REPRINTED WITH PERMISSION
FROM THE MORTGAGE
BANKERS ASSOCIATION (MBA)

# RANKING COMPS: ALL PROPERTY SALES ARE NOT CREATED EQUAL

by PHIL HUFF

**FASTER ISN'T ALWAYS BETTER.** That's a tough pill to swallow for a lot of folks, especially in this instant-gratification world. But if we, as an industry, don't respect the fact that certain aspects of our business are inherently more tortoise than hare, we just might end up in the same mess we've been struggling to get out of over the past several years.

I'll explain what I mean. We're seeing some pretty dramatic increases in home values in certain geographic areas across the country. In fact, in some areas, home values have increased 20 percent, 25 percent and even 30 percent in the past 12 to 18 months. That's a big jump in a short period of time.

In parts of California, Arizona and Florida, as well as regions like Las Vegas, home prices are "recovering" so quickly, it's tough to take the rebound at face value.

The industry, not to mention the country, is anxious for solid recovery in the housing market. That doesn't mean we should categorize the housing market's "quick turnaround" as a good thing. In fact, I'm not so sure we should even call the appreciation we're seeing a turnaround at all.

A turnaround implies that the appreciation is solid and will hold up over time. I'm not convinced the price increases we're seeing pass that test. When home values appreciate as fast as they have in certain areas, it's time to take a deeper look.

Before we go further, I want to clarify something. I'm not saying that home values shouldn't increase from the massive drop we saw several years ago. They should, and it's a sign of a normal, healthy economy for home prices to rise. However, I think we've gotten a skewed view of the time it takes for home values to appreciate. We're anxious for a recovery and we don't want to wait. We as a society, and as an industry, have become so accustomed to rocket-fueled changes that anything that takes time just seems old and outdated.

**The underlying reasons for price increases need to be looked at more closely.**

These days, we won't even wait for email when texting and instant messaging will do. We need our smartphones and tablets so we won't have to wait to get to a computer to check the score of the ballgame, or shop, or check our email.

We just don't like to wait. And thanks in large part to the progress that's been part of our lives for the past decade or two, we feel entitled to living every part of our lives in the express lane.

Given the pace of today's new normal, it's not surprising that many folks—consumers and mortgage industry professionals alike—see nothing odd about rapid and dramatic increases in home values, even though rapid and dramatic price increases were a primary contributor to the mortgage meltdown.

Maybe if we hadn't become so accustomed to moving from fast to faster, more people would have raised an eyebrow when property appreciation went from fast to exponentially exploding in the early part of the 2000s. But today, even after the mess the industry has been through, many people remain oblivious to the warning signs—including home prices appreciating too rapidly. And that's what needs to change.

I'm not saying all rapid increases in value are necessarily bad. What I am saying is that the underlying reasons for price increases need to be looked at more closely.

We need to assess what a property is truly worth, rather than what someone is willing to pay for it at one given moment. We need to determine if the appreciation is valid or if it's a short-term spike caused by some unusual—and perhaps temporary—factors.

There are a lot of factors that go into home appreciation. For one, there's the desirability of the region. The areas that are seeing rapid appreciation, in general, are places that people have always—and likely will always—want to live. Another factor is that, with improvements in the job market, there are probably

more people in a position to buy now than there were several years ago.

However, these two factors probably aren't enough to cause the 25 percent jumps some areas have seen over the last 12 months. So what is turbo-charging home appreciation, then?

One of the main ingredients in the industry's "Miracle Grow" is investors. The pattern is clear: More and more, homes are being bought up by investors. Those purchases have fueled much of the increase in both sales and home prices. And investors are frequently paying with cash, something the average first-time or move-up homebuyer isn't able to do.

Investors of all kinds have come into the market. There are institutional investors, smaller mom-and-pop operations, and individuals. Some are local to the areas where they're buying; others are investing nationwide. There is quite a bit of foreign money as well.

As diverse as the investor market is, however, investors do have one thing in common. They're liquid and ready to buy.

Consider this: All-cash sales accounted for one-third of real estate transactions in May, according to the existing-home sales report released by the Chicago-based National Association of Realtors® (NAR) in late June. Individual investors, who account for many cash sales, purchased 18 percent of homes in May, the NAR reported.

