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RE: 2009 Call For Papers Award

Dear Jim,

Congratulations! It is my pleasure to notify you that your article, *Evaluating Stigma in Single Family Houses Beyond Paired Sales*, has placed second in the 2009 Call For Papers Competition.

The scoring was so close that you and Max Sanders, MAI tied for second place. Therefore, the first and second place prize money has been divided between both of you.

We are now pursuing publication of your paper to various publications, media outlets, and the Appraisal Institute. In addition, your paper will be posted to the North Texas Chapter's web site (www.ainorthtexas.org).

Thank you for your participation in the project, and the excellent paper you wrote.

Sincerely,

Ruth A. Kelton
Executive Director

/rk

Evaluating Stigma in Single Family Houses *Beyond Paired Sales*

Jim Goodrich, SRA, MAI

The term *Stigma* is sometimes used to denote market resistance to a property because of some adverse issue associated with the property itself or the surrounding neighborhood. Many times buyers and sellers are aware that a condition with a house may result in stigma, but are at a loss as to how to quantify that stigma. Appraisers sometimes are asked to quantify this stigma. But just how is that done? One such methodology often used to quantify stigma is the *paired sales technique*. Using this technique, the appraiser compares two or more sales which are reasonably similar to each other, but one or more has an issue which may result in stigma damage while the other(s) do not. After adjusting for other more easily quantifiable differences, the remaining differences are attributed to stigma. This technique has been taught in appraisal classes for years, and while it undoubtedly has value, it has serious limitations as well. The use of paired sales to quantify stigma can be problematic on several fronts:

1. Are there an adequate number of pairings? To be reliable, several pairs should be used with the outliers thrown out. In the real world obtaining several pairings is usually very difficult however.
2. Are the other adjustments easily quantifiable? When the pairings have only minor differences (living area, number of garage bays, etc.) it may be easy to isolate the damage to stigma. Again, in the real world, many times this is not the case.
3. Have all of the other differences been identified? Most residential appraisers use form reports to report their findings. The basic elements of comparison are listed in the first column and for most non-complex mortgage type assignments this is sufficient. However, many times there are other, harder to quantify, elements of comparison. For example, did the house which had a recently repaired foundation sell lower than other properties because of stigma due to a repaired foundation or was it due to one of the following:
 - The upstairs master bedroom which the market did not accept
 - The fact that the pool took up the entire back yard
 - It had a strong smoke or other odor
 - The seller just was more motivated in a quick closing than top dollar?

So, with the limitations in using paired sales, what other methodologies can be employed when attempting to evaluate stigma in a residential property?

There are two additional methodologies:

1. Survey experienced Realtors to get their reactions to the issue which may involve stigma. Realtors are many times very influential in formulating buyer behavior. If the responses to a well written survey given to a good sample of Realtors correlate with the conclusions from the paired sales analysis, great. If not, it is likely that there is a significant flaw in the paired sales analysis.
2. Finally, if a paired sales analysis is used, the analyst should temper the conclusions if necessary with the judgment and experience of a seasoned appraiser or Realtor. Seldom are two cases identical and results may need some modification. For example, a paired sales analysis may show a \$300,000 house which was 15 years old and sold in a strong seller's market sold at a 5% discount due to a \$20,000 recent foundation repair. However, the 5% discount may need to be modified when applied to the subject, a \$400,000 house 5 years old with \$20,000 of foundation work selling in a much weaker buyer's market two years later.

Indeed there are additional factors which deserve consideration and may be used to modify the findings from either the paired sales analysis or agent survey. Some of those are listed below. There may be more.

1. **The unaffected value of the house.** Typically, the more expensive the house, the higher the discount. Buyers of more expensive houses typically have more options for other houses and neighborhoods. They can be more selective as a rule. These buyers are typically more educated and aware of the factors which adversely affect property values.
2. **The age of the house.** Generally, the newer the house, the higher the discount.
3. **The cost of the repairs.** Typically, the more costly the repairs, the higher the discount.
4. **The uniqueness of the subject or the difficulty in replicating the subject.** Typically, the more unique (site and/or improvements) the subject is, the lower the discount since it is not easily replicated.
5. **The strength of the market.** Typically, when the market is weak and it is a buyer's market, the discounts are higher. Conversely, when the market is very strong (a seller's market), buyers have limited choices and discounts tend to be lower.
6. **Nature of the defect and the likelihood of reoccurrence.** When the issue is easily understood (such as a foundation problem caused by poor fill on a cut and fill lot), the discount tends to be smaller as opposed to a more complicated issue (a foundation problem caused by an underground spring).

The likelihood of reoccurrence is of paramount concern for buyers. When the likelihood of reoccurrence is low, this translates into a low discount and conversely, when it is high or uncertain, a higher discount is indicated.

In conclusion, when evaluating stigma, the paired sales technique is a starting point, if paired sales are available in sufficient quantities. But a proper analysis doesn't end there. Agent interviews can be very helpful in determining if the paired sales analysis is pointing in the right direction and they can be used in the absence of adequate paired sales. Finally, since each case of potential stigma is unique, the analyst should modify the conclusion from the paired sales analysis if appropriate.