

# Substantial Improvement/Damage Appraisal Guidance

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## For Local Floodplain Managers, Building Officials and Certified Appraisers

Communities have had some difficulty in reviewing independent appraisals to real property for compliance with the substantial improvement and substantial damage rules in 44 CFR 60. C.

**SUBSTANTIAL IMPROVEMENT**, 44 CFR 59.1. Definitions: “Substantial improvement” means any reconstruction, rehabilitation, addition or other improvement to a structure, the total cost of which equals or exceeds 50 percent of the market value of the structure before the start of construction of the improvement.

**FEMA’s Market Value Needs:** In common parlance, market value is the price a willing buyer and seller agree upon. The market value of a structure reflects its original quality, subsequent improvements, physical age of building components and current condition. However, market value for property can be different than that of the building itself. Market value of developed property varies widely due to the desirability of its location. For example, two houses of similar size, quality and condition will have far different prices if one is on the coast, or in the best school district, or closer to town than the other—but the value of the building materials and labor that went into both houses will be nearly the same.

For the purposes of determining substantial improvement, market value pertains only to the structure in question. It does not pertain to the land, landscaping or detached accessory structures on the property. Any value resulting from the location of the property should be attributed to the value of the land, not the building.

Acceptable estimates of market value can be obtained from these sources:

- An independent appraisal by a professional appraiser. The appraisal must exclude the value of the land and not use the “income capitalization approach” which bases value on the use of the property, not the structure.
- Detailed estimates of the structure’s actual cash value—the replacement cost for a building, minus a depreciation percentage based on age and condition. For most situations, the building’s actual cash value should approximate its market value. Your community may prefer to use actual cash value as a substitute for market value, especially where there is not sufficient data or enough comparable sales.
- Property values used for tax assessment purposes with an adjustment recommended by the tax appraiser to reflect current market conditions (adjusted assessed value).
- The value of buildings taken from NFIP claims data (usually actual cash value).
- Qualified estimates based on sound professional judgment made by the staff of the local building department or tax assessor’s office.

Some market value estimates are often used only as screening tools (i.e., NFIP claims data and property appraisals for tax assessment purposes) to identify those structures where the substantial

## Substantial Improvement/Damage Appraisal Guidance

---

### For Local Floodplain Managers, Building Officials and Certified Appraisers

improvement ratios are obviously less than or greater than 50 percent (i.e., less than 40 percent or greater than 60 percent). For structures that fall in the 40 percent to 60 percent range, more precise market value estimates are sometimes necessary.

Higher Local Standards: Some communities may have adopted a lower substantial improvement/damage threshold, i.e., 40%, or a cumulative window of two or more years. Please refer to the local floodplain management ordinance for the jurisdiction the property is located in.

The Scope of the Appraisal Report: *The report will be used to determine the contributory value of the improvement to the property.*

Intended Users: The list of intended users of the appraisal report should include: *The person requesting the appraisal, the name of the county or community who has building jurisdiction, (County Name) Tax Assessor's Office South Carolina Department of Natural Resources, and the Federal Emergency Management Agency.*

In order for an independent appraisal to be accepted the appraiser will need to determine the contributory value of the improvements (existing structures) to the property. The appraiser should determine:

- 1) *Market value of the site as if vacant and ready for building at its highest and best use;*
- 2) *Depreciated cost of the improvements (existing structure) to arrive at an estimate of the market value via the cost approach;*
- 3) *Sales comparison approach to be completed to determine an indicated value for the property as a whole.*

Age of the Appraisal: Since an appraisal of a structure is a snapshot in time and the real estate market changes daily the appraisal should be no more than 21 days old when submitted to the local government as supporting documentation for a building permit or substantial improvement/damage determination.

**SUBSTANTIAL DAMAGE**, 44 CFR 59.1. Definitions: "Substantial damage" means damage of any origin sustained by a structure whereby the cost of restoring the structure to its before damaged condition would equal or exceed 50 percent of the market value of the structure before the damage occurred.

