



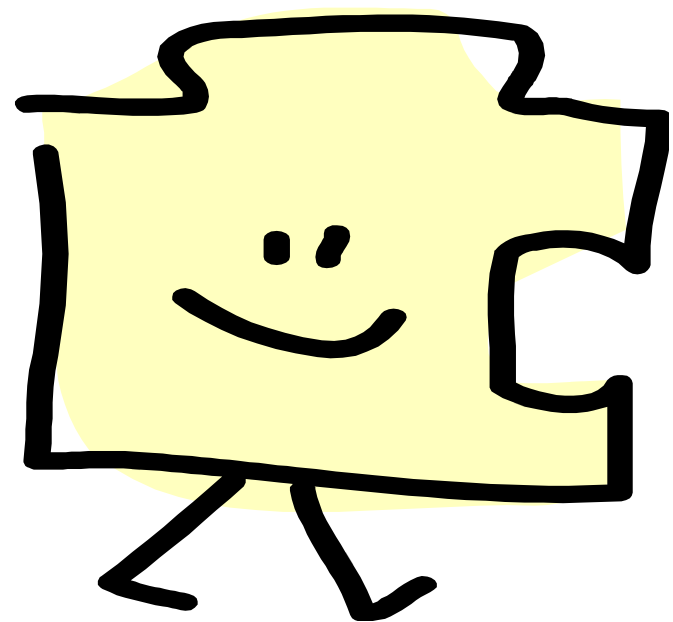
DEPRECIATION

THE PROBLEM

Generally the ***DISCUSSION*** on depreciation is geared to small town assessment jurisdictions with limited market data.



Depreciation is an enigma to most assessors because the process as applied in the appraisal process is not thoroughly understood.



There are many definitions of depreciation, but in terms of the appraisal process:

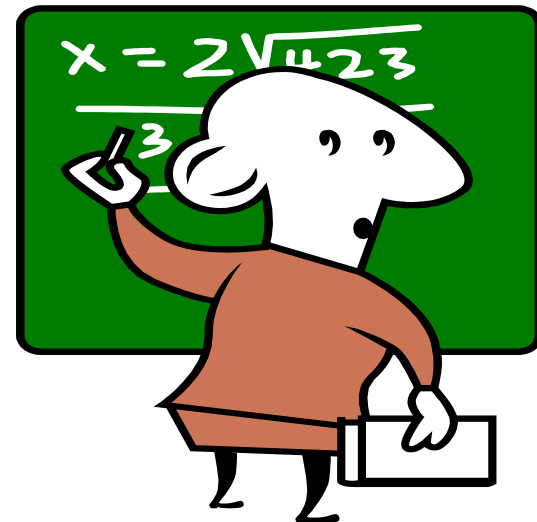
“THE LOSS IN VALUE FROM ALL CAUSES EXCEPT DEPLETION, AS MEASURED BY THE DIFFERENCE BETWEEN REPLACEMENT COST AND THE MARKET VALUE OF THE IMPROVEMENT”



The use of depreciation in appraising in the simplest form can be expressed as a formula

- Replacement cost – depreciation = market value
- By transposition depreciation can be obtained:
- **Replacement cost – market value = depreciation**

The entire theory of depreciation in appraising is expressed by these formulas



Assessors have often considered depreciation as wearing out or poor condition. Too often assessors think of depreciation in appraising as being due to poor condition, age, inutility, or location.

THESE ARE NOT THE CAUSES OF DEPRECIATION, ONLY THE EVIDENCE OF IT.

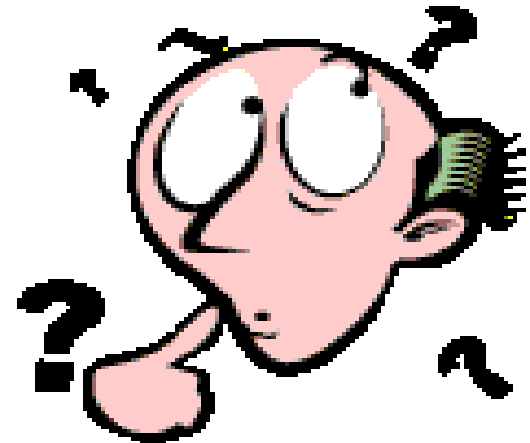


Depreciation in appraising is caused by the adverse reaction of buyers to these factors as evidenced by the reduction in purchase price because of them.



