

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

A. Appraisal Organizations

10. 1978-1979

- b. "Site Analysis and Market Feasibility",
SREA, July 17, 1978

SITE ANALYSIS AND MARKET FEASIBILITY
Society of Real Estate Appraisers
1978 International Conference, Toronto, Canada
Monday, July 17, 1978

*Appears to be
missing some
parts
See V. A. M. a.,
for more complete
out lines*

Presented by Prof. James A. Graaskamp, CRE, SREA
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- I. Basic Concepts
 - A. Changing Concept of "Highest and Best Use" to "Most Probable Use"
 - B. Most Probable Use Leads to Most Probable Price
 - C. Most Probable Use Suggests Most Probable Buyer Profile
 - D. Project Feasibility Compared to Financial Viability
 - E. An Appraisal is a Forecast of Property Productivity and Market Behavior
 - F. An Appraisal is a Feasibility Study for A Stereotyped Client
- II. Property Analysis to Determine Alternative Uses
 - A. Systematic Components of Property Analysis
 - B. Physical (static) Attribute Analysis
 - C. Market Implications of Physical Attributes
 - D. Legal-Political Attributes of Site Use Control
 - E. Structural Improvements and Building Codes
 - F. Preliminary Identification of Alternative Uses and Physical and Legal Attributes
 - G. Linkage Attributes of Site and Structure to Surrounding Features, Social Structure, Economic Structure, etc.
 - H. Dynamic Attributes of Site and Structure
 - I. Environmental Impact Attributes of Site and Structure
 - J. Questions to Focus Appraiser Selection Alternative Uses
 - K. Determination of Plausible Alternative Uses - Scenarios
 - L. Ranking of Scenarios for Economic Power
 - M. Economic Power has to be Qualified in Terms of Marketing Risks and Capital Budgeting Risks of Each of the Alternative Uses Before Alternative Uses Can be Ranked in Summary Fashion as in Exhibit 6.
 1. Note that Exhibit 6 integrates the basis elements of preliminary feasibility analysis
 2. Remaining discussion will emphasize market risk which is the primary cause of misleading appraisal conclusions

III. Methods of Market Analysis For Appraisal

- A. Effective Demand for Real Estate Space
- B. Type of Buyer for Property
- C. Real Estate Market Analysis Defined
- D. Merchandising Data Defined
- E. Market Comparison Data
- F. Market Segmentation
- G. Appraisal and the Competitive Standard vs. Competitive Edge
- H. The Front Door Approach for Measuring Entrepreneurial Contribution

I. Basic Concepts

- A. The appraiser and the feasibility analyst have recently begun to merge their analytical approaches as revealed by the striking redefinition of the fundamental concept of appraisal, specifically the concept of highest and best use.
1. Highest and best use concept -
"A valuation concept that can be applied to either the land or improvements. It normally is used to mean that use of a parcel of land (without regard to any improvements upon it) that will maximize the owner's wealth by being the most profitable use of the land. The concept of highest and best use can also be applied to a property which has some improvements upon it that have a remaining economic life. In this context, highest and best use can refer to that use of the existing improvements which is most profitable to the owner. It is possible to have two different highest and best uses for the same property: one for the land ignoring the improvements; and another that recognizes the presence of the improvements."
P. 57, Real Estate Appraisal Principles and Terminology, Second Edition, Society of Real Estate Appraisers 1971
 2. "Highest and Best Use: That reasonable and probable use that will support the highest present value, as defined, as of the effective date of the appraisal. Alternatively, that use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and which results in highest land value. The definition immediately above applies specifically to the highest and best use of land. It is to be recognized that in cases where a site has existing improvements on it, the highest and best use may very well be determined to be different from the existing use. The existing use will continue, however, unless and until land value in its highest and best use exceeds the total value of the property in its existing use. Implied within these definitions is recognition of the contribution of that specific use to community environment or to community development goals in addition to wealth maximization of individual property owners. Also implied is that the determination of highest and best use results from the appraisers judgment and analytical skill, i.e., that the determined from analysis represents an opinion, not a fact to be found. In appraisal practice, the concept of highest and best use represents the premise upon which value is based. In the context of most probable selling price (market value) another appropriate term to reflect highest and best use would be most probable use. In the context of investment value an alternative term would be most profitable use."
Real Estate Appraisal Terminology, Edited by Byrl N. Boyce, Ph.D. SRPA, Ballinger Publishing Co., Cambridge, Mass. 1975

3. At Wisconsin we use two concepts, one representing the ideal solution and one representing the most practical current solution.
 - a. The most fitting use is that use which is the optimal reconciliation of effective consumer demand, the cost of production, and the fiscal and environmental impact on third parties. Reconciliation involves financial impact analysis on 'who pays' and 'who benefits' - thus the rash of debate on how to do impact studies.
 - b. The most probable use will be something less than the most fitting use depending on topical constraints imposed by current political factors, the state of real estate technology, and short term solvency pressures on consumer, producer, or public agency. In short, the appraiser must demonstrate reasonable fit to land use controls, community politics, technical design constraints, effective demand, and viable cash flows for the project.

