



ISSUE PAPER

Subject: **Mold's Impact on Commercial and Residential Finance**

Issue: Currently, there is no standard detailing a permissible level of mold in indoor spaces. The lack of standardization has given rise to questions and concerns as to how to address mold considerations and how to properly protect all parties' interests. Both the actual physical damage to a multifamily or commercial building and the stigma of a possible mold presence can harm the value of the collateral. For residential lenders, there is concern about the potential impact that overly broad federal and state laws could have on residential financing.

Background:

It is not uncommon to find mold in indoor environments. Mold feeds off of materials such as wood, dust, paper, and carpets and can grow in normal room temperatures. Excessive moisture (pooled water, leaks, humidity, etc.) is the key component of mold growth. Construction materials, such as paper-faced drywall and wood, can also be susceptible to mold growth if not maintained properly. Modern-day energy efficient buildings are more prone to mold growth since they are designed to seal in heat and air-conditioning, which locks in moisture. Older construction practices allowed moisture to escape.

Industry Guidelines

Lenders and servicers are seeking guidance to address the issue of mold, which has caused a sense of unrest in the legal, insurance and investment community. MBA created a Mold Working Group, under the Commercial Real Estate/Multifamily Finance Board of Governors' ("COMBOG") Loan Origination Committee. The Working Group issued a draft White Paper on mold for industry comment at the CREF Convention in February 2005 and opened the paper to a 45-day industry comment period. MBA's completed White Paper, "Mold: Steps Toward Clarity" is now available on the MBA website. The White Paper was developed as an informational guideline for addressing mold in several circumstances, including: insurance availability, litigation, prevention and maintenance, assessment, remediation and new construction. It has become popular for some lenders, particularly on multifamily properties, to require an

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Operations and Maintenance Plan to clearly identify the agreed upon steps to remediate if mold is found during the term of the loan.

Although MBA continues to monitor mold's impact on single family financing, there has been no industry request for a working group to focus on the issue.

Several organizations are looking to develop criteria or standards for mold detection and remediation. Although there are no environmental standards for mold, organizations including the Indoor Environmental Standards Organization ("IESO"), the National Multi-Housing Council ("NMHC"), and the Environmental Protection Agency ("EPA"), have each developed publications on evaluation, prevention and control of mold in multifamily, commercial and residential properties. Other groups, including the National Institute of Building Sciences ("NIBS"), are contemplating long-term studies of the effects of mold on multifamily and commercial buildings. The CDC produced educational materials encouraging single family homeowners to routinely inspect their homes and maintain the components that contribute to water accumulation. In single family real estate transactions, home inspections do not necessarily include environmental assessments since there are no federal environmental standards.

Also regarding single family properties, HUD published Notice H 2004-08 on May 28, 2004, requiring the "Radon Gas and Mold Notice and Release Agreement" to be included with all sales contracts for HUD-acquired single family properties. The purpose of the agreement is to notify purchasers of the potential health effects of radon gas and mold, and mitigate the potential liability to HUD by ensuring potential homebuyers have received the cautionary information.

With respect to multifamily and commercial properties, MBA actively participated in the ASTM International's E50.02 Commercial Real Estate Transactions Sub-Committee Mold Task Force ("E50.02 Committee") development of an inspection standard for observing mold. ASTM directed the E50.02 Committee to develop a standard for detecting mold and conditions conducive to mold (water damage, excess humidity) in multifamily and commercial buildings. The E50.02 Committee has completed a stand alone, limited screening process that can be used in conjunction with other property assessment reports. ASTM completed the standard in April 2006.

Scientific Research

To date, there is no definitive scientific evidence showing any causal relationship between a healthy person's exposure to mold in an indoor environment and decreased health. Despite numerous studies, claims that exposure to "toxic" mold (containing mycotoxins) causes severe health symptoms (memory loss, chronic fatigue, hemorrhaging, headaches) have not been proven by scientific data. Also, mold is a natural substance, not a man-made chemical, which predates mankind and has a positive role in the balance of the planet's ecosystem and should therefore not be simply eradicated. No environment becomes mold free without extreme sterilization (i.e., hospitals, laboratory spaces).

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The Center for Disease Control and Prevention (CDC) requested that the National Academy of Sciences (NAS) conduct a study on the health effects of indoor mold on humans. The NAS report, "Damp Indoor Spaces and Health," was completed on May 25, 2004.

In summary, the Committee concluded that there is not "sufficient evidence of a causal relationship" between mold and health outcomes and that additional scientific research is required. The Committee stated there is "insufficient information on which to base quantitative recommendations for either the appropriate level of dampness reduction or the 'safe' level of exposure to dampness-related agents. ... Questions of exposure and dose have not, by and large, been resolved." The Committee offered recommendations for additional research, education and evaluation for possible government economic incentives for construction and maintenance of indoor environments that prevent or reduce dampness.

Litigation

An increasing number of lawsuits have been filed in the past 3 years for mold and water damage claims. Although there has not been a major impact on single family financing, a few residential "mold" cases have dominated the media spotlight with a select number of high-profile plaintiffs (Ed McMahon, Erin Brockovich, Bianca Jagger) and large verdicts. While sources estimate the average residential claim is actually \$34,000, the press-highlighted large verdicts have attracted attorneys to "mold" cases. The commercial lawsuits to date are less publicized and less frequent; apartments/multifamily, schools and courthouses have been the largest targets to date. The possibility of large verdicts and negative publicity remain a potential threat to commercial real estate transactions.

