

FUNCTIONAL OBSOLESCENCE

Functional obsolescence is a loss in value caused by a flaw in the structure, materials or design of the machinery, equipment or real property improvement when compared with the highest and best use and most cost-effective functional design requirements at the time of appraisal.

Most types of functional obsolescence involve excess capital costs (caused by a super adequacy) or excess operating expenses (caused by a deficiency).

ECONOMIC OBSOLESCENCE

Economic obsolescence is a loss in value caused by a negative influence that is external to the subject property. Most of the time this loss in value is incurable. Examples of these external negative influences may be an oversupplied market or proximity to an environmental disaster.

BEST WAY TO DETERMINE IF OBSOLESCENCE EXISTS

Just because a property is operating at less than design capacity does not mean that obsolescence exists. No property will operate at 100% of capacity 100% of the time. There are always seasonal fluctuations, peak periods and lag periods, downtime for maintenance, etc. Properties, ideally, would run at optimum capacity or the capacity that allows the owner to achieve his/her investment goals. This requires an economic analysis. The best way to determine whether any form of obsolescence exists with the subject property is to perform a proper income approach to value for the subject property. This would require estimating future operating revenues and future operating expenses associated with the subject property and converting these estimates of future cash flows to a present value through the use of a weighted average cost of capital.