

# **Construction Defects: The Appraisal Challenges**

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*March 3, 2011*

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**CONSTRUCTION DEFECTS AND STIGMA**

*Published in*

Mealev's Construction Defects

July, 2003

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**Abstract**

Properties suffering from construction defects exhibit a diminution in value resulting from both the actual cost to cure as well as the residual stigma losses. In the unremediated state, the sum

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**Chinese Drywall**

*A Greenfield Advisors White Paper*

John A. Kilpatrick, Ph.D., MRICS and Christopher A. Miner, MAI  
June 5, 2009

*The Chinese Drywall issue is rapidly unfolding, and Greenfield Advisors has been tracking the issues since they first came to light. The following is based on the best information available to date, which is believed to be reliable.*

In 2005, a spike in housing construction appeared in the southeastern United States as a result of major hurricanes in the previous year.

As homes from 2006 began to be built with this Chinese drywall, manifest problems, notably rot, odors, smells and corroding copper pipes, heat exchanger coils, and electrical wiring. Scores of lawsuits have been filed. People noticed the pattern and reached the conclusion that the Chinese drywall was contaminated and defective.

# An Exploratory Review of the Effects of Toxic Mold on Real Estate Values

*by Robert A. Simons, PhD, and Ron Throupe, PhD*

**abstract**

This article reports the outcomes of ten litigated toxic mold cases; a contingent valuation (CV) analysis of toxic mold in North Carolina; and mold case studies of an apart-

**D**espite widespread recent interest in toxic mold, real estate literature has not addressed the issue by it.

John A. Kilpatrick, Douglas C. Brown, MAI, and Ronald C. Rogers, PhD

## The Performance of Exterior Insulation Finish Systems and Property Value

Exterior insulation finish systems, or synthetic stucco, is a siding material used on the exterior of a million residences and several thousand commercial buildings in the United States, Canada, and Europe. EIFS use has been linked with

*Bill Mundy, MAI, PhD*

## The Impact of Hazardous Materials on Property Value

Public opposition to the handling, storage, or disposal of hazardous materials in proximity to human or wildlife populations is high. How to safely deal with such hazardous materials is thus becoming a significant national issue. The impact of hazardous materials on property value is difficult to measure, however. While some models of real and perceived risk exist, to integrate them with actual market behavior is problematic. A theory of how contamination influences value that incorporates the damage related to lost income as well as the damages incurred by the loss of opportunity to fully use a property is presented in this article. In addition, the effects of both the uncertainty concerning a particular hazard and the persistence of a perceived risk over time and distance are considered.

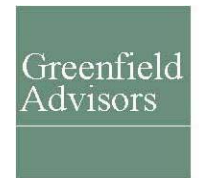
**T**he issue of the safe handling, storage, and disposal of hazardous materials is especially true if a property is in proximity to a generating



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# Construction Defects: The Appraisal Challenges

1. What does the appraisal literature tell us about stigma?
2. What is the operative relationship between engineering/architecture work and appraisal?
3. What are the current valuation issues? What's on the horizon?



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# Construction Defects: The Appraisal Challenges

Why Appraisal?

- ➔ Are engineering claims “trumped” by market value arguments?
- ➔ Pre- and post-remediation stigma



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Stigma? *For example....*

- Perceptions of risk
- Incurable aspects of the deterioration
- Market perceptions
- Increased monitoring/bonding costs
- Increased required rate of return (for commercial properties)



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*Dangers to unschooled appraisers –*

Appraisers held liable to homeowners (American Law Review, 1983, 2002)

Appraisers required to indemnify lenders (University of Illinois Law Review, 1984)



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*Empirical Evidence -- residences*

Pre-remediation – homes may be utterly unmarketable

Post-remediation – discounts ranging to 30% to 40% or even more



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*Empirical Evidence – commercial property*

Rapid cost/benefit analysis

Increase in cap/discount rate



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*Is stigma compensable?*

Alfert, et. al, (2005, Florida Bar Journal)

Mayer v. Sto

*Loss in value caused by structural or geotechnical problems must take into account the cost to repair the damages and the residual loss in value after the repairs—*

*— Sanders, writing in the Appraisal Journal, 1996*

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# Construction Defects: The Appraisal Challenges

*Current/Future Trends*

Green Buildings

Impact of the credit market melt-down



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Dr. John Kilpatrick is an economist and the Managing Partner of Greenfield Advisors, specializing in economic market and valuation analysis, principally in real estate matters, headquartered in Seattle.

Dr. Kilpatrick holds a Ph.D. in Finance from the University of South Carolina, where he also taught Real Estate and Corporate Finance in the Moore School of Business. He served as the founding Administrator of the South Carolina Supercomputer Network and as the Secretary/Treasurer of the Academic Coalition for Intelligent Manufacturing Systems, based in Washington, DC.

Dr. Kilpatrick is the author of four books and numerous journal articles. He is a frequent speaker before national groups, including the U.S. Senate Subcommittee on Science, Technology, and Space and the National Trust for Historic Preservation. His work in real estate finance has been the subject of recent articles in the New York Times, the Boston Globe, and the Wall Street Journal. He is the author of the forthcoming chapter on Brownfield Valuation in the Lexis-Nexis Matthew Bender's Brownfield Law and Practice. In 2001, the National Park Service honored Dr. Kilpatrick by producing a monograph summarizing his work in the valuation of historic neighborhoods.

His recent clients include the U.S. General Services Administration, the Hearst Family, the Japan Real Estate Institute, and numerous private investors, corporations, university endowments, trusts, and law firms. Among his other honors, Dr. Kilpatrick is a member of the Faculty of Valuation of the Royal Institution of Chartered Surveyors (UK) and is featured in the 2006 edition of Who's Who in America.



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