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Facing up to uncertainty - by Bill Pastuszek

May 27, 2022 - Spotlights

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COVID forced us to adjust, at horrible cost of over a million American lives and countless others across the globe, and, it's not over.

From the negatives, there are positives. The way we work and live evolved. We adjusted, in some case, creating new paths and better ways of living and working with more discipline, more focus, more compassion, if you will. This evolution should not stop. We should not fall back to mediocre habits of pre-COVID existence.

Real estate appraisal measures and analyzes human behavior through marketplace activity. An underlying rational process underpins appraisal even though markets are not always perceived as rational. Appraisers and other analysts don't make markets; the appraisal process is rooted in understanding market participant behavior.

COVID provided an opportunity to help redefine what an appraisal's value opinion really means. The huge information gap about what was to come and what people and markets would do about it sparked thinking about how to appraise under such unprecedented conditions of uncertainty. Surely there were precedents – the 2008 Financial Crisis, 9/11, Hurrican Katrina, for example – but nothing of the massive scale of the resulting economic shutdown.

There were many discussions during the shutdown of what an appraisal's effective date really represents. Some argued that without being able to reliably forecast the future, it made values unreliable, uncertain, and, in effect, meaningless by some measures. Others argued that an appraisal can reflect and quantify market uncertainty based on cogent analyis of market attitudes and activity, or lack thereof. Still others argued that any market value opinion is subject to uncertainty, which is a pretty reasonable argument to make, as uncertainty always exists in some form or another in markets and creates risk.

USPAP defines Effective Date as follows: the date to which an appraiser's analyses, opinions, and conclusions apply; also referred to as date of value. The Dictionary of Real Estate Appraisal provides the following definition: The date on which the appraisal or review opinion applies.

Appraisers invested time crafting assumptions, explanations, and disclaimers to explain to clients that uncertainty was heightened due to the unprecedented circumstances around COVID. Many of these warning/notices underscored the importance of the appraisal's effective date.

In terms of COVID, most observers were expecting some sort of nuclear winter: it never really happened. Despite all the pandemic's tragedy, markets suprisingly began to recover and adapt as quickly. Two years post-lockdown, real estate markets, almost across the board, have bounced back, and, in many cases, surpassed pre-COVID perfomance.

Markets began to make sense of uncertainty and observers and analysts began to understand changed market dynamics. Investment activity, having paused, then re-energized itself.

Asset sectors responded differently. Herd instinct did not rule. And as time went on, transactional activity showed that various sectors made sense out of uncertainty. So indeed, there was rationality in marketplaces.

For appraisers, comparables are key. There was a period of time where there was a lack of transactions. That lack of activity was telling in and of itself, reflecting the extreme uncertainty investors – owners, lenders, buyers and sellers – were experiencing at the time. It was necessary to consider pre–COVID comparable data and make sense out of those transactions under COVID uncertainty.

In COVID, the amount of survey and forecast information was an enormous aid in bridging the comparable data gap during the year of COVID. Many analysts found that anecdotal market participant information became more important than ever.

The recession that took place was the shortest and steepest ever. During the lockdown's worst, the stock market dropped and dropped. Then it rallied beyond expectations. Wasn't that the height of irrationality?

Another concept applicable to uncertainty is forecasting. The Dictionary definition: To estimate, calculate, or indicate in advance. Forecasts made by appraisers are based on past trends and the perceptions of market participants concerning their continuation or alteration. Forecasting is not predicting or estimating, but providing supported opinions.

Value opinions were not less reliable during that time; if correctly developed, they reflected prevailing market attitudes of market uncertainty; uncertainty that appraisers could and did measure. But the effective date allowed both appraisers and users to understand the conditions of uncertainty.

We are not done with uncertainty. Without a clean end to COVID, the world and real estate are plunged into the tragedy of a war and its far-reaching social and economic upheavals. Surely, this is different than COVID but is similar in terms of creating large scale global uncertainty.

Real estate tends to be a long game: it's illiquid and generally slow to react to events in the short-term. Skilled investors and analysts are concerned when the unexpected – and the catastrophic – occurs but do not over react, but adapt. Reacting to events is a short game and better left to Twitter and modern day journalism.

Value is expressed as a point in time so that appraisal users can understand that the unexpcted may affect value after the effective date. Real estate market tend to look over long horizons; that's a good thing. Wars, inflation, higher interest rates affect economic behavior often in nuanced and unanticipated ways.

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