

DEPRECIATION

Depreciation is not merely a decrease in property value due to physical deterioration. Literally, it is defined as a loss in value from any cause. Depreciation can be broken down into two parts: physical depreciation and obsolescence.

1. Physical depreciation refers to the loss of value through the combined effects of wear and tear, use, and exposure to the elements.
2. Obsolescence refers to the loss of value that arises from sources within the building or from sources external to the building. Obsolescence may further be sub-divided into two parts.
 - a. Functional obsolescence, which arises from sources that lie within the building, represents a loss of value caused by out-of-date architectural style or faulty planning, antique or eccentric design, over capacity or inadequacy, lack of modern convenience, and others.
 - b. Economic obsolescence, which arises from sources external to the building, is defined as loss of value caused by such factors as supply, legislative enactment limiting property rights, aging of residential or commercial districts, loss of neighborhood integrity and many others.

It is the duty of the appraiser to estimate physical depreciation by inspection of the structure and to estimate obsolescence by investigating the facts. The estimated percentage of depreciation deducted from 100% = “percent condition”, or “percent good”. For example, a building that is estimated to be 30% depreciated is said to be in 70% condition.

“Straight-Line” method of depreciation is the most commonly used and is extensively employed by appraisers. It assumes that the value of a building will decline at a uniform rate throughout its useful life. However, it is recommended that this method be used only up to a point. Thereafter, the “observed condition” method should be the dominant one. This involves inspection and investigation on the part of the appraiser. When “observed condition” differs from “straight-line depreciation”, the former should take precedent. A depreciation table is included in this manual, but there are definite limitations to its use; at best, it is a guide and must be applied with judgement.

Depreciation is perhaps the most important single factor of a reasonable value estimate. Chapter 4 of this manual provides a more in-depth discussion of this subject.