

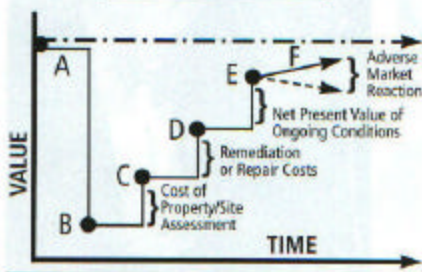
Ten Standard Classifications of Detrimental Conditions

By Randall Bell, MAI

There are dozens of Detrimental Conditions (DCs) that affect real estate values. These range from temporary construction easements and deferred maintenance to environmental contamination, geotechnical issues and natural disasters. As the following chart details (often informally referred to as the DC-10 Chart), all DCs may be placed into one of 10 standard categories. This type of classification is essential in order to avoid the error of measuring the effects of one DC by utilizing data from another DC, which has different valuation attributes.

The basic premise of measuring the value of a property, which has been impacted by a DC, is to recognize all, or a combination of, six basic elements. These are: (1) the value as if no DC exists, (2) the value upon the occurrence or discovery of the DC, (3) the value upon the assessment of the condition, (4) the value upon the condition being resolved or remediated and (5) the net present value of any residual or ongoing costs or losses, and (6) the effects of any negative market perceptions or adverse market reactions, which is sometimes referred to as *stigma*. Each DC Class has distinct graphic patterns that center upon the inclusion, non-inclusion, timing and impact of these six elements.

Complex Detrimental Condition (DC) Model DC Classes VII to X



Generally, the first step with any DC, is to value the property as if it were a Class I condition, where there is no DC. This is reflected as Point A. Upon the discovery of the DC, the value may fall to Point B. Some DCs require an assessment, such as con-

ducting a soils or engineering study. The value during this period is usually the lowest, as a potential buyer would likely require a very significant discount to entice them to purchase a property where the extent of damage is unknown.

Upon the completion of a study, if in fact one is required, the value will generally increase to Point C. If repairs are required, then the value will increase to Point D upon completion. As expected, the cost of repairs is measured by D minus C.

Point E reflects the value of the property after considering the net present value of any ongoing conditions, such as absorption costs, loss of utility, continuing oversight or maintenance, additional financing or insurance costs, and any restrictions on the property's use.

In some conditions, a residual condition or adverse market perception remains. This stigma, also known as onus or taint, is indicated as Point E, where applicable. This reflects the resistance of typical buyers to purchase a property that has been damaged, and where there remains a question as to the adequacy of the repairs, the fear of future related issues arising, or simply the trouble of owning a previously damaged property.

As this chart details, the basic classifications reflect the distinct graphic attributes of each classification. For example, the value patterns of deferred maintenance is similar to a construction easement, and slope instability is similar to soils contamination; however, the value patterns of a construction easement are distinct from soils contamination. Both Class V DCs and Class IX DCs may reflect a loss attributable to adverse market reactions (*stigma*), but these graphic patterns are distinctly different. Class V DCs do not require special engineering studies or remediation costs, and any related Class V stigma virtually always diminishes over time, while the perceptions related to a property with soils contamination may worsen over time, in the event that governmental standards are made stricter.

The DC-10 Chart depicts the full range of conditions. For example, one may con-

tend that a DC exists, but upon investigation, it is determined to be a Class II, or Benign Condition. This issue often arises where a buyer, acting out of buyer's remorse, cites a benign condition as an excuse for rescinding the sale. On the other hand, some conditions may be so severe, that the cost to repair or remediate is greater than the property's value. This is reflected by the Class X category.