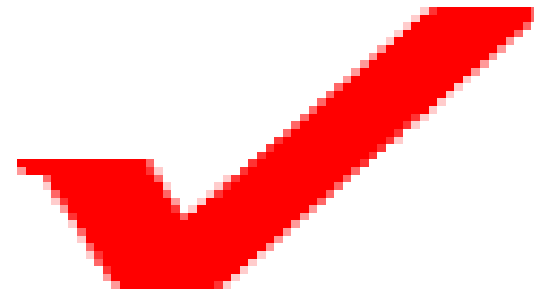
- Assessors possibly have become confused over the use of depreciation in appraising because they were taught that it should be broken down into its component parts of:

- Deterioration
- Functional obsolescence
- Economic obsolescence

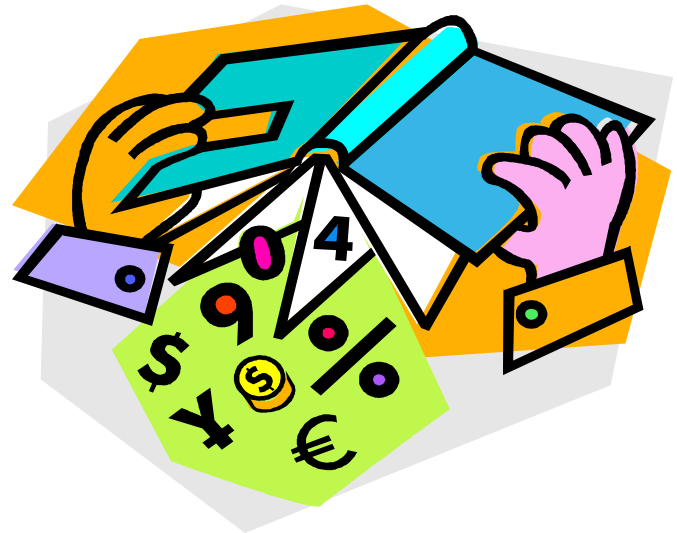


In theory this is the desirable procedure; but actually it is immaterial how depreciation is allocated to its sub-classifications,

***PROVIDED THE TOTAL IS
CORRECT***



Assessors tend to take an accountants concept of periodic decline in value and carry that over into appraisal/assessment practices. This is evident when assessors use depreciation tables to estimate depreciation in appraising.



The best such tables can be no more than rough approximations of the average decline in value per year.



The cost approach is the only approach that uses depreciation in the valuation process



In terms of depreciation; ***USING THE COST APPROACH EXCLUSIVELY :***

Market Value most likely cannot be achieved



RESIDENTIAL IMPROVEMENTS



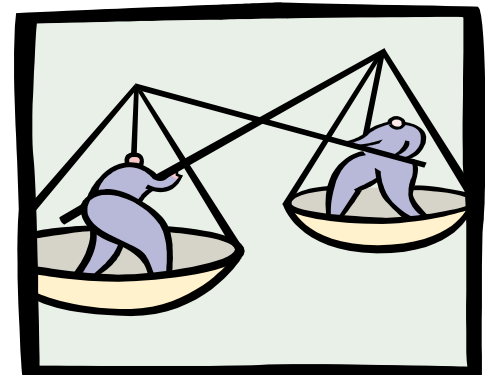
In most cases the depreciation tables for residential strata are modified by **market modifiers**; thus the market comparable approach is influencing the cost approach.



Chronological Age *versus* Effective Age

Usually one of the first things we want to know is the age of the building. If all things are equal; the value will vary inversely with age but all things are not equal. Things like remodeling, maintenance & rehabilitation are not always equal.

IT IS NOT THE ACTUAL AGE THAT GIVES A DECISIVE INDICATION OF THE VALUE.



Chronological Age *versus* Effective Age

The key factor in estimating depreciation is not chronological age but rather effective age.

How old does our structure appear to be when we relate it to others which are typically comparable?

Assessors must make this judgment & arrive at a rational physical depreciation factor.

