The Residential Market: Impact of Current Conditions on Valuation

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Professor of Real Estate
University of San Diego

Michael Sklarz
President
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Moderator:
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2012 President-Elect
Appraisal Institute
Richard L. (Rick) Borges, II, MAI

2012 President-Elect
Appraisal Institute

- Mr. Borges is the president-elect of the Appraisal Institute for 2012. The following year he will serve as president and in 2014 will become the Appraisal Institute’s immediate past president for one year. He also will serve on AI's Executive Committee those three years and will be a member of the Board of Directors during that time as well.

- He has been a member of the Appraisal Institute since 1978, a member of the National and Indiana Associations of Realtors and the Jackson County Board of Realtors since 1974 and the Columbus (Ind.) Board of Realtors since 1997.

- He received the President’s Award from the Appraisal Institute in 2009, the Richard E. Nichols, MAI, SRA, Lifetime Achievement Award from the Hoosier State Chapter in 2008, the Edward L. White Achievement Award from the Hoosier State Chapter in 2000, the Dick Snyder Service Award from the Indiana Association of Realtors in 1984 and the Realtor of the Year Award from the Jackson County Board of Realtors in 1982.

- He is an Indiana certified general appraiser, an Indiana real estate broker, an Indiana Level I and Level II assessor-appraiser, an Appraiser Qualifications Board-certified Uniform Standards of Professional Appraisal Practice instructor and an Indiana certified tax representative.
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Getting Started

- 120 minutes
- Questions will be answered at the end of the webinar. Use the Questions box to submit a question.
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- Tech Issues: GoToWebinar (800) 263-6317
The views expressed in today’s webinar do not necessarily reflect the official position of the Appraisal Institute.
POLL QUESTIONS (3)
PRESENTER INTRODUCTIONS
Mr. Miller is a Professor of Real Estate at the University of San Diego with the Burnham-Moores Center for Real Estate.

He was V.P. of Analytics for the CoStar Group in 2010-2011, a public commercial real estate data and market analysis company headquartered in Wash DC.

He is Editor of the Journal of Sustainable Real Estate, a journal which he founded in 2009 with the support of CoStar. See www.josre.org Previously he was at the University of Cincinnati where he was Academic Director and the founder of the real estate program.

He has spent time as a Visiting Faculty at Depaul and the University of Hawaii.

He started his academic career at the University of Georgia. He received his Ph.D. from the Ohio State University in Finance and Real Estate with a minor in City and Regional Planning.

He is active on the Editorial Board of several national/international journals and is a past President of ARES, the American Real Estate Society.

Dr. Miller has numerous academic articles, books and articles in trade market publications on housing, brokerage, mortgage risk, valuation, sustainable real estate and many other topics.

His research on housing market analysis and forecasting with Michael Sklarz spans three decades.
Mr. Sklarz is the President of Collateral Analytics, a Honolulu based company whose products include automatic valuation models (AVMs), home price indexes and forecasts, and real estate and mortgage market analytics.

He has more than 25 years of professional experience in real estate research, analysis and real estate technology product development in the United States and global real estate markets.

Previously, he was Head of Analytics at Fidelity National Financial and Chief Valuation Officer for Fidelity National Information Solutions.

He was also previously the Director of Research at Prudential Locations, Inc., where he helped pioneer the development of new analytic tools and databases to track and forecast the Hawaii and U.S. real estate markets.

He holds a B.S. in Engineering Mathematics from Columbia University and a M.S. and Ph.D. in Engineering from the University of Hawaii.

He is also a Fellow of The Homer Hoyt Institute.
Impact of Residential Market Conditions on Valuation and Automation Tools for Appraisal

Michael Sklarz, PhD
President of Collateral Analytics
And
Norm Miller, PhD
University of San Diego
AI Webinar
August 22nd, 2012
Topics We Will Cover

• Case Shiller Versus Reality briefly
• Leading Indicators of Prices
  – Months Remaining Inventory
• Market Conditions
  – the 1004MC report
  – Automated Market Condition Reporting
• Automated Interactive Appraisals
  – The state of the art
Case Shiller Metro Level Indicators Are not a Very Good Indicator of Local Market Prices

• If they are used for market trends or to bring a price forward your error will be significant.
Minneapolis Price Changes for April 2010 - April 2011 By Zip Code

Source: Collateral Analytics

- Minn % Change
- C-S for Minn %

(green line) where 59% of the Zip Codes declined less than Case Shiller
Note: This is a two edged sword. C-S overstates the decline but also overstates the increase.
Conclusion on Case Shiller

• Don’t use it to bring prices up to date
• Use only locally derived price trend indices, hopefully adjusted for size and mix (regular sales or REOs or both)
Leading Indicators of Home Prices

• Employment
  – Interest rates (normally)
  – Credit Access measurements
• Sales volume
• Turnover rates
• Days on Market (be careful with this one)
• Months remaining inventory
• Foreclosure rates
• More factors available in our papers, see www.collateralanalytics.com
San Diego Real Price Change Versus Turnover Rate from 1981 through First Qtr 2011
Foreclosure Sales as % of Total Sales Versus San Diego Home Prices PSF

- **Sold Price PSF of all Sales**
- **Foreclosure Sales Percentage**

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The limits to valuation accuracy

Appraisers have a very difficult job – the idea of providing a precise point estimate of value is virtually impossible.

