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Real estate advice for a boom and bust economy

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Recently, I was in discussion with a group of colleagues regarding the boom and bust cycles of real estate, about which I've written in the past for the New England Real Estate Journal. Previous research showed that the boom and bust cycle is the "new normal," i.e. that we can always expect it. More importantly, there is evidence that such cycles may come faster and more dramatically than the past, due to improved communications and other technology, and greater impact from worldwide events.

Boom and bust cycles are caused or exacerbated by followers. Bubbles are created by euphoria, irrational exuberance, with people desperately wanting to get in. Burst bubbles or busts are created by distress, panic, with people desperately wanting to get out. Both situations create extreme behavior that can take a modest trend into a steep curve up or down. If this happens faster than it has in the past, it will make for a very difficult environment in real estate valuation.

As my colleagues and I discussed this phenom, in the context of appraisals, some felt whatever phase you were in on the boom/bust curve, you had to stick to the facts of the day, i.e. the comparable sales closest to the date of valuation. They believed appraisers cannot, nor should they try to, predict the future. From a Counselor, or advisory point of view, I thought we had to at least consider where we are in the cycle, and what the direction of the cycle may be, in order to give good advice on buying and selling, timing, and at what value.

There is a concept being used in Europe that would mitigate against this conflict. They call it "sustainable value", and it is about considering the general trend line through the boom and bust graph to give a prediction of where values "should be", that is, where they would be without excessive stimulus in one direction or the other. It is a more stabilized approach to valuation than considering only the most recent comparable sales, without looking at trends. I like this concept, as it allows for a broader range of timing for valuation. It may not be as precise, but it may be more realistic in a dramatically changing environment

Shortly after the discussion, I had the opportunity to work on a large and extraordinary coastal property. I was acting in an advisory capacity, and thus discussing both value and strategy for marketing. The property clearly had development potential, but not at this moment in time. Comparable sales for large properties, and even for smaller subdivided parcels, were few, far between, and obviously low priced. Our market peaked sometime in 2006/07, and tended down to a bottom in sometime 2009/10 (although some say we may still sustain more devaluation).

Because my subject was a large land tract, I had to look into the future, since if it were developed, its sales would occur over several years. The property was extraordinary, and based 30 years of experience, I knew it had more value than recent comparable sales would suggest. However, there was no real evidence, except for a generally acceptable point of view that we are at or near the bottom of a bust cycle, and prices are low. I consulted with the client, and decided to create a range of values based upon timing. I gave today's value based upon current comparable sales, and then a range of different values based upon a modified line through a peak and trough chart. In other words, I looked more at "sustainable value" based upon the quality of this property, the low supply of something as wonderful, and the knowledge that this quality could generate euphoria as we come out of the bust cycle.

In an advisory position, I may have bent some rules of pure appraisal doctrine. But I believe I gave good advice on this property so that it would not be sold too fast, at a level suggested by the distressed sales at the bottom of the market. I think I did the right thing.

Daniel Calano, CRE, is the managing partner and principal of Prospectus, LLC, Cambridge, Mass.