

# Price Versus Fundamentals – From Bubbles to Distressed Markets

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“What needs to happen now is difficult, but we need to get real estate back to the value that it’s worth”

Todd Maclin, Chief Executive of commercial banking at JPMorgan Chase January, 2010

“Price is what you pay, value is what you get”

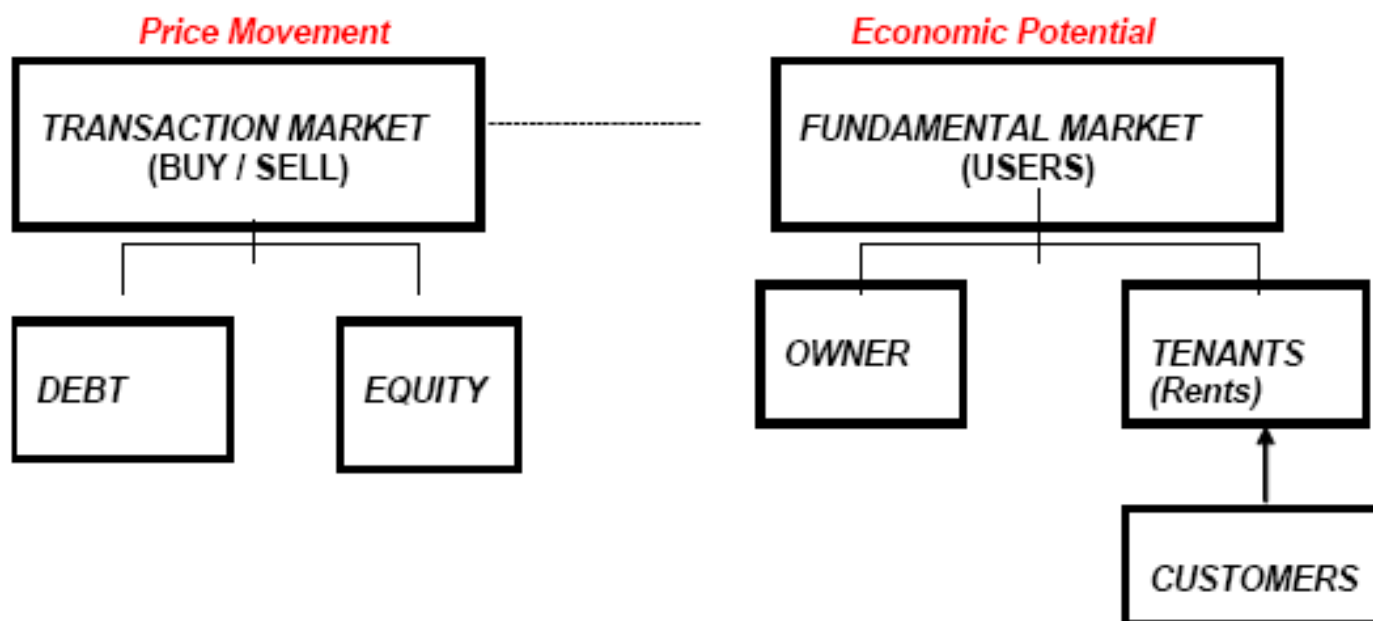
Warren Buffett



An appraisal of real estate requires recognition of two different economic concepts

- The capital- transaction market (buy/sell) market
- The fundamental - demand derived from demographics (based on population, employment & income).
- The two economic concepts can have differing value indications when either market is in great flux.

**TYPES OF REAL ESTATE MARKETS'**



# Market Cycle Pattern



The case study is a one acre corner parcel

Data Input:

- Five Recent Comparable Sales
- The Most recent Sale was the Corner Convenience Store across the Street
- Now Convenience Store Market is currently Overbuilt for at least five years
- Land Discount rate is 10%. ( includes holding cost)

What is the Value of the Following Pad Site ?

Office  
Complex

← 1 Mile →

Single Family

Major  
Thoroughfare

Apartments

New Conv. Store  
Land @ \$16/SF

New Fast Food  
Land @ \$10/SF

New Fast Food  
Land @ \$10/SF

1

2

3

Major

Thoroughfare

Apartments

Major  
Thoroughfare

Subject

New Fast Food  
Land @ \$10/SF

4

Shopping Center

New Conv. Store  
Land @ \$16/SF

5

Single  
Family

Not to scale

## Answer: It depends on The Question

- Transaction Value Says  
\$16 SF for Corner Pad Sites
- The Sustainable Value ? (Fundamentals User Value)  
\$10SF

PV, 10%, 5 years, \$16/SF = \$9.93/SF

# Reconciliation Becomes The Capstone to the Appraisals

- If the three approaches are separated into independent valuation techniques then the reconciliation becomes the appraiser's instrument to reconnect the three approaches.

## A Solution- Begin with the three approaches being applied independently

- Income Approach - apply fundamental demand concepts and DCF based on the forecast.  
Avoid Sales Derived Cap Rate analysis.
- Sales Approach - Apply current sales and listings.  
The Direct Cap approach may be placed here.
- Cost Approach - apply the normal process but exclude economic obsolescence.

# Conclusions

- The problem is that in real estate two market segments are vacillating with some interaction with each other and then at other times independent of each other.
- When the data overlaps are not correctly recognized and /or analyzed, then the value conclusions can be uncertain.
- The solution may be to not just pick one type of data to utilize in valuation - like transaction only or fundamental data only - but to know when to use data from each market segment; know when to mix the data, and when not to mix the data and when to use the two different market segments to check results from the others.