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Data, judgment and analysis - by William Pastuszek

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The following falls into the category of Broadly Generalizing, but the issues need to be discussed. This isn't the first time the subject has been discussed in this column and it's probably far to say that the writer believe that it can't be discussed enough.

Economic behaviors are often the result from decisions based on 1.) no knowledge and no sound basis for action; 2.) limited and possibly incorrect, unconfirmed or lightly confirmed, information; 3.) selective, subjective data that confirms a preconceived idea (confirmation bias). Real estate behavior is no exception and investment decisions are not always based on sound logic or accurate data.

Technology and human nature make for a potent combination in producing illogical and incorrect results and aiding in self-fulfilling prophecies. Feed enough data into a program and something is bound to result to make sense to somebody.

Real estate market observation can be like that too. The data is the data but the human element – the interpretation of the data – the “last mile” in understanding markets. It's important to know what others think of the data; what is it saying to them? Considering the source is critical in evaluating anecdotal data in order) for it to be part of the empirical research? Does the source fall into any of the three categories in the first paragraph?

Despite all the data analysis tool available, real estate markets still consist of relatively sparse data points. They operate in sectors that have slow dynamics with changes coming slowly, and are subtly nuanced with the results of changes not often immediately apparent. Large scale events - say COVID - have plenty of potential ramifications that may not become apparent. While stocks markets respond to events somewhat reflexively, the long horizons of real estate may not even twitch in the short terms. Longer term, the moves may be huge.

Investment real estate markets are long term. A quarter or two of bad economic news isn't going to affect the bricks and mortar... Assets lack the immediate liquidity that is available in the stock and bond markets. While that may be a good thing, it also means that investments should not be entered lightly; getting in is easier than getting out, most of the time. Given the heights of CRE markets achieved post-COVID and the resulting deceleration, it's clear that growth and decline are cyclical, and that each sea change is caused by a new set of events that are different in terms of their weighting in each cycle.

The foundation of more than one real estate bust has been built on running with the herd, relying on technology driven forecasts, and overlaid by the facile conclusions of media and prognosticators. What may really be going on may have to be read “in between the lines,” reading trends and forecasts as useful data points and adding the intelligence gathered from being “on the street,” blending both big data and reliable anecdotal, primary information.

The best investors seem to understand the asset, both quantitatively and qualitatively, and are willing to pay a fair price for it. Once the decision is made, after the fact analyst can punch up appropriate support. The best investors turn down far more deals than they accept.

Much pessimism seem to exist in commercial real estate. That's not entirely justified: ongoing pessimism is as bad as "irrational" optimism. The economy is not in bad shape, even though many think it should be better than it is.

Residential markets are a cause for concern. Tight supply limits buyers' choices. High rates have decreased affordability. Price appreciation continues in most markets. Buyers are conditioned to pay over asking. The GSEs are working hard to make home ownership more affordable, perhaps at the expense of prudent lending.

The NAR settlement is likely to affect housing – exactly how remains to be seen – and the way homes are being bought and sold.

As a former appraisal teacher was fond of saying, "Trees don't grow to the sky." (This is a German proverb: "Bäume wachsen nicht in den Himmel." My high school German isn't responsible for any translation issues.) The phrase suggests that there are natural limits to growth and improvement. While the saying is attributed to the limits of companies' growth, it is a concept that applies to real estate.

In uncertain markets, running with the herd can be dangerous since there's no way to know when the herd decides to turn, stop, or reverse course. Common sense, supported by good data and good data analysis, and critical thinking should rule in the end. Dig deeply into transactions and trend. Ask questions. Talk to people, not screens. Then act based on strong data, supported by several sources.

(The original article was written in 2015. I took another look at the issue in 2022. Given what is going on in 2024, it was well worth revisiting the subject.)

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