New Appraisal Principles for Tough Times

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"An urgent need exists for better forensic appraisal methods to support property valuations in this time of declining values."

By **John Garippa.**, as published by **Real Estate NEW JERSEY**, December 2009

Over the past 18 months, property values have declined significantly for all asset types in New Jersey. While this resulted in record numbers of property tax appeals, actual transactions between buyers and sellers demonstrating this erosion of value are limited. This can be problematic when dealing with the finite valuation dates demanded by the New Jersey Tax Court.

Tax Court judges won't accept opinions of expert witnesses unless they provide supporting evidence that a property's value has declined. Despite the fact that few actual sales are available between buyers and sellers, property values can still continue to erode. The real question is: What steps can a property owner and appraiser take under such difficult conditions?

Events over the past year have proven that valuing property at a specific point in time, a necessity for tax appeals, can be almost impossible using the typical valuation parameters of comparable sales. Under New Jersey tax law, all real property must be valued for the 2009 tax year based on a valuation date of Oct. 1, 2008. But the events of last summer and fall were catacylsmic for all property types.

The entire nation watched as our financial system began a meltdown that culminated in the collapse of Lehman Brothers on Sept. 15, 2008. During this several-month period, the stock market lost almost 40% of its value. This tsunami affected real estate just as much as it did stock portfolios.

To demonstrate this point, consider a hypothetical sale where the deed was transferred on Oct. 1, 2008. In stable times, such a transaction might be the gold standard of defining what a willing buyer would pay and a willing seller would accept for a property on the very date defined by New Jersey tax laws for valuations. However, if this sale were like most others, the parties would have negotiated the terms at least three to six months before.

Looking back to the period six months prior to the Lehman Brothers collapse reveals an entirely different world, from an economic standpoint, than the one America faces today. No one would suggest that value parameters arrived at during that quieter time would reflect the disastrous conditions found on Oct. 1. Under stable market conditions, comparable sales can be relied upon to demonstrate market value. The lack of sales transactions in the past year has rendered comparable sales a limping metric for property tax purposes. Thus, an urgent need exists for better forensic appraisal methods to support property valuations in this time of declining values.

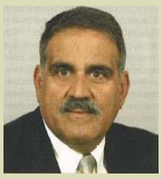
It's easy to forget that the basic laws of economics govern the real estate market. The economic base of a community revolves around businesses generating income from their activity. Therefore, the first step to take in demonstrating eroding values is an examination of the industries and businesses that generate employment and income in a community. Such a study would review changes in employment levels as well as population trends because these issues affect household income and other important factors that ultimately affect the demand for, and worth of, real estate.

Next, look at movement in rents, levels of rent concessions, increases/decreases in foreclosures, building occupancy figures for both office and commercial properties and even the direction of delinquencies in mortgage payments to determine the scope of property value diminishment. (For information on housing trends dig into Standard & Poor's Case Shiller Home Price Indices as well as data provided by the National Association of Realtors in reference to velocity of sales and median prices.)

In times of great price turmoil, analyze the loss in value in the various stock market indices as this may define how individuals view their wealth. Another important index to study is the Purchasing

Managers Index. The PMI represents a composite of five sub-indicators (production levels, new orders from customers, supplier deliveries, inventories and employment levels) that are extracted through surveys produced by the Institute of Supply Management. These surveys are sent to more than 400 purchasing managers around the country. While this measures only manufacturing trends, it is considered a good predictor of changes in gross domestic product and the economy as well.

As a result of the enormous instabilities experienced in the past year, the former methods of valuing property must be reexamined.



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