To date, most lawsuits are not won on claims for medical and psychological damages based on mold health effects. The courts have developed a test for allowing expert testimony to be heard in any lawsuit; a judge must consider two issues before permitting an expert to testify: one, if the type of mold involved could generally cause the type of injury claimed; two, has the plaintiff had a sufficient amount of exposure (inhalation, ingestion) to cause the specific injury plaintiff claims. This is a high standard for a plaintiff; it is difficult to prove a certain level of mold exposure in an indoor space rises to the level of harmful, since there is no scientific research of a "toxic" or harmful mold threshold and there is no federal or state set guideline for acceptable levels.

The successful lawsuits have focused on contractual relationships and tort actions. Yet, the reality exists that while a mold health claim may not win in court, the lender may still suffer irreparable harm. Because of the media attention around the issue, attorneys will continue to pursue claims and the taint of allegations of "toxic mold" in a multifamily or commercial building may tag a rental space as undesirable.

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With regard to single family financing, the seriousness of mold's impact is still uncertain. While anecdotal stories exist of mold's impact on homeownership, lenders have not reported a widespread impact on residential originations due to mold. However, insurance companies' fear of losses due to mold has been cited as one of the reasons behind escalating property casualty insurance costs and decreasing availability. Mold claims and judgments in particular have led many insurers to seek exclusions for mold coverage from basic homeowners' policy terms. Provisions allowing insurers to restrict mold coverage to limited cases have been approved in more than 30 states and the District of Columbia.

Legislation

Many state legislators have attempted to pass bills to protect people from any potentially harmful indoor mold. To date, very little legislation has been passed and there is no determined or accepted set of standards for a permissible level of mold in multifamily/commercial buildings or single family residences.

On a national level, in March 2003, Representative John Conyers, Jr. (D-MI) introduced the United States Toxic Mold Safety and Protection Act of 2003 (H.R. 1268), also known as the "Melina Bill." The bill had 34 co-sponsors and was referred to the House Energy and Commerce, Financial Services, Ways and Means and Judiciary Committees. H.R. 1268 did not leave committee and therefore expired with the end of the Congressional term in 2004. On March 14, 2005, Representative Conyers reintroduced the Melina bill, H.R. 1269, which was referred to the House Financial Services Committee. No committee action has been scheduled.

A number of states are now adopting laws that set building and performance standards, and require mold disclosure regulations for multifamily/commercial and single family properties. For example, Texas passed a law requiring building and performance standards to reduce mold exposure in residential construction, and include measures to recognize mold, limit water intrusion into homes, and remediate the effects of mold growth. Montana adopted a mold disclosure law under which sellers and landlords are required to disclose the presence of any known mold, and to provide notice of any known mold tests and/or remediation. If the seller or landlord complies with these disclosure obligations, they may not be held liable in any action based on the presence and propensity for mold in the building. California, Louisiana, and Maryland have also passed laws involving mold concerns.

Mold legislation has also been introduced in Connecticut, Florida, Massachusetts, Michigan, Minnesota, New York, Pennsylvania, Texas, Virginia, and Washington. Several key issues contained within this legislation include:

- a. Scientific and health research – studies on the effects of mold on individuals in an indoor environment (some include trying to define an exposure limit)

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- b. Regulation of mold assessment – special license, type of review, disclosure
- c. Education – requirements for educational materials and training
- d. Disclosure in real estate transactions to tenants, homeowners, lessees
- e. Remediation/Clean up of known mold in indoor environments

Both the federal government and the states continue to try and find answers to what possible effects indoor mold may have on humans. To date, states have leaned toward increased education and awareness of the issue as the most practical solution. States have also commissioned their own studies to understand any scientific and medical links. The country continues to be in a fact-gathering mode, with no clear answers yet determined.

MBA Position: MBA is supportive of measures that protect the health and safety of homeowners and commercial occupants. As no environmental standards have been established for mold, MBA cautions against additional mandates on the real estate finance industry. MBA also cautions against legislation that is overly broad and could adversely impact sellers, builders, and lenders.

Status: With the release of the NAS study determining there has been no causal relationship established between mold and health outcomes, the industry continues to focus on mold identification and remediation. Absent a standard, MBA will continue to inform, educate and offer best practices for mold identification, monitoring and remediation. The MBA also represents members with a view to identify areas for lender advocacy processes to minimize lender liability.

MBA's completed commercial/multifamily White Paper, "Mold: Steps Toward Clarity" is now available on the MBA website at http://www.mortgagebankers.org/cref/index.cfm?STRING=http://www.mortgagebankers.org/resources/katrina/cref_mf.html. The ASTM standard was completed in April 2006.

MBA will continue to monitor developments on this issue.

CREF Staff Contact: **Katie Schwarting**
(202) 557-2742

Residential Staff Contact: **Rachel Voss**
(202) 557-2865

Legislative Staff Contacts: **Josh Denney**
(202) 557-2816

Burton Wood
(202) 557-2806

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