases, the subject itself may have sold or experienced other market activity (or lack thereof) which would make it suitable for study.

Case studies may be individual properties, which are often analyzed using a standard adjustment grid format. For example, a case study property with a history of geotechnical problems that sold for \$1,000,000, might be compared to three otherwise similar properties without geotechnical disclosures which sold for adjusted prices of \$1,200,000-1,300,000, suggesting a discount of approximately 17-23%. Ideally, several such case studies would be used to provide conclusive evidence of value diminution, or lack thereof.

Multiple property case studies involve the analysis of a group of relatively homogeneous damaged properties, which are compared to other groups of undamaged properties to evaluate possible differences in price, sales velocity or other measures of market activity. This type of analysis is often useful in class actions and residential construction defect cases involving large numbers of plaintiffs, using statistical measures of central tendency and time trending. Multiple property studies are particularly amenable to graphical analysis, which is especially helpful in allowing a layman to see a visual picture of complex mathematical relationships. Graphical time series analysis also allows the appraisal expert to examine the subject's market behavior relative to critical events, such as when alleged problems became known, suit was filed and disclosure became mandatory, etc.

Summary

There are numerous variations on the case study approaches described. They illustrate, however, the practicality of measuring value diminution using market-based information. The appraisal profession has long acknowledged that cost does not equal market value; similarly, cost of repair or remediation does not necessarily equal value diminution, which in most cases provides a better measure of real economic loss. It is clear that the courts intend for diminution in value to be an alternative measure of damages in real property cases, and is prudent for counsel to investigate this alternative, either for their own case, or for the purpose of addressing opinions that will likely be proffered by opposing experts.



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