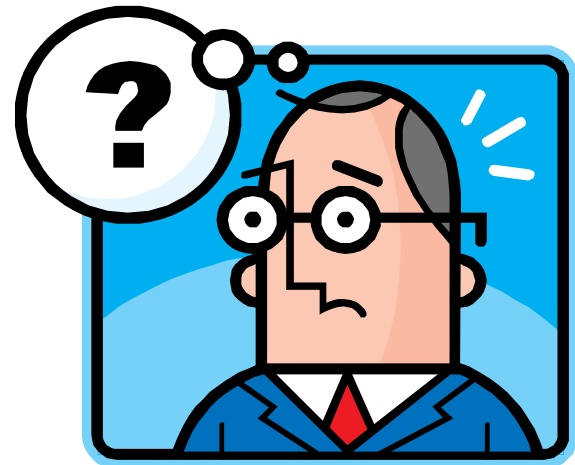


Minimum Effective Age

or

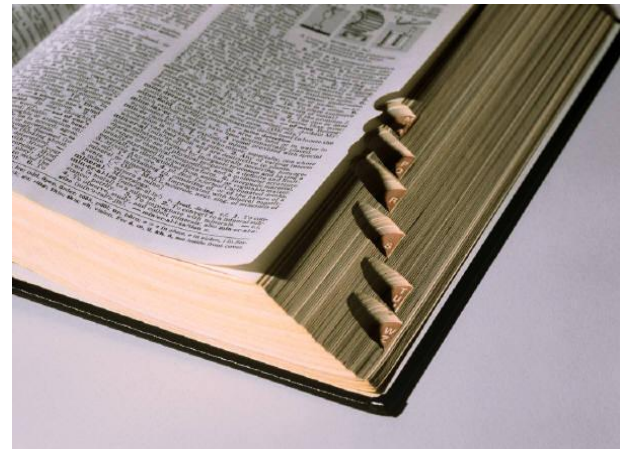
Base Effective Age

WHAT IS THIS???



The use of minimum/base effective age is based on the premise that the depreciation on a useable/habitable (older) property does not drop below a specific percent remaining.

This is measured by the market



Condition, Desirability, Utility

CDU HOW---WHEN do we apply this???



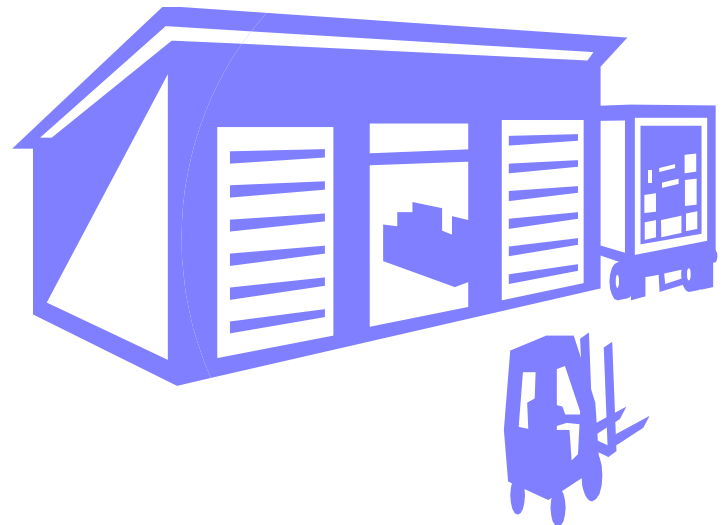
Depreciation must be estimated in accordance with how it occurs in each assessment jurisdiction.

Because of variations in each jurisdiction the assessor must fit his assessment techniques & thinking to the peculiarities of each local market.



