

Inverse obsolescence! What is it? It may be an evolving concept in the appraisal field

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Almost 25 years ago I had a brainstorm with a concept of an appraisal term called inverse obsolescence. It's a term which I have not really have seen specifically referred to in the appraisal profession. As appraisal theory has taught us over time, obsolescence (functional or external) is a diminishment of value which is nonphysical. It is an intangible diminishment of value which is measured in the marketplace by various techniques.

In the cost approach, in order to estimate a final value; reproduction cost new is first estimated less accrued depreciation/obsolescence plus the site value. The site value is based upon the site as if vacant and put to its highest and best use. This approach generally is relatively basic and traditional. The most difficult aspect of the cost approach is estimating functional or external obsolescence. Inverse obsolescence is sort of the mirror image of functional and external obsolescence. Inverse obsolescence represents not a diminishment of value but an enhancement or an increase in value that the improvements take on due to factors many times external to the property such as changing building codes or zoning.

One of the prime examples of inverse obsolescence occurs when the subject improvements are located on a site which is legal due to a pre-existing nonconforming use. As is evidenced in many parts of the country, zoning laws have changed considerable during the past 25 years due to a variety of reasons including exclusivity, changes in use patterns of a neighborhood, etc. There are many properties, both residential and commercial, which are in the category. As an example, a high performing retail building was originally built upon a lot with 100 ft. of frontage which was the legal zoning requirement in 1962. In 1970 the zoning code was changed that required 125 ft. of frontage. The current use is legal via a preexisting non-conforming use status. The existing improvements have an enhanced value since the building size and parking has been sufficient over the years and remains so. Part of the proof of this is if the site was appraised to it's highest and best use as if vacant, the value could technically be minimized because the frontage does not meet current zoning and nothing could be built upon it without a variance or a zoning change. Using a very general hypothetical example, in the case of a legally undersized parcel, the value as is vacant may be \$75,000/acre; while a fully developable parcel which conformed to the zoning, all other things equal, may be worth \$250,000/acre. By keeping the preexisting nonconforming improvements on the legally undersized parcel gives those improvements very substantial enhancement value due to inverse obsolescence.

I have heard opinions on what this is attributed to. Some say that it is attributed to land value and some say it is attributed to an adjustment not accruing to either the building improvements or the site. I attribute it to improvements "inverse obsolescence." This represents the "mirror image" of functional or external obsolescence. The existing building improvements take on some substantial

enhanced value which increases the remaining economic life and decreases the effective age due to the ability of the improvements to enhance the total property value. It makes sense to consider this benefit accruing to the improvements. As an example, in some jurisdictions in which the property was destroyed by fire, rebuilding rights would not necessarily transfer with the land. In some jurisdictions, the rights to rebuild based upon the pre-existing nonconforming use may be prohibited. Therefore, the existence of the building may be the sole reason for the pre-existing nonconforming use status. Thus, inverse obsolescence accrues to the building by increasing the remaining economic life and/or reducing its effective age. It could be attributed mainly to inverse functional obsolescence in that it accrues to the improvements but via preexisting non-conforming use policies of a municipality. Thus, inverse obsolescence may be attributed in part to external obsolescence which is defined as a diminishment of value due to factors external to the property such as zoning.

In summary, inverse obsolescence may be an evolving concept in the appraisal field which needs more answers.

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