Why are investors flocking to the real estate market? Many are confident that the housing market has already bottomed out, and are buying up the inventory of houses in key markets—including distressed and foreclosed properties. Investors may be looking to flip the properties and make a quick profit. Or perhaps they are looking to rent them out indefinitely or while they wait for further price appreciation.

While home purchases by institutional and individual investors are helping prices to recover, in many cases they're squeezing out first-time and move-up homebuyers. This investor activity can skew home values considerably higher—something we're definitely seeing in markets like Las Vegas and parts of Florida.

With pockets flush with cash, investors can lure sellers and agents with faster, surer closings, as the average homebuyer is relegated to plodding along the way of the mortgage approval process. When a market gets hot, investors start bidding against each other, driving up prices in the process. What's more, because most investors purchase homes with cash, a lot of times they don't even bother with a traditional appraisal or home inspection. They pay a price that will work well with their objectives.

With an all-cash deal, there's no lender involved to bring recent comparable sales into the value discussion. And once the investor pays for the home, there's nothing stopping that new purchase price from throwing home values askew.

I have nothing against investors. I think they're a viable and important part of the housing market. I do, however, have an issue with the ripple effect caused by those investor-backed all-cash deals, particularly when the industry isn't taking the steps it needs to take to protect itself from the artificial inflation that can harm the housing market, the economy and the homebuyer.

When the house of cards falls down, the devastation isn't limited to one homeowner or one lender. It's more widespread. It can cover entire neighborhoods and numerous homeowners. And when it comes to the impact on companies in our industry, it's the small businesses that suffer, not the big banks. Once an all-cash deal is closed, the sales price becomes public record. So when Mr. and Mrs. Homebuyer want to purchase a home in the neighborhood, those all-cash sales are going to directly impact the price of their future home.

I'm sure some of you may want to remind me that traditionally, all-cash deals were considered a truer benchmark of a home's value; that because they didn't have an appraisal to stand in the way of what a buyer was willing to pay, they represented a truer value. I'm here to say that's not the case in today's market. These buyers may be driving prices up now, but is that appreciation sustainable? Will a neighborhood dominated by non-owner-occupied homes hold its value the way a neighborhood of owner-occupants will?

The mortgage meltdown occurred when lenders started lending more money on a property than it was really worth. We learned the hard way that we couldn't determine what a home was worth by figuring out what an amateur property flipper (often with no skin in the game) was willing to pay. We need to remember that if there were cracks in that reasoning back then, it certainly won't hold water now.

Only time will tell if the higher prices are truly sustainable. Prices could go even higher. Or a spike in interest rates could signal an end to the recent appreciation we've seen.

And that's why I believe that when we use comparable sales to determine a property's value, there should be a ranking system that would give less weight to investor-purchased and non-owner-occupied homes. In other words, we need to rank our comps; investors buy with different motivation than traditional homebuyers.

While we don't want to keep investors out of the market, we do want to recognize all-cash investor transactions for what they are. When determining a value for a property, traditional home sales should carry more weight than all-cash investor sales. All-cash sales should impact home values, not dictate them. We can't allow investor activity to determine home values across entire neighborhoods.

Fortunately, evaluating comps based on method of payment is no more difficult or time-consuming than evaluating for traditional factors such as age or distance from the subject property, assuming you use the right technology. In fact, this is one area where faster and better run hand-in-hand.

Technology can evaluate a virtually limitless number of factors—including how a property was purchased—on each and every comparable sale. It can essentially determine whether a sale is comparable or not. Plus, it can do it faster, more accurately and more consistently than a person ever could.

No one wants to be priced out of a market. Not owner-occupants, not investors. If we want the housing market to recover, we need to protect property values and keep lenders from lending more than a home is worth. When home values increase based on inorganic factors, we're basing home prices on illusion. And that's not good for anyone.

---

**Phil Huff** is chief executive officer of Aliso Viejo, California–based Platinum Data Solutions, a provider of technology and services that automate and standardize how appraisals and collateral are underwritten. He can be reached at phuff@platdata.com.