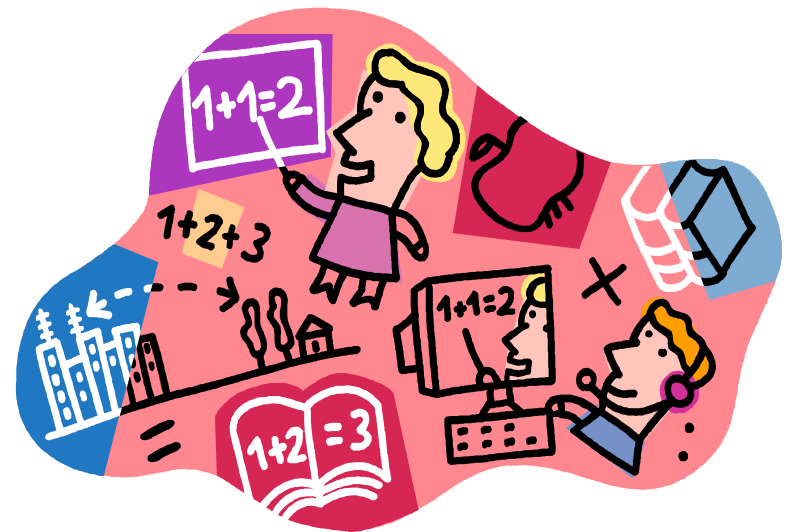
NON-RESIDENTIAL IMPROVEMENTS

Depreciation of non-residential structures is considerably more challenging than residential structures mainly due to the amount of information available.



Cost approach & non residential buildings

Even more so than residential; assessors tend to take the accountant's approach and apply depreciation as straight line or decline balance from tables.



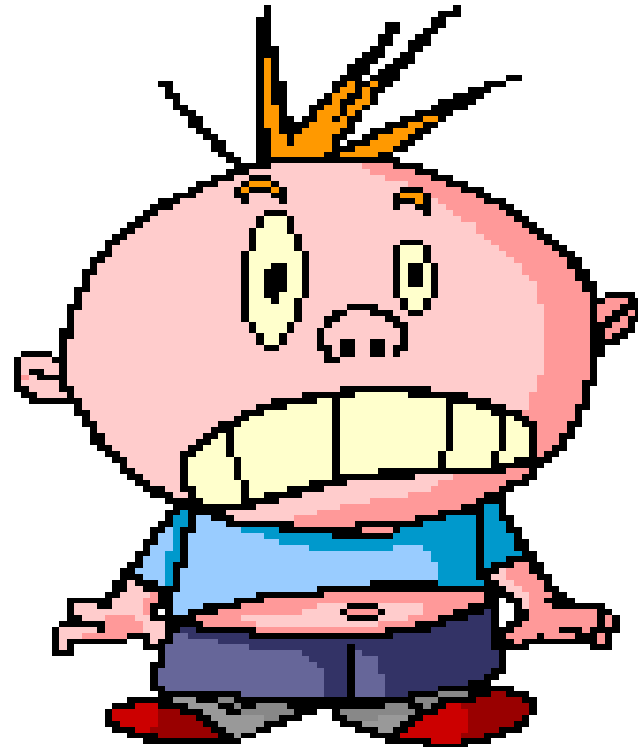
In terms of depreciation it would be most desirable to avoid exclusive use of the cost approach and the depreciation tables associated with cost approach.



Based on the type of municipality or the type of property it is not always possible to avoid the cost approach and depreciation tables.



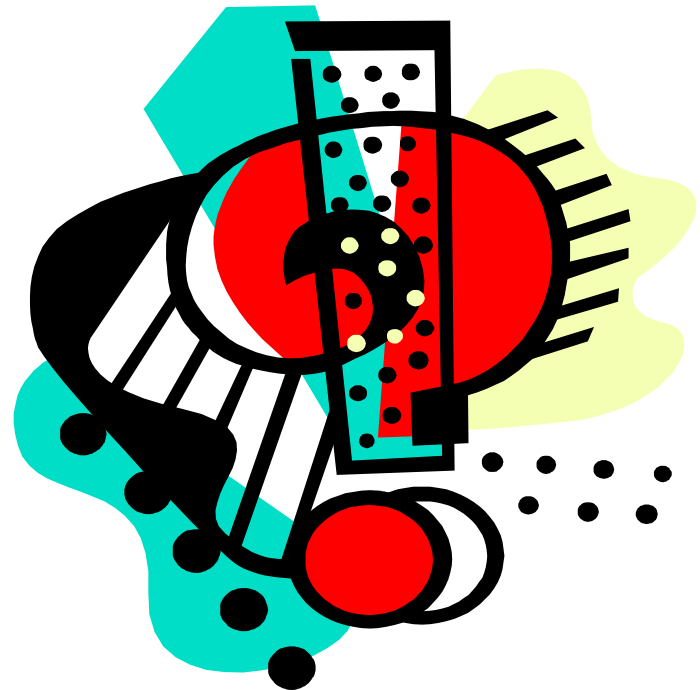
Recently assessors are switching the non residential data base to the Marshall/Swift (M/S) format.



