

UNDERSTANDING PROPERTY CONDITIONS

Applying Maslow's Hierarchy of Needs

BY DAVID R. LEWIS, SR/WA, ASA, MRICS

In uncertain economic times, market conditions can fluctuate drastically depending on the psychology of market participants. Appraisers convert human behavior into measurable indicators of market value opinions, and the standard appraisal practices ensure a degree of consistency. However, when an appraiser is faced with making price adjustments based on market conditions, there are certain pitfalls that should be avoided.

Appraisals can become a repetitive process where past adjustments are used based on historical information that may not reflect current conditions. Significant shifts in market conditions can occur based on whether the basic needs of market participants are being met. As a result,

appraisers should seek to convert human behavior into measurable indicators of current market value opinions.

As markets change, Maslow's Hierarchy of Needs can assist in explaining how human behavior affects the demand for goods and services, while assisting appraisers in formulating conclusions, opinions and recommendations based on sound reasoning.

Market Value Indicators

In his 1943 paper *A Theory of Human Motivation*, Abraham Maslow put forth a theory that suggests all humans have five basic needs: physiological needs, security needs, social

needs, esteem needs and self-actualization needs. Courses in marketing teach Maslow's hierarchy to help explain consumer motives during the purchasing process. The logic follows that if producers design products that meet basic consumer needs, those products will more often be chosen over those of competitors, thus increasing sales.

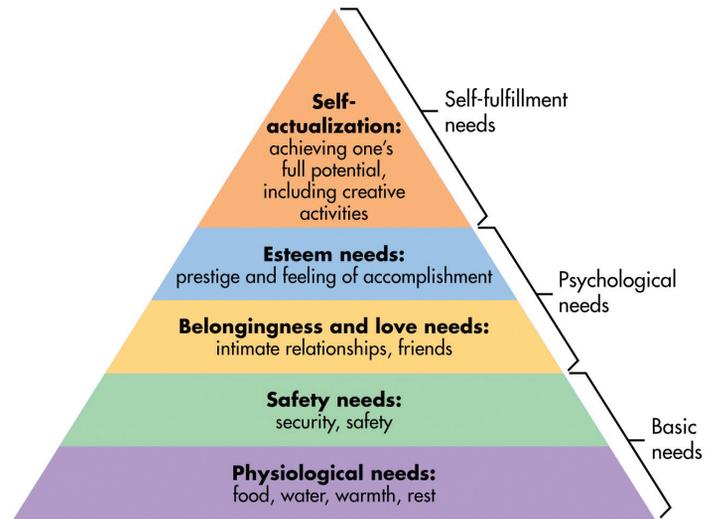
When appraising property, the direct sales comparison approach is often used. This approach is based on the principle of substitution - that the value of a property can be determined by analyzing prices obtained from similar properties. Adjustments are then made to reflect any physical, locational or legal differences that may alter the sales prices of the comparables and account for differences between the comparables and the subject property. Independent variables such as rights conveyed, financing, conditions of sale and market conditions are also considered, as are physical attributes.

The primary adjustment factor when using the direct sales approach is market conditions, as they may have a significant influence on how market participants consider the physical and locational attributes of a property. Market conditions reflect the economic health of the buyers and sellers. As suggested by Maslow, physiological needs come first, so in a down economy, market participants will be more concerned with meeting basic needs. Certain amenities may not be considered as important and affordability may become more desirable. In the residential market, a larger house may lose some of its appeal. Those characteristics that define good marketability may change, and the appraiser should consider what factors are changing as a result of significant changes in market conditions. The appraiser should fully understand how human behavior is changing the market and apply appropriate adjustments that have been justified by market evidence.

This theory can also be applied in situations that involve partial acquisitions and assignments where severance damages must be considered. Most appraisal assignments require an opinion of value for an entire property and typically require the appraiser to find similar properties that have sold using the direct sales comparison approach. The appraiser should attempt to use sales that have a minimum of adjustments and use the principle of contribution or marginal productivity.

The application of making adjustments requires the appraiser to ask what the presence, absence or amount of the property features makes in the adjustment process. Assignments may require the land be valued as if vacant and available to be developed to its highest and best use. Nonetheless, the entire property is analyzed and the opinion of value is for the whole. The relation between the land and improvements must be considered. While paired sales are difficult or often impossible to find, the appraiser will want to find evidence in the market for adjustments. The reaction of buyers to the differences is the true test of adjustments.

