

The commonly held belief - It can move markets, true or not

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I am writing this article on the backside of Hurricane/Tropical Storm Irene, which was supposed to be the largest storm of the century, except for Katrina. I watched the storm while vacationing on Buzzards Bay in southeastern Massachusetts, and thankfully it did not live up to newscaster expectations.

Agitated and worried about the increasingly bad forecast, however, there were many people who were taking all the prudent precautions, boarding up houses, stocking up on water and flashlights, pulling boats out of the water and so on. Most waterfront owners were extremely nervous about the projected surge that was to be four to eight feet higher than normal tides. The next tier of houses from the water were not so worried, and felt less envious of their waterfront neighbors than they had in the past. In fact, most waterfront people would have gladly swapped houses for ones on higher ground, at least for the moment.

As I watched the storm, and talked to the worried owners, I thought about potentially diminished values for waterfront property, either real because of actual damage, or perceived because of fear. The TV stations hyped the frightening story for days. Who wouldn't be afraid. I thought that it doesn't take too much to change perception of property value under this kind of dire circumstance.

A financial analyst once said that the most dangerous thing in the financial market is a "commonly held belief." What he meant was that a thought or belief, whether initiated by fact or rumor, can get a foothold and grow larger than reality. In other words, as the thought becomes "a commonly held belief" it takes on a life of its own, whether real or not. It becomes the self-fulfilling prophecy. It can move markets. This is as true of real estate as it is of the equity markets. The commonly held belief that Irene was a major storm, and would produce a major coastal flooding surge, had a lot of waterfront owners doubting their investment.

This is not a new phenomenon. We see it currently in real estate markets across the country. For example, in addition to a truly troubled economy, most people believe that the building glut in south Florida will cause condominium values to be lower for many more years than other markets. This belief itself has frightened buyers and further dampened the market. On a similar note, most people believe that the California fiscal crisis and taxes necessary to correct it will continue to depress real estate values in California. People are leaving in part because of that belief. In the extreme, values in watering holes like the Hamptons, Martha's Vineyard or Nantucket can suffer after something as trivial as a few cases of Lyme disease. It often doesn't take much to create a commonly held belief. In the past, there were many other examples of real estate values being impacted by belief. To

name a few, the very pricey Nantucket has had "popularity volatility" over the years. In the early 1900s, Nantucket was touted as the vacation area of the future. This reversed during the depression, and once reversed, took another 30 years before people believed there would ever be value there again. In the late 1800's, Newport was the vacation choice of the nation's wealthiest people. However, it went downhill after some decided it was no longer the place to be. Only relatively recently have the old mansions been turned into condominiums, with buyer confidence returning.

It would be nice if real estate value were only based on a factor of supply and demand (need), with demand caused by quantifiable measures of population and economic growth. The post war suburban invasion is a textbook example of both factors at work. However, these primary factors can be modified by just as powerful, but less predictable, social and cultural factors. People can simply decide an area is no longer attractive, or safe, or viable. And people begin to talk to one another, and the newscasters begin to pick up the story. These days, of course, there can be millions of tweets or Facebook posts that fuel that movement of a commonly called belief. It all adds a little more uncertainty to an often difficult-to-predict real estate market.

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