

OBSOLESCENCE: FORM OR FUNCTION

By: Paul K. Bidwell, MAI, SRA, CCIM

In order to understand functional obsolescence it is important to realize what the word function actually means. According to many definitions within published texts function is a kind of action that is *proper* and is the purpose for which something is designed or fits. It is a perception on which a base measurement is considered. Appraisers must understand that we are dealing with perception of market participants when it comes to measuring any form of functional obsolescence. To take the term further the word obsolete indicates that something is worn out, in disuse, outmoded or in some negative way not in its best character.

Functional obsolescence for various reasons can be difficult for appraiser to accurately measure even though the concept is fairly simplistic. Functional obsolescence is always something that pertains to the property itself or within the boundaries of the property. We typically divide obsolescence into two different categories one being a deficiency (defective item) and the other being a superadequacy (too good of an item).

Obsolescence in terms of deficiencies can involve items that currently exist for the subject property that is being appraised or may not even be present on the date of valuation. Such is the case when an item is omitted from construction that is required for its current function in the marketplace.

The appraiser must consider both cost and value of the item that is obsolete at the time of the appraisal. Typically the depreciated cost of the obsolete item minus the value of that item will lead to the amount of functional obsolescence deducted. Following is an outline of the various forms of functional obsolescence and appraiser will encounter when appraising real property.

Types of Functional Obsolescence

Deficiency

- Existing Improvement (Deficient)
 - Curable
 - Incurable
- Nonexisting Improvement (Deficient)
 - Curable
 - Incurable

Superadequacy

- Curable
- Incurable

The most important thing in identifying any of the six forms of functional obsolescence is to look through the eyes of the typical market participant when the appraiser is viewing the property. Keeping in mind the concept of market value the willing market participants must in the case of the seller acquiesce to probably less of the purchase price from the willing buyer given the obsolescence that is analyzed within the subject property. Conversely, the willing buyer will consider the form of obsolescence in formulating a reasonable purchase price knowing that some deficient or super adequate item exists.

The concept of cure ability is also focused upon feasibility at the time of valuation. There are two components within any item of obsolescence must be considered which is the amount of value added for the deficient item to be cured as well as the actual cost to cure that item with the pure mathematics being that if the value added is greater than the cost to cure the functional deficiency is curable and conversely; if the value added is less than the cost to cure than the functional deficiency is incurable.

Sometimes the value added is mathematically obtained by utilizing income estimates as to what additional contributory value is gained. However sometimes the value added cannot be obtained by the use of income estimates. When this happens it is the responsibility of the appraiser to measure what the market would place as an added value for the deficient item to be repaired. Sometimes it is difficult for the appraiser to “wear the shoes” of the typical market participant in the area location the subject property is located. One has to truly consider the actual location and market nuances when determining if there is a deficiency or not that is worth placing a deduction within your value conclusions.

Form is another word that typically describes items of functional obsolescence. Usually the word form considers how a property being appraised has a certain shape and structure that is either in the norm or out of the norm for competitive properties in the market. Either a potential owner occupant or an investor looking at the purchase of a property will definitely consider its form for the intended use. If the potential buyer under the concept of market value is going to be an owner occupant how will the form of the building in terms of its structure and use as well as shape impact the potential purchase price? In addition, a potential investor will look at the building under the same thought process in terms of form but with the intent of knowing what is the level of income one can receive depending upon any issues with regard to what was previously explained to shape and structure.

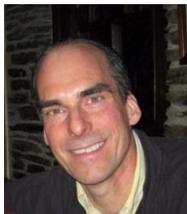
It's very important upon the appraiser to measure the observations of the local market participants when it comes to determining if an adjustment for functional obsolescence should be applied in all of their valuation approaches applied. If the property one is appraising is outdated and has deficient form and/or function the deduction made has to

be in line with what the local market would consider. Therefore, it's critical for the appraiser to observe competitive properties and see if any other comparables have different features as compared to the subject in terms of determining if a deduction needs to be applied for some form of obsolescence.

Once the appraiser starts the viewing or inspection of the subject property it is best to consider viewing the property in the perception or awareness of the typical market participant and not as the appraiser. This can be extremely difficult to do since appraiser's as a whole tend to be overly critical and try to relate previous experiences and examples directly upon each property we view. A seasoned appraiser will not do this; instead every single property is viewed individually based upon its distinct characteristics (form and function) relative to the specific market in which the respective property is located. If the appraiser can do this every time they view a property, there should be no mistakes in isolating either deficient or super adequate items of obsolescence found in the property. It should be noted that this paper is not intended to go through the process of calculating the item of obsolescence, there are many excellent appraisal texts the appraiser can obtain that properly show the calculations necessary to properly deduct for any form of functional obsolescence.

In conclusion, determining functional obsolescence for the real property in which you are appraising can sometimes be difficult simply because you are not viewing the building structure in its proper light with respect to the competing market in which is located. Try always when opening the door to a property and start to view it internally as if you are the potential investor or potential purchaser of the property with respect to form and function based on the intended highest and best use. By doing so, the ability to accurately determine all forms of functional obsolescence should become more apparent to the appraiser and provide a more accurate determination of market value.

About the Author



Paul K. Bidwell, MAI, SRA, CCIM is an owner and principal of Affinity Valuation Group, LLC, represents clients locally and regionally. He has provided real estate counseling and valuation services for a wide array of clients since 1984. Earlier professional work comprises both institutional and fee appraisal assignments that include many product types from residential to special purpose properties. His clients include lending institutions, local, state and federal government agencies, law firms, and individual property owners. He has also helped in the coordination of large work

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