Challenges in market analysis - by Bill Pastuszek

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In these times of active markets, and seemingly unprecedented demand for appraisal services, analysts are challenged to provide cogent, relevant, and accurate market analyses as part of valuation assignments. The evolution of the appraisal process, rising from the needs of users and the responses of practitioners, has placed a great premium on creating a relatable context for the valuation process.

Appraisers are often heard to mutter, at the beginning of an assignment "where are the comps, there are no good comparable sales out there, what am I going to do?"

While not an incorrect question, is the timing wrong? Is the first part of the appraisal process to find "comps?"

The Uniform Standards of Appraisal Standards (USPAP) provides a chart of the appraisal process. (You can find this chart in any recent USPAP version or do a internet search for it.) The process places highest and best use analysis and market analysis before developing the three approaches. Interestingly, the Appraisal of Real Estate (14th ed.) places comparable data selection before market analysis and highest and best use analysis. Neither is wrong and there are valid arguments for the ordering of the activity in each case.

Comparable sales, rents, expenses, capitalization rates all have to be examined in the context of the market conditions from which they stem. When a piece of comparable data is collected and confirmed, the date of that "event," i.e., the comparable, is critically important. Why is this important? That data "event" needs to be related to the effective date of the appraisal. Moreover, it begs the question as to whether some adjustment for changes in market conditions is merited.

More and more, we are being asked to look at the big picture and relate the micro economic analysis in a single property appraiser to the larger market. Access to huge amounts of data is relatively cheap and easy. Appraisers are besieged by surveys, studies, charts and graphs that ostensibly promote appraisers' understanding – or misunderstanding - of the characteristics of the real estate market relevant to the assignment.

The challenge that appraisers, and all real estate market observers and analysts face, is how to understand what data is relevant and how it applies in an assignment. This is a process of continually questioning the relevance and meaning of the data being considered.

A continuing challenge is to match the level of the market data with the subject's market. A common issue in appraisals is to provide market analysis data for Class A space – whether office, industrial, lab, or apartments – for comparison with a lower level asset, or, just a different asset. The ability to refine data to more closely relate it to the subject's market position is a critical skill to have in today's layered, nuanced markets.

The problem exists whether the market is well surveyed or not. In larger markets, where data is plentiful, the challenge is to identify which data, or dataset, is relevant. Working in outlying markets presents a challenge to data-driven analysts and places greater weight on localized knowledge. The problem in those types of market is how to efficiently and effectively present the local knowledge in a report, as the local knowledge isn't always easily quantifiable.

Fundamental analysis is based on primary data and can include personal confirmation and verification of market data such as comparable sales, income, and cost data. Inferred analysis relies more heavily on secondary data.

Many appraisers still "mistrust" secondary data and really aren't comfortable with relying on data that they can't directly "put hands on." A common objection is "how can I trust the data when I know there are errors in it?" An appraisal's scope of work decision is to determine when to rely on secondary data and how to rely upon it. Oftentimes, widely used data sources do contain errors. Those errors do not render the entire dataset invalid. A large enough sample, appropriate for market analysis, will provide reliable results, If an analysis needs to get more specific, the particular dataset can then be more closely vetted. For actual comparables used to arrive at the final opinion, the degree of confirmation needs to be high.

An appraisal relies on both primary and secondary information. Contemporary appraisal practice indicates that an appraisal, in order to be credible, will be able to take into account various information sources. The level of data used and analysis is crucial to provide credible results. It's not enough to be "right," but to have a report to show the support and logic for the value opinion. A legitimate criticism of the appraisal process is that it relies heavily on "art" and often lacks the rigor of "science." More than ever, the report process needs to strive to be ever more "transparent," so that a reader can follow the appraisal's argument and understand how the result was obtained.

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