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Appraisers: Don't stop the party? Look carefully at what the market is telling you

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Real estate markets rise, fall, sputter, rise again, only to fall again. Somebody said, "It's the Economy, right?" Not necessarily. While economic fundamentals are better, there is no compelling single reason why markets are performing wildly beyond expectations and common sense. A very smart person once made a case, not so long ago, in fact, for the notion of "irrational exuberance," a way of describing behavior with no obvious explanation.

Mind you, I have no quarrel with some healthy real estate performance in housing markets. After years of excruciating misery, it's good to see markets bounce back.

Are we in a period where prices don't seem to be based on logic and the past? Markets have a logic all their own. Even experts don't see the underlying logic until events have unfolded and they have the benefit of some hindsight.

Let's examine some possible drivers and popular explanations of the surge. Pent-up demand surely plays a role and there are many buyers that have sat on downpayments and equity to see which way things were going to and when. Low interest rates are surely a factor. Rates have come up in the past weeks, igniting further housing frenzy.

There is clear evidence of offers exceeding, often significantly, listing prices with virtual buyer feeding frenzies over attractive listings. Real estate brokers despair about pricing under these conditions.

If brokers don't get it right, what does an appraiser do under these conditions? Not easy, but not insurmountable.

The obvious question. Is this a bubble or the new way of doing things?

Here's some advice to appraisers. It doesn't matter what it is. We have an opinion (not an estimate) of value at a certain point in time that reflects market thinking as a "snapshot." The prices of the comparables we analyze to arrive at our opinions, reflect the bundled thinking of buyers and sellers with respect to the unknowable future in that instant.

What matters is understanding the small market sliver we are analyzing. What matters is supporting how we adjust (or don't adjust) for differences between our subject and the sales/listings/offers we select as comparables.

The art of appraising is in the selection and treatment of comparables. We know there are plenty of sales out there but few represent true comparisons for our property. We wrestle with small datasets as a matter of course. Clients and other interested parties look over our shoulders as we go about our analyses.

Appraisers have not been very good in supporting adjustments, particularly market condition or "time" adjustments. Part of it is the nature of markets (see above); the other is the lack of the ability to identify and analyze submarkets systematically and consistently.

In the past six months, in Massachusetts, MLSPIN notes a median price of $315,000 for a single family home with an average days on market of 114 and a sale price/list ratio of 98%. Contrast this to the previous six months, the median was $300,000 with DOM of 117 and a sale price/list ratio of 96%. In the past month, the median price was $355,000 with average days on market of 83. The trend of the pricing data suggests strongly surging prices: is it sustainable?

From the 30,000 foot view above, it's easy to look at the data and draw conclusions which might be right and could be just as easily be completely wrong. Not much detail to work with.

How do appraisers find the right level of market analysis? Clearly, large scale trends are generally useful but drilling down to an appropriate sub market level escapes many appraisers. The much maligned MC1004 form has forced appraisers, many unwilling, to provide a measure of consistency and transparency in market analysis. But it's not enough. We need to take the next step. Many appraisers have taken that next step and now provide analyses of listings, offers, of more detailed sub market activity. Many either don't or are "rudderless," i.e., they would like to be able to do it, but are without guidance.

In the current market, the most current data is critical. Also critical is the ability to make sense of market movements and be able to apply the results of that quest to the micro-economic analysis at hand, the appraisal of the subject.

The appraisal profession has the tools to move to this next level of analysis. For many reasons, we still stick with a decades old reporting format and development process, hampering the ability to cogently and efficiently explain current market behavior. The best appraisers get the job done despite these handicaps; the industry overall needs an injection of more innovative thinking to deeply apply how the appraisal process works in today's markets.

For now, appraisers, look exceedingly careful at what the market is telling you. And remember, these markets too will pass. What remains is your integrity, intelligence, and your well supported opinions and well written reports.

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