In the case of the *CAMA*lot program there is the option to use either the Alberta depreciation tables or the M/S depreciation tables.

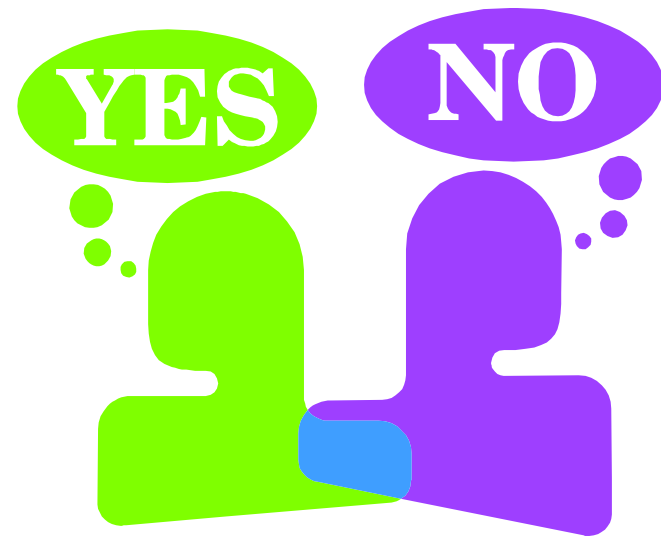


CAMAlot (Todd) indicated most assessors are using the Alberta Tables. How did we decide these particular tables are appropriate?



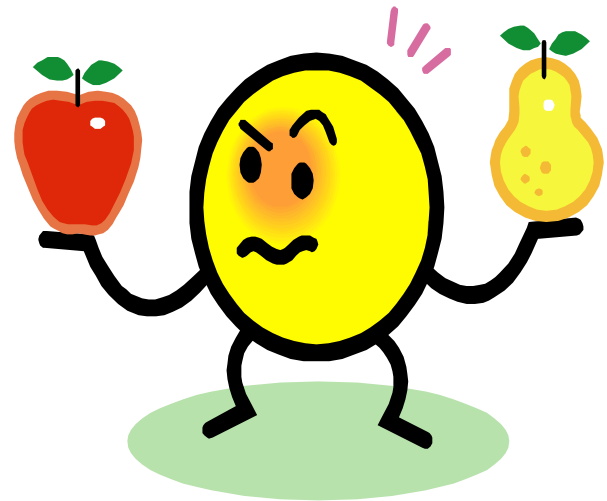
Generally it is accepted that M/S is cost heavy and depreciation light.

Can we let the market/rentals tell us what table we should use??



DEPRECIATION and OCCUPANCY

Generally the 84 manual rates were not heavily oriented to occupancy. The M/S rates and the income approach are strongly based on the occupancy of the structure.



DEPRECIATION and OCCUPANCY

Can we consider that occupancy has an effect on the depreciation of the building? Maybe; should all building on main street or all warehouses get the same economic obsolescence?



DEPRECIATION and OCCUPANCY

The bank versus the gift store versus the clinic versus the insurance office. Is it appropriate to have different obsolescence factors for different occupancies?



Depreciation of so called specialty buildings;
how do we handle the mobile home park or the
golf course or the meat packing plant.

If you are using depreciation tables (cost
approach) on the mobile home park then most
likely the value is *understated!*

Conversely the golf course is *overstated!*



The proper application of depreciation in appraising requires a thorough understanding and knowledge of depreciation theory and how it occurs in the local market.

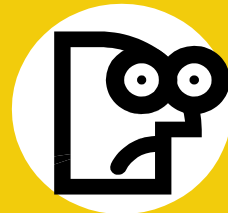
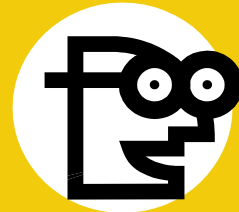
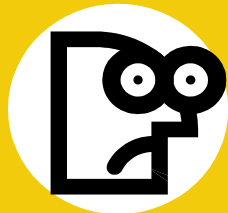


It is important to remember that depreciation in appraising is the difference between replacement cost and the market value of the improvement.



Depreciation in appraising is a market phenomenon, and therefore must be estimated with local market conditions. It cannot be measured by depreciation tables since they represent only averages of doubtful reliability.





It's QUESTION TIME !!

