

## Did you miss us?

Our December, 2006, issue talked about what a busy year that was. As you might guess, 2007 has also continued to be pretty busy. As a result, *The Greenfield Advisor* has taken an inadvertent hiatus. Hopefully, we can get back to a somewhat regular publication schedule.

One reason we've been so busy is the flood of class action litigation projects that have hit us in the past couple of years. As long-time readers may remember, I wrote a pair of articles on the appropriate real estate appraisal methods in class action cases, one for *Class Action Litigation Report* (October, 2004) and one for *Toxic Law Reporter* (January, 2005). Actually, these were more-or-less the same article – there may have been some updates from one to the other, but the two articles were pretty interchangeable. In short, these articles laid out the framework for conducting a mass appraisal of a large-scale real estate problem, consistent with appraisal standards (USPAP) and with best practices in the real estate literature.

Not surprisingly, the articles met with some criticism, since the availability of well-established, statistically reliable, and acceptable methodology gives lie to the notion that class action is unsuitable from an appraisal perspective. Nonetheless, since then we've elaborated on the subject with a series of peer-reviewed journal articles which explore various aspects of mass appraisal as well as a chapter on valuation methodology in Prof. Robert Simon's excellent book, *When Bad Things Happen to Good Property*, co-authored with me by my colleagues Bill Mundy, Will Spiess, and Ron Throupe.

The availability of substantive appraisal support for a class-action model has led us to be called as expert consultants or witnesses in a whole series of large cases – five in Louisiana alone, plus two in Maryland, two in Michigan, two in West Virginia, one in Kansas, one in Texas, and elsewhere. I'm pleased to say that in all but one case our clients have prevailed on class certification. (That denial of a state-wide class action in New Jersey is presently on appeal.) As of this writing, we're working on two new class certifications, both involving flooding issues in New Orleans post-Katrina. Either one of those, once certified, will by itself be potentially the largest real estate class action in history.

The most notable class action case to settle thus far (the Murphy Oil Spill in the suburbs of New Orleans), has at least partially led so far to one journal article (co-authored by myself and Prof. Sofia Dermisi of Roosevelt University in the *Journal of Real Estate Literature*) as well as a presentation at the American Real Estate Society meetings. Most of the other cases are generating extensive amounts of data as well as important advances in empirical methods which will be summarized in papers and scholarly presentations for years to come.

However, there are significant common observations coming out of these successful class certifications, and we're in the process of working up a journal article on those right now. Key among these are:

*The Importance of Data Base Development* – Even the smallest of these class actions require extensive data base construction, principally including hedonic factors, which can be used for the valuation model. Generally, the local tax records are a good starting point, but follow-up sampling and validation is important. Management of such an extensive data base requires empirical and statistical tools, people, and experience.

*Systematic Damages versus a Damaging Event* – In the former case, property value impacts may have occurred slowly over a period of time, and indeed property pricing in the affected area may not yet be fully at equilibrium. As such, identification of a control area is important. The control area should provide evidence of pricing in the class area as if the class area had never been affected. In other words, the control area or areas should be comparable to the class area. On the other hand, if the damage came from an unanticipated event, then transactions in the class area itself, prior to the event, may be illustrative of the actual unimpaired values.

**Damaged Markets May Not Be at Equilibrium** – While the characteristics of real estate market equilibrium are well developed in the literature, the phenomenon of market disruption is not so well defined. Even in neighborhoods where the damaging phenomenon (i.e. – contamination) has been long-lived and systematic, market prices may not be evidence of true underlying market values due to failure in the necessary conditions for market equilibrium to emerge. As a result, transaction prices in the affected area may be inconclusive evidence about either unimpaired values or damages.

**Stated Preference Models are Highly Useful** – Transaction prices are revealed preference, and in disequilibrium situations can be either misleading or wholly absent of any useful information. On the other hand, survey research, a stated preference model for examining utility by directly measuring market valuation of amenities or disamenities, has consistently proven helpful, particularly in a case like Murphy where market participants had to sort between two different disamenities (flooding versus an oil spill). Opponents of such methods tend to dredge up old cautions dating back to the period right after the Exxon Valdez Oil Spill, when appropriate methods for survey research were first being developed for real estate valuation. They also tend to confuse contingent valuation methods for natural resource preservation estimates (e.g. – willingness to pay models) with the methods used for measuring disamenity values (e.g. – willingness to accept models). Fortunately, the courts generally see through these smoke screens.

**Valuation is Usually Expressed as a Hedonic Model** – Generally, the output of a mass appraisal model takes on some hedonic form, consistent with a sales comparison approach. (Of course it's noteworthy that a sales adjustment grid is just a special case of a hedonic model). As a result, the output is statistically characterizable, consistent with a well-accepted array of peer-reviewed empirics, and easy to adapt to other aspects of the case.

**GIS is a Critically Important Tool** – If a picture may tell a thousand words, then a well-done map may tell the whole story. GIS is often just thought of as computer-driven cartography, but integration of GIS early into the data-gathering process provides a template for telling the whole story. Maps are just the visual representation, but spatial statistics, particularly when faced with a complex topography, can be extraordinarily valuable in guiding the analytical process and understanding the results.

**Theory and Empirics are Not Enough** – In any project, the appraiser is also a teacher, faced with the task of explaining a complex process (the appraisal analysis) to a courtroom full of lay people. This teacher role is doubly important in a large class-action project, since the appraiser also has to describe a mound of data in a clear, understandable fashion.

In one recent case, the opponents of class certification proposed performing individual appraisals on over 300,000 individual affected residences. We estimated that these appraisals alone would cost from \$100 million to \$200 million, and the judge would be forced to wade through a set of documents 4.5 million pages long. That would be a stack of paper roughly 1,500 feet high. Clearly, the mass appraisal process provides an efficient and robust alternative to such lunacy.

**Upcoming** – I'll be a featured speaker at the Integrated Wealth Management conference in New York City, September 10-12, sponsored by Institutional Investor magazine. The focus of the conference is on the high-net-worth portfolio, and the meetings are geared toward family office and portfolio managers. For more information, contact [www.iievents.com](http://www.iievents.com).

Also upcoming, in October, Seattle's famed Edgewater Hotel will play host to the semi-annual meetings of the Real Estate Counseling Group of America ([www.recga.com](http://www.recga.com)). Founded in 1970 by the late Dr. Bill Kinnard, through the years RECGA has been a leading source of cutting-edge thinking in real estate valuation methods and models.

If you have any questions, please contact me at [john@greenfieldadvisors.com](mailto:john@greenfieldadvisors.com)

John A. Kilpatrick, Ph.D.