

The Do's And Don'ts of Depreciation & Obsolescence

Speaker: Justin McMann

Topics of Conversation:

- ◉ What is Depreciation?
- ◉ What is Obsolescence?
- ◉ When is Functional Obsolescence used?
- ◉ When is Economic Obsolescence used?
- ◉ Mobile Homes and Obsolescence.
- ◉ Do you need to make an adjustment?
- ◉ Making the adjustment.
- ◉ Overbuilt Structures.
- ◉ Other unique ways to use Functional Obsolescence.

What is Depreciation?

- A noncash expense that reduces the value of an asset as a result of wear and tear, age, or obsolescence.
- Depreciation is used to reduce replacement cost to better represent the value according to age and condition.
 - This can vary on structures with similar age depending on maintenance performed.

Examples of Structures with similar age but different conditions:

LITTLE MAINTINANCE
PERFORMED

COMPLETELY REMODELED
AND RESTORED



New Roof w/skylights, original windows & Interior



Camp dismantled, pressure washed & sanded, new roof, windows and interior, refinished Floors.

What is proper depreciation?

Opinions will vary depending on who you ask, many depreciate new structures 3-5% to start and average 1% depreciation per year.

You do not need to depreciate on a yearly basis and many CAMA systems such as Trio can be set to automatically depreciate to what you specify, for example, every 5 years to add an additional 5% depreciation.

Do not use depreciation to remove value from new construction that is not yet complete.

Keep in mind the most important thing an assessor can do is be consistent.



What is Functional Obsolescence?

Obsolescence from lack of completion or other factors that affect the function of the structure.

INCOMPLETE STRUCTURE



COMPLETED STRUCTURE



Other factors affecting functional obsolescence.

- A structure that is overbuilt.
- A home that has an obsolete kitchen affecting the function of a typical kitchen.
- A home built with a poor layout.
- Damage to a structure where physical depreciation may not be applicable.
 - ie: damage to a new house.

To keep your functional obsolescence consistent make a cheat sheet.

- No Flooring – 5%
- No Siding – 5%
- No Trim – 5%
- No Roofing – 5%
- No Kitchen – 10%
- No Drywall or interior finish – 10%
- No Plumbing – 10%
- No Electrical – 10%
- Shell of House – 50%

What is Economic Obsolescence?

It is obsolescence due to external factors surrounding the property.

- Abuts or is near railroad tracks.
- Too close to the road.
- Near the Freeway
- Near a change in zoning (next to the gas station).
- Airport noise.



Keep In Mind

Functional obsolescence is curable in most cases, so keep an eye on property that has this type of obsolescence because it can change, of course properties with long-term functional obsolescence will not need to be reviewed quite as often.

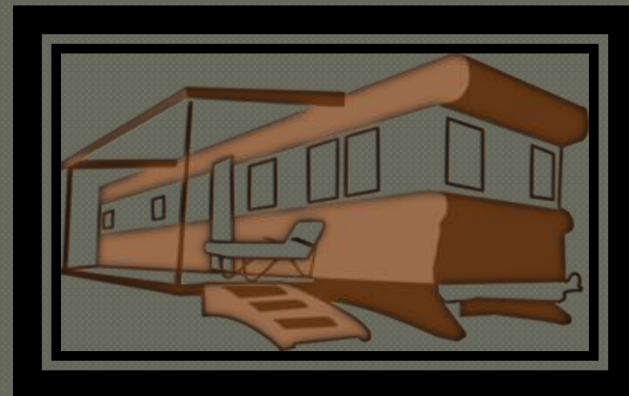
Economic obsolescence is typically incurable mainly because it is out of the control of the property owner and efforts to cure the problem are generally expensive and value depleting.

Mobile Homes & Obsolescence

At times it can be tricky to determine “just value” of a mobile home, after all they do come in many different sizes and unlike most structures we value they depreciate rapidly and can be relocated much easier than a stick built home.

If your lucky enough to have a good sample of sales of mobile homes in your town you may notice that the older 8'10' and 12' wide mobile homes will typically hold a higher ratio than that of a 14' or doublewide mobile home.

Some assessors have found that mobile homes narrower than 14' need additional functional obsolescence due to factors such as inadequate room sizes, and less desirability.



How Much Obsolescence?

There will be varying opinions depending on the availability of sales and location so do some homework.

What I have seen is some assessors give a reduction of 15-25% on 12' wide mobile homes & 25-50% on 8' & 10' wide mobile homes.

Just remember **BE CONSISTANT!**

Take Caution When Adjusting the Depreciation of a Remodeled Mobile Home.

Unlike stick built homes mobile homes don't necessarily give you a return on investment when remodeling and upgrading takes place. So take caution when visiting a mobile home with new windows, roof and some sprucing up of the interior, it may need an adjustment to its depreciation, but not the same adjustment that you would give to a conventional home, in many cases no adjustment is needed.

You may find yourself asking...

- ⦿ How do I know what is overbuilt and what is not?
- ⦿ Is that a poor layout?
- ⦿ How close is too close to the railroad tracks?
- ⦿ How far from the jail do you have to be for home values to not be affected?

First ask yourself this.

- Are there recent sales (3 yrs.) in areas that may or may not need obsolescence?
- Am I confident in the inventory of my buildings?
 - Building permits?
 - Routine review of buildings?
 - Consistency of grade's and physical depreciation?
- How quickly can I remedy this?

Taking Action:

- Remove the towns value of the buildings on the subject property from the sale price.
 - Be sure to not include the value of any new or improvement's made to existing buildings after the sale.
- You are left with a representation of land value.
- Apply your land residual if the lot exceeds standard base lot size.
- You now have a Home Site value.

Taking Action Continued:

Once you have repeated these steps on the available arms length transactions you can then use the resulting home site values to look for areas that may be more or less desirable and how that may require you to make adjustments to certain neighborhoods to maintain equity.

Are these homes overbuilt?



Overbuilt Structures:

Overbuilt structures are buildings that are larger than the typical and therefore lose value when looked at as a value per sq. ft.

In a perfect world where we have sales for all examples of property types we can get a good handle on just value. Unfortunately that's not always the case, remember to use caution when making changes that you may have little to no data to support the adjustment.

Overbuilt Structures Continued:

Here are some examples of functional obsolescence for overbuilt structures.

1 story houses over 1,800 sq. ft. -15%

1.5 story houses over 1,600 sq. ft. -15%

2 story houses over 1,500 sq. ft. -15%

Any house C+5 and lower over 2,000 sq. ft.
assessors discretion.

Garages & Sheds over 900 sq. ft. -10%

Other unique ways to use Functional Obsolescence:

- FBA in houses of less than B grade will need -5% to -10% functional obsolescence, the lesser the quality of houses or FBA, the greater the value to be removed.
- Lack of standard plumbing -5%
- Lack of standard heating -10%
- Non-seasonal houses w/elect. heat -5%
- -25% for all outbuildings after the first most functional outbuilding.

- -25% on in-ground pools.
- Houses in poor condition (-55% for C grade and higher -45% for D grade and lower) may need an additional -25% to -50% functional obsolescence to be used at assessors discretion.
- Barns & Sheds in poor condition -50 to -70% to be used at assessors discretion.

Remember these are examples of how
obsolescence can be used and are not
intended to be used in any
municipality without proper data to
support its use

Thank You For Your Time