Two key points:

- The damage can be from any cause—flood, fire, earthquake, wind, rain, or other natural or human-induced hazard.
- The substantial damage rule applies to all buildings in a flood hazard area, regardless of whether the building was covered by flood insurance.

# Substantial Improvement/Damage Appraisal Guidance

## For Local Floodplain Managers, Building Officials and Certified Appraisers

**MARKET VALUE OF A SUBSTANTIALY DAMAGED BUILDING:** Market value is calculated in the same way as for substantial improvements. The Market value is to be retroactive to a point before the damage. Use the pre-damage market value (building only).

**COST TO REPAIR:** Notice that the formula uses “cost to repair,” not “cost of repairs.” The cost to repair the structure must be calculated for full repair to the building’s before-damage condition, even if the owner elects to do less. It must also include the cost of any improvements that the owner has opted to include during the repair project.

The total cost to repair includes the same items listed in Figure 8-1. As shown in Example 2 below, properly repairing a flooded building can be more expensive than people realize. The owner may opt not to pay for all of the items needed. The owner may:

- Do some of the work, such as removing and discarding wallboard.
- Obtain some of the materials free.
- Have a volunteer organization, such as the Mennonites, do some of the work.
- Decide not to do some repairs, such as choosing to nail down warped flooring rather than replace it.

Basic rule: *Substantial damage is determined regardless of the actual cost to the owner. You must figure the true cost of bringing the building back to its pre-damage condition using qualified labor and materials obtained at market prices. Donated materials and labor prices are calculated at fair market value.*

Figure 8.1

### Items to be included

- All structural elements, including:
- Spread or continuous foundation Footings and pilings
  - Monolithic or other types of concrete slabs
  - Bearing walls, tie beams and trusses
  - Floors and ceilings
  - Attached decks and porches
  - Interior partition walls
  - Exterior wall finishes (brick, stucco, siding) including painting and moldings
  - Windows and doors
  - Reshingling or reroofing a roof
  - Hardware
  - All interior finishing elements, including:
    - Tiling, linoleum, stone, or carpet over subflooring
    - Bathroom tiling and fixtures
    - Wall finishes (drywall, painting, stucco, plaster, paneling, marble, etc.)
    - Kitchen, utility and bathroom cabinets
    - Built-in bookcases, cabinets, and furniture
    - Hardware
  - All utility and service equipment, including:
    - HVAC equipment
    - Plumbing and electrical services
    - Light fixtures and ceiling fans
    - Security systems
    - Built-in kitchen appliances
  - Central vacuum systems
    - Water filtration, conditioning, or recirculation systems
    - Cost to demolish storm-damaged building components
    - Labor and other costs associated with moving or altering undamaged building components to accommodate improvements or additions
    - Overhead and profits

Comment [LSJ1]: Add code deficiencies

### Items to be excluded

- Plans and specifications
- Survey costs
- Permit fees
- Post-storm debris removal and clean up
- Outside improvements, including:
  - Landscaping
  - Sidewalks
  - Fences
  - Yard lights
  - Swimming pools
  - Screened pool enclosures
- Detached structures (including garages, sheds and gazebos)
- Landscape irrigation systems

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REVIEW APPRAISALS: Should the local government question the accuracy of an appraisal they can either require a second appraisal to be done or a "Review Appraisal" be submitted. The review appraiser responsibilities: are to: examine analysis and presentation of data; and, assure all appraisal requirements are met.

**Comment [LSJ2]:** Third party review by appraisers: How appraisers are regulated via USPAP, using USPAP Standard 3 to get a third party review done and example results  
Guidelines for evaluations in lieu of full appraisals  
Guidelines for reviewing, validating and using existing appraisals

### HISTORIC STRUCTURES

Historic structures are exempted from the substantial improvement requirements subject to the criteria listed below. The exemption can be granted administratively if the current NFIP definitions of substantial improvement and historic structure are included in your ordinance, or they can be granted through a variance procedure. In either case, they are usually granted subject to conditions.

If the improvements to a historic structure meet the following three criteria and are approved by the community, the building will not have to be elevated or floodproofed. It can also retain its Pre-FIRM flood insurance rating status.