Maslow's Hierarchy of Needs



Degree of Elasticity

In partial interest appraisal assignments, the contributory value of certain elements or partial interests is often required. These types of assignments present unique challenges to the appraiser. Whether the assignment is a whole property or a partial interest problem, the combination of elements should be considered. However, the combination of principles may not fully explain how property elements contribute to the whole. Property elements may have different contributory characteristics based on market conditions.

One way to explain this is by using the "price elasticity of demand." Elasticity is used in economics to describe responsiveness of the quantity demanded in relation to price. It helps describe how quantities will fluctuate if price increases. Demand is considered to be elastic if an increase in price causes quantity to decrease with a resulting loss of income. Demand can be inelastic if an increase in price does not cause a significant change in quantity and income increases. In real estate, property elements can be viewed based on the degree of elasticity. How property elements respond to changes in overall market prices can also assist in understanding contributory value in regards to price.

The elasticity or inelasticity of the demand for certain property elements may change at a different rate. This may be an important concept to consider in making adjustments on whole property, partial acquisition and diminution of value assignments. Consider a single-family neighborhood that is subject to external obsolescence. In an active market, the properties may not be as negatively influenced. While the properties may sell for less, buyers may be willing to tolerate the condition improving marketability. This would also be influenced by the purchasing power of the market participants. Buyers higher up on the hierarchy of needs may be looking for amenities. In buyer

markets, the same properties may become less marketable because they may have better choices that are not impacted by the external obsolescence. Again, it would depend on the financial status of the buyers. If the market has a high degree of first-time buyers, the needs reflected in the market may be more about affordable shelter than amenities.

Opinion of Value

In considering the value of specific elements in partial acquisition and diminution assignments, the value of the land and the contributory value of the improvements must be considered. The appraiser must specifically address the loss of a given element or interest. For example, many partial acquisition assignments are for street widening projects where a strip of land is required along the frontage of properties. Such acquisitions may require the acquisition of improvements.

To develop an opinion of value, the appraiser must develop an opinion of the land being acquired and the contributory value of the improvements within the acquisition area. Determining the contributory value of improvements, in part, can be accomplished through the cost approach. If the improvement is not needed to directly support the highest and best use of the property, then the depreciated cost is often used. Depreciation is typically not used if the improvements are needed to maintain the highest and best use of the property. In this case, the full replacement cost is used. In diminution of value problems, isolating the subject of dispute (an element of value) may be required in determining how it impacts the whole, a before and after analysis. Property elements necessary to develop a credible opinion are considered whether the assignment is a partial acquisition, diminution of value, or an appraisal of a total property.

The type, quality and location of improvements on a site can enhance or detract from the value of the whole. Consider that a misplaced improvement can produce functional obsolescence. Referring to elasticity, such an improvement may be highly elastic. As price increases in the overall market, the presence of the misplaced improvement may cause the demand to decrease for a particular property. This is called contributory elasticity. An increase in overall market prices may make the property less marketable as compared to other properties. However, if the improvement is well located, the increase in market prices may not significantly reduce demand and would not detract from the marketability. The price in this situation would be defined as inelastic.

In a street improvement project, I had the responsibility of developing an opinion of value for a strip acquisition that included two large trees that were located at the driveway entry.

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The property was a rural site improved with a Victorian house that was set back at the end of the driveway. The location of the driveway and the trees provided an enhanced amenity, as the trees served as an effective entry statement. Their absence could reduce the property’s marketability. In developing an opinion of contributory value of the improvements, the degree of elasticity could be considered to assist in the understanding of the site in relation to the improvements. As overall market price increases, the contributory value of the improvements could also raise marketability of the whole property. The amenities increase marketability, and in this example, the trees improved marketability and could be described as providing contributory inelasticity.

Summary

While people in the appraisal profession often use principles like marginal productivity to describe and analyze property, using well-established economic terms may better explain current property conditions. Market conditions reflect the mindset of the buyers and seller, who make decisions using a host of variables that can fluctuate based on the state of the economy. By applying consumer behavior theories like Maslow’s Hierarchy of Needs, appraisers may gain a better understanding of the decision-making process relative to the current market conditions.



David R. Lewis, SR/WA, ASA, MRICS

Dave is an appraiser and land use planner who provides consulting services to the public and private sector. He spent more than 35 years working for local government agencies and now specializes in diminution of value, appraisal review, expert witness, litigation support, easement issues and other appraisals. Dave authored several guides published through the American Society of Appraisers and assisted in developing their international real property courses.