# NAVIGATING THE COMPARABLE MINEFIELD

*The current realities of how appraisers navigate the "comparable landscape" begs the question, "what kind of value is it anyway?" Palumbo and Wagner present a case study to demonstrate how complex valuation can be, even when data is plentiful.*

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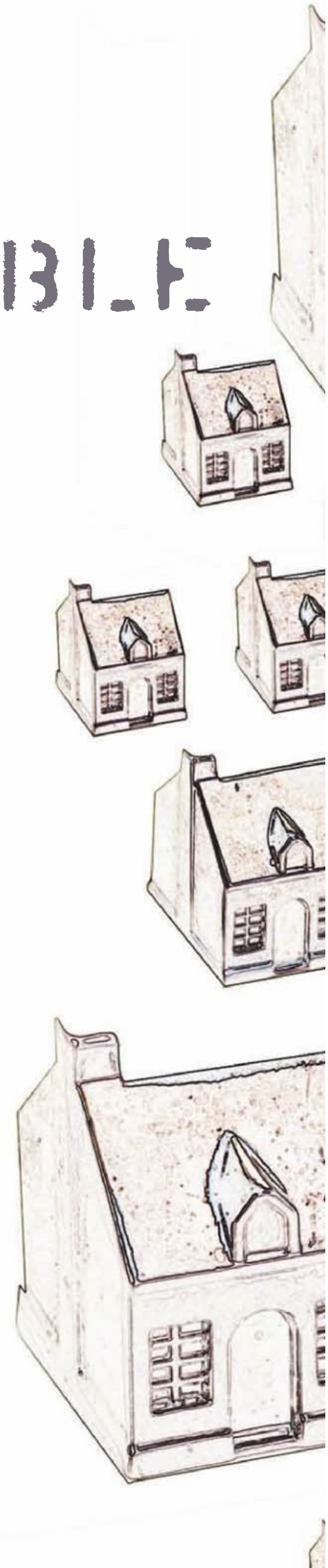
As the dust settles on the real estate market and the world is hoping to get "back to normal" as soon as possible, a harsh reality is facing the valuation professional. The reality is that in the "new world," the definitions of various types of value are meshing or becoming hybrid-type "values" that contain a few elements of different definitions.

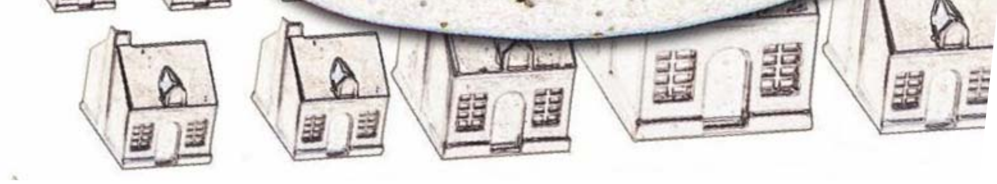
## 'The Value Problem

The "Dictionary of Real Estate Appraisal," 5th Edition, published by the Appraisal Institute, contains several types of "value" definitions including "liquidation value," "market value," "business value," and "disposition value," among a few others. Add the Worldwide ERC® definition of "anticipated sales price" to the list of published value definitions and you can create a list and an argument that value comes in many shapes and sizes.

Value can be a difficult thing to evaluate, especially when the elements of the definition are questionable or partially present. Therein is the problem.

Other referenced and defined terms within the real estate industry include "forced sale," "short sale," and "distressed sale." These terms are helpful and specific but may, in the end, be less meaningful if the entire market segment is interspersed with different "kinds" of sales. In other words, is there a way to ensure that the "anticipated sales price" value is "pure" and only consists of arms-length "vanilla-type" transactions, sold in an unaffected environment, even if that environment may not exist? Take, for example, the following description of a recently "completed" relocation appraisal.





### Appraisal Example

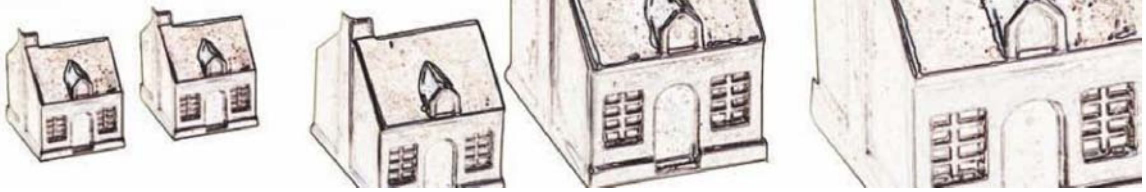
The home being appraised was a 3-year-old property located in a townhome development in suburban Chicago, IL. The neighborhood was about 75 percent complete and still had competition from the builder. Initial research found 23 properties had sold in the prior year in the local MLS system, so it appeared that sales data was plentiful to develop a reliable anticipated sales price.