When encountering any DC, the parties involved should first determine its classification, and consider the six graphic elements. This will lay the foundation for a meaningful evaluation of the diminution in value resulting from the condition. Once the DC has been properly classified, relevant market data should be researched and applied to the study. With any DC, a conclusion based solely upon the appraiser's "experience and expertise" is reckless at best, and probably unethical. Market data can and should be utilized in the study of any DC. While beyond the scope of this article, a meaningful analysis will not only consider all remediation costs, but also any assessment costs, engineering studies, mitigation costs, risk factors, improvement demolition and reconstruction costs, costs of absorption, additional financing costs, restrictions on use, ongoing conditions, adverse market reactions and the net present value of any insurance proceeds or recoveries. □

Randall Bell, MAI is the principal of Bell & Associates, Inc. of Santa Monica and Laguna Niguel, Calif. He holds an MBA in Real Estate from UCLA, is a Certified General Real Estate Appraiser and a Licensed Real Estate Broker. His experience involves the valuation of all 10 classifications of Detrimental Conditions, including environmental contamination, natural disasters, geotechnical issues and crime scene stigma. Mr. Bell is an instructor for the Appraisal Institute, was the Chair of the Litigation Seminar in 1994 and 1995 and has published numerous articles in various legal and professional publications, including Right of Way. The formulas that accompany this chart and selected case studies will be published in a future issue of Right of Way.

The Impact of Detrimental Conditions on Real Estate Values

Class		Definition	Types of Conditions	Diminution in Value
I	No Detrimental Condition	Undisputed absence of detrimental issues	Straightforward Valuation	<p>Key to Graphics</p> <p>----- Value with No Detrimental Condition - - - - - Value with Detrimental Condition A = Value Prior to Detrimental Condition B = Value upon (Discovery of) Condition C = Value upon Assessment of Condition D = Value upon Condition Resolved/Repaired E = Value upon Ongoing Costs/Losses Resolved F = Adverse Market Reaction</p>
II	Benign Condition	An act or event occurs, but has no effect on value	Class III through X Conditions, where there is no impact on value	<p>No or Benign Detrimental Condition</p>
III	Market Condition	The increase or decrease of value due to general market conditions	Economy Supply & Demand	<p>Increasing Values Decreasing Values</p>
IV	Temporary Condition	A short-term event	Absorption/Bankruptcy Construction Easement Deferred Maintenance Neighboring Construction	<p>Temporary Condition Absorption</p>
V	Indirect Condition	A non-real estate event that is perceived to affect the property value	Crime Scene/Legal Action Disease/Tragedy Riot/Civil Unrest Superstition	<p>Short-Term Effect Adverse Market Reaction</p>
VI	Imposed Condition	An act or forced event that affects value	Bond or Tax Assessment Downzone/Historical Site Eminent Domain/Ground Lease Nuisance/Loss of View Power Lines-EMF/Easements Sewage or Power Plant Surrounding Use/Illegal Use Traffic/Airport Noise	<p>Imposed Act or Event Diminishing Effect</p>
VII	Super-Surface Construction Condition	A construction issue above grade	ADS Compliance Asbestos Construction Defect Lead Paint	<p>Repaired Condition Residual Condition</p>
VIII	Sub-Surface Construction Condition	a construction issue below grade	Drainage/Tunneling Grading/Cut & Fill Retaining Wall or Slope Soil Compaction	<p>Repaired Condition Residual Condition</p>
IX	Curable Environmental or Natural Condition	A natural occurrence or contamination issue that can be economically and physically remedied	Archeological Site Earthquake/Natural Disaster Endangered Species Expansive/Subsiding Soil Geotechnical/Flood/Landslide	<p>Repaired Condition Complex DC Model</p>
X	Incurable Environmental or Natural Condition	A natural occurrence or contamination issue that cannot be economically or physically remedied	Ground Water Contamination Landfill/Radon Gas/PCB's Soil Contamination/LUST Toxic/Hazardous Waste	<p>Loss of Value Liability</p>

The graphs illustrate the common characteristics of conditions that may impact values but in no way are intended to quantify these issues. Exceptions do exist. ©1996 Randall Bell, MAI