1. The building must be a bona fide "historic structure." Figure 7-13 has the definition that must be followed.
2. The project must maintain the historic status of the structure. If the proposed improvements to the structure will result in it being removed from or ineligible for the National Register or federally-certified state or local inventory, then the proposal cannot be granted an exemption from the substantial improvement rule.

The best way to make such determinations is to seek written review and approval of proposed plans by the local historic preservation board, if it is federally-certified, or by the state historic preservation office. If the plans are approved, you can grant the exemption. If not, no exemption can be permitted.

3. Take all possible flood damage reduction measures. Even though the exemption to the substantial improvement rule means the building does not have to be elevated to or above BFE, or be renovated with flood-resistant materials that are not historically sensitive, many things can and should be done to reduce the flood damage potential. Examples include:

- Locating mechanical and electrical equipment above the BFE or flood-proofing it.
- Elevating the lowest floor of an addition to or above the BFE with the change in floor elevation disguised externally.

### CORRECTIONS OF CODE VIOLATIONS

The NFIP definition of substantial improvement includes another exemption:

44 CFR 59.1 Definitions: "Substantial improvement" means .... The term does not, however, include ... Any project for improvement of a structure to correct existing violations of state or local health, sanitary, or safety code specifications which have been identified by the local code enforcement official and which are the minimum necessary to assure safe living conditions

## Substantial Improvement/Damage Appraisal Guidance

### For Local Floodplain Managers, Building Officials and Certified Appraisers

Note the key words in this exemption: correct existing violations, identified by the local official, and minimum necessary to assure safe conditions. This language was included in order to avoid penalizing property owners who had no choice but to make improvements to their buildings or face condemnation or revocation of a business license.

This exemption was intended for involuntary improvements or violations that existed before the improvement permit was applied for or before the damage occurred—for example, a restaurant owner who must upgrade the wiring in his kitchen in order to meet current local and state health and safety codes.

You can only exempt the items specifically required by code. For example, if a single stair tread was defective and had to be replaced, do not exempt the cost of rebuilding the entire stairway. Similarly, count only replacement in like kind and what is minimally necessary. If the owner chooses to upgrade the quality of a code-required item, the extra cost is not exempt from the formula—it's added to the true cost of the improvement or repairs.

Unfortunately, many property owners and builders pressure local building official to exclude “code violation corrections” from their voluntary improvement proposals. There are “code violations” in all structures built before the current code was enacted. In many cases, those elements must be brought up to code as part of an improvement project.

This is very different from a code violation citation that forces a property owner to correct those violations and make improvements that were otherwise not planned. The building official must know about and document the violations before or at the time the permit is issued.

#### Example

A small business in a 40-year old building was damaged by a fire. The building's pre-fire market value was \$100,000. The insurance adjuster and the permit office concluded that the total cost to repair would be \$45,000.

However, the community's building code states that whenever an applicant applies for a permit to modify or improve a building, the building must be brought up to code. This building would need the following additional work:

- Replace unsafe electrical wiring.
- Install missing fire exit signs, smoke detectors and emergency lighting.
- Widen the front door and install a ramp to make the business accessible to handicapped and mobility-impaired people.

The total cost of these code requirements would be an additional \$8,000. However, since these were required by the code before the fire occurred, they would not have to be counted toward the cost to repair. Based on the basic formula:

$\$45,000 = 0.45$  or 45%; Therefore the building is not declared substantially damaged

## Substantial Improvement/Damage Appraisal Guidance

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In this example, the building can be repaired without elevating or floodproofing. However, the permit office should strongly recommend incorporating flood protection measures and flood resistant materials in the repair project.

#### Instructions for Appraiser

**Appraisal Assignment:** To determine the contributory value of improvements to the property.

**Scope:**

1. Determine the Market Value of the site as if vacant and ready for building at its highest and best use ;
2. Determine the depreciated cost of the improvements to arrive at an estimate of market value via the cost approach;
3. Sales comparison approach to determine an indicated value of the property as a whole.

If being used for Substantial Damage determination the value is to be retroactive to a point (month of) the occurrence of the damage.

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