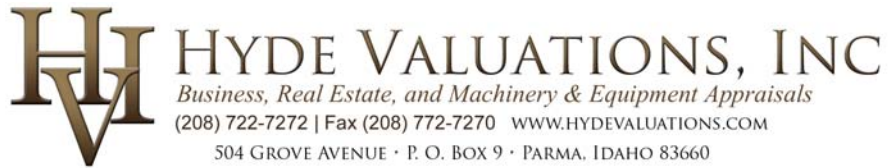




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## *Obsolescence Comes in Various Flavors*

There are many definitions of obsolescence. Basically, in my view, obsolescence is a reduction in the usefulness or the desirability of something (usually an asset such as real estate or an intangible asset such as a patent) which could be caused by any number of things, such as: an outdated design, lack of function, economic conditions and other negative influences. The impairment of the asset generally results in a loss of value of the asset. Determining the amount of loss from one of the various types of obsolescence requires an experienced and knowledgeable appraiser.

The most common types of obsolescence include:

- Functional Obsolescence
- Technological Obsolescence
- External Obsolescence (also referred to as Economic or Environmental Obsolescence)

Obsolescence in business appraisals is most commonly found in the valuation of intangible assets and the determination of the remaining useful life of an intangible asset. Intangible assets, in a similar fashion to fixed assets, such as equipment and real estate, lose value from a variety of reasons.

Functional obsolescence is the loss of value from the impairment of function of an asset that is generally difficult to correct – it can be either curable or incurable. Generally functional obsolescence is caused from either a superadequacy or a deficiency. A superadequacy is basically an over improvement that does not result in an increase in value equal to its cost. A deficiency is essentially the lack of something that is considered “typical” in the market. These concepts are most easily understood when examples using real estate are considered. For example, a superadequacy would likely be a house with a ten-car garage in a neighborhood with two-car garages. The cost of building a ten-car garage would not result in an increase in the value of the property equal to its cost. A deficiency would be a house with five bedrooms and one bathroom. Some situations where functional obsolescence is encountered can be fixed – curable functional obsolescence (most curable functional obsolescence is the result of a deficiency). Other situations are considered incurable meaning that the cost of fixing the problem exceeds the incremental value associated with it. Examples of curable functional obsolescence would be things like remodeling an outdated kitchen or installing air conditioning. Examples of incurable functional obsolescence would be: a house with access to one bedroom only available through another bedroom; or a house with features far more extravagant than all others in the area such as: 18 foot ceilings, granite counter tops, high end kitchen appliances, and expensive plumbing fixtures in an area of “starter” homes.

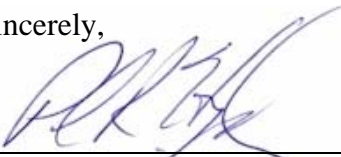
Technological obsolescence results from a change in technology that causes a product to lose value. This is most commonly seen in things such as computers and cell phones. Many new products are introduced with fancy features that result in an older model being judged obsolete by the market. The useful life of some of these new technological products can be very short as new and improved versions are introduced by competitors.

External obsolescence is the result of some occurrence outside the control of the asset, often real estate. For example, real estate in an area can be devastated by the loss of a major employer in a market. Another example would be the discovery of contaminated soil on a property from an old underground fuel storage tank on a neighboring property.

There are various appraisal techniques and methods that are used by appraisers to measure and determine the effects of obsolescence regardless of the type. Failure to recognize and account for obsolescence can have serious consequences, and will very likely lead to an incorrect value conclusion. Knowing how to recognize and identify the existence of obsolescence, and understanding which tools to use in the appraisal process, is imperative as an appraiser.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

Sincerely,



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