Home prices are actually very volatile. In homogeneous neighborhoods, we see month-to-month differences in value on the order of +/- 5%; in heterogeneous markets the monthly variations are often twice as much.

Some examples show how much variation we see even in homogeneous markets, below:
Toms River NJ Zip 08757 is a very homogeneous market
Homogeneous Market - Toms River Zip 08757
Quarterly Regular Single Family Sold Price and Sales

Note relatively smooth price particularly when plotted quarterly
Toms River Zip 08757 Single Family Quarterly Regular Sold Price per Living Area

Price per living area is an excellent way of normalizing price data and helps smooth the data further.

We use an Hodrick-Prescott Filter to smooth the various price series.
Monthly price series are typically quite volatile even in homogeneous markets.

Significant number of sales.

Toms River Zip 08757 Monthly Single Family Regular Sold Price and Sales
Toms River Zip 08757 Single Family Monthly Regular Sold Price per Living Area

Regular Average Sold Price Per Living Area

Price/Living helps smooth the monthly series but there is still a lot of volatility
Toms River Zip 08757 Quarterly Regular Single Family Price per Living Area Volatility

The quarterly Price/Living volatility has averaged about +/- 4%

Our Price/Living Volatility is the percent difference between the actual prices and the smoothed series.
Toms River Zip 08757 Monthly Regular Single Family Price per Living Area Volatility

Monthly zip code Price/Living volatility has averaged about +/- 6%
A Submarket of Toms River: Neighborhood of 22 Roxton Place NJ 08757

Note: We have defined about 300,000 neighborhoods around the U.S. for our AVM and other analytic products. We need to do this to select the most similar comps for valuations and for monitoring micro-market trends. A typical zip code has 10-20 neighborhoods.

Note the significant price volatility even within the same neighborhood.
Neighborhood of 22 Roxton Place NJ 08757
Monthly Price per Living Area

Regular Average Sold Price Per Living
Single Family

Trend

Monthly Price/Living is still quite volatile even in a very homogeneous neighborhood

Volatility or noise
Neighborhood of 22 Roxton Place NJ 08757
Regular Monthly Price per Living Volatility

Regular Average Sold Price Per Living Volatility
Single Family

Monthly neighborhood Price/Living volatility has averaged about +/- 10 to 12%
La Jolla CA Zip 92037 is a more heterogeneous market
Heterogeneous Market - La Jolla Zip 92037 Quarterly Regular Single Family Sold Price and Sales

Regular Average Sold Price and Number of Sales
Single Family

Note much more volatile quarterly prices
La Jolla Zip 92037 Single Family Quarterly Regular Price per Living Area

Price/Living helps but series is still very volatile.
La Jolla Zip 92037 Single Family Quarterly Regular Price per Living Area Volatility

The quarterly Price/Living volatility has averaged about +/- 5 to 8%
La Jolla Zip 92037 Monthly Regular Single Family Sold Price and Sales

Regular Average Sold Price and Number of Sales

Single Family

Very volatile when looking at all sales on a monthly basis

Significant number of sales
La Jolla Zip 92037 Single Family Monthly Regular Price per Living Area
La Jolla Zip 92037 Single Family Monthly Regular Price per Living Area Volatility

Monthly zip Price/Living volatility has averaged about +/- 10 to 15%
Why should there be such an emphasis on a precise point value? With regard to the riskiness of a new mortgage, it did not matter to lenders if the appraised value was highly accurate here from 2000 through 2005.
22 Roxton Place NJ 08757 Subject Property Similar Comps

Why limit the appraisal to 3 to 6 comps?

Sales in past 12 Months in Blue Actives in Green
1596 Vista Claridad CA 92037 Subject Property Similar Comps

Why limit the appraisal to 3 to 6 comps?

Sales 12 Mths - Blue
Actives - Green
Contingent - Gray
Expired - Red
Pending - Yellow
Withdrawn - Purple
There are a number of home price indexes which can be used to time-adjust comps for Toms River or Roxton Place. These include CBSA, county, city, zip code, or neighborhood HPIs.
HPIs for Edison-New Brunswick CBSA and More Micro Markets (2011Q1=100

Depending on the HPI used, there will be significant differences in the prices of past year time-adjusted comps

The potential variation over the past year for time-adjusting comps could be as much as 20%
Risk Profiler
Conclusions

• Market conditions can be integrated into the appraisal process but will require more attention to leading market indicators.

• Price dispersion and confidence limits are becoming a valuable piece of valuation reports.

• More expert system comp analysis and automated market condition analysis is essential in order to operate efficiently and profitably in the future.
Use the Questions box to submit a question.
Webinar Handouts

Webinar handouts can be downloaded from the resource page which is included in your connection e-mail.
Upcoming Webinars

Coming Soon…

- September 12 – Appraisal Management Liability
- September 18 – Regression Analysis is Becoming Mainstream: Are You Prepared?
Please complete the brief survey that will appear on your screen immediately following this webinar. We will also send the link to the survey in a follow-up e-mail.

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