After a closer examination of the available data, 14 of the 23 sales were new construction builder sales, some recently closed, others older sales. Of these sales, there was a large range of value and many had both advertised and non-advertised builder concessions. The builder was selling new units for a lower price than original purchase price of the subject property. Typically, when a property is 3 years old and there is plenty of resale data available, new construction sales are excluded from the analysis. It should be noted that builder competition always plays an important role in developing value, as buyers typically will select a new property over a used property.

The remaining nine comparable sales were found to have a mix of conditions and sales terms that were not evident until closer examination.

- Five sales were bank-owned foreclosure sales or short sales (a short sale is a property that sells below its mortgage loan balance). Four of these five sales had closed in the past one to four months. These sales all closed for $20,000 to $50,000 less than their new purchase price.
- One sale was a relocation sale that occurred three months ago. This sale closed for $10,000 less than its new purchase price.
- Three were arms-length sales between a typically motivated seller and buyer, not under duress. These properties closed nine months, 11 months, and 12 months prior. These three sales all resold near a break-even point to slightly above the new price.

The 23 sales under consideration suddenly became a complex "minefield" of data. Each sale was carefully researched and examined and, depending on which comparables were selected for the final appraisal report, the final value conclusion



could have in excess of a 25 percent range in adjusted values.

The appraiser is hired for his or her local expertise and, under these circumstances, the final value opinions can vary significantly, say, if one appraiser elects to use the most recent data and another elects to exclude distressed sales in the appraisal reports.

Another concern is the arms-length transactions that were 9 to 12 months old soon will be too dated for a future buyer's mortgage appraisal. Shortly, unless new sales occur, the only resale data will be the distressed sales.

The relocation appraisal was completed using data that included the 3-month-old relocation sale, a 9-month-old arms-length sale, a 1-month-old new construction sale, and a 1-month-old foreclosure sale. After reasonable adjustments were applied, the adjusted value range was more than 15 percent. The value was concluded nearest to the adjusted relocation sale.

## A Prevailing Misconception

There is a prevailing misconception that one "should not use" any sales other than arms-length in developing an opinion of anticipated sales price. The second criteria under the definition of anticipated sales price in the Worldwide ERC® Summary Appraisal Report reads, "Both Buyer and Seller are typically motivated or well advised and acting in what they consider their best interest."

When the prevailing economic situation is not favorable, sellers are motivated by the need to sell and a specified time period can affect the net result. "Well advised" can be taken to mean many things for both the buyer and seller, but the bottom line is the sellers generally know market conditions are "favorable or unfavorable." Regardless, they want the most they can get for their property. By logical extension, the buyer is motivated by similar forces on the opposite side, which is to not pay too much. How can the appraiser be expected to find such sales data when it does not exist or is overwhelmed by the prevalence of other types of sales?

If the market is dominated by short sales, foreclosures, and distressed sales, how can the argument be made that there is "another market" that will ignore or side-step the price levels and the trend these sales indicate. Ignoring this crucial aspect of the market is the equivalent of creating false expectations.

If the reason for disposition of each sale is taken at face value and eliminated solely based on the category in which they fit, there would be very little data left from which to draw conclusions.

Foreclosures, short sales, and distressed sales must be considered in the mix as part of the "normal market" in the current environment because, for the most part, they sell and compete in the marketplace. If the sales are below the normal market range or are not exposed properly, they could be thrown out.

It is a common misconception that the use of sales and listings of shorts sales and foreclosures are "unfair benchmarks" at face value. This is not practical thinking for two reasons. First, buyers see prices of homes sold and expect the same prices—they do not care how the prices were achieved. Prospective buyers also see listings and sales and negotiate the best price they can regardless of the seller's situation. As long as all sales and listings are exposed in the market through the same mechanism (i.e., MLS, open to the masses, willing buyers, and willing sellers), everything becomes relative and market forces will prevail.

Short sales or foreclosures not exposed in this manner should be analyzed to determine if they should be discarded in the same manner as sales outside the market norm. In the end, it is the appraiser's job to identify what the market is based on the data.

## The Solution

There may not be a perfect solution to combat this minefield, but there is a way to survive it. Just the realization of the potential issues and having a "best practice" in dealing with such obstacles is enough. In the end, that "best practice" is to navigate with caution, dig deeper, and use a comprehensive narrative when necessary.

Careful and time-consuming verification can aid this process but, even after diligent study, there may be a wider range of value than desired. An effective solution to justify the final value conclusion in those cases where a variety of sales data is used is a simple and concise "reconciliation."

In the reconciliation part of the appraisal, the appraiser discusses why the final value was chosen given the quality and quantity of data. It is here that specifics in a clear narrative can be indentified. The reader should leave with a clear understanding of why the subject lands in a particular spot on the "minefield." After all, the subject property will become a comparable sale someday, and it too will have a "story" that someone will attempt to verify and analyze.

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