- B. The term 'most probable price' avoids the arrogance of 'highest and best use' as well as the implication of absolute certainty as to the appraisal conclusion. Moreover it recognizes that pure economic logic for the property owner will be limited by the impact on community as perceived by land use administrators and the impact on investment risk as perceived by potential investors in the market.
 1. An appraisal is first a feasibility of a site in search of a use;
 2. Alternative uses suggest alternative tenants and/or buyers
 3. Appraisal must forecast what the most probable buyer will pay to benefit from the most probable use

- C. Most probable use immediately reduces the market to a particular segment of space users and suggests both the tenancy and the investor group who will be interested.
 1. Proper market segmentation of possible tenants determines the degree of monopoly pricing and stabilized revenues which the project may enjoy.
 2. Proper segmentation of the most probable buyer leads to selection of relevant comparables or in the absence of sales data, relevant assumptions on how the most probable buyer might behave in pricing the property.

- D. Feasibility is a non-financial concept of fitting a real estate solution and service package to a context of public priorities and customer needs.
 1. The project must fit the general market, a specific consumer group, the environmental limits of the land, the nature of existing usable improvements, legal and political controls imposed by the public, the need for compatibility with the total and natural man-made environment, and the limits of physical design construction.

2. Correct identification of a space-time unit - a room night, a clinic day, an event day, or a design crowd per day.
 3. Identification as to who really signs the check for rent or purchase.
 4. Correct identification of linkages to generators of demand or dynamic site attributes.
- D. --- For example, consider measuring of demand for an ice hockey arena by a private investor. With a little research one would quickly learn that:
1. 85% of all prime time is used by youth hockey teams
 2. Youth hockey teams involve boys aged 6-15
 3. Ice time is leased to each team in each age group
 4. Most teams have two hours of practice per each 1-hour game
 5. There is one game per week average in a 34 week season
 6. Hockey equipment costs \$100-200 per boy
 7. Households with less than \$8,000 income cannot often afford to participate
- E. The supply of ice hockey time might be 16 hours a day x 360 days or 5,760 ice hours. If the breakeven point is 3,000 hours at \$20/hour one can then test the feasibility by determining the number of teams in an area which need indoor ice and the potential for additional teams in the area. If each team need 3 hours a week for 34 weeks, you need about 30 ice hockey teams to break even. Then you can begin to look through marginal revenue from figure skaters, family skating, refreshment sales, and perhaps equipment rental and sales.
- F. Many types of real estate require multiple demand models for different segments of the market which require similar facilities, for example, a motel demand model might include sub-models for:
1. Summer vacations
 2. Business meetings
 3. Transient travelers
 4. Snowmobile users
 5. Snow skiers, both cross country and chuishers
 6. The weekend vacationer
- G. Several years ago we did a student housing study which made possible the identification of 22 different sub-sections in the student housing market in terms of location, type of facility, and price related to different student classifications.
- III. Having identified a sub-market segment the next objective is to survey that group to find out how many would move if there were a product to fit their needs. Even if you have a better mousetrap there are some mice who are too lazy to try it out or are previously committed by lease or purchase to another location.
- A. The market analyst will first try to determine how many in a certain market are buying lots or renting apartments or whatever per year and this is called an absorption rate.
- B. The second problem is to determine how many of those on the move can be captured for a specific project and this is the capture rate.
1. For example, there may have been 200 single family lot sales in the Madison west side in a given year - which measures the

- the absorption of single family lots.
2. If a developer wants to sell 20 lots a year in his subdivision he needs to capture at least 10% of those absorbed, assuming conditions are right to maintain the 200 unit absorption rate.
- C. To have people consider his offering he must correctly define the competitive standard of feature expected by all those in a particular market. To be confident of capturing his 10% efficiently, he must look for some particular competitive edge.
- D. A competitive edge can be discovered by researching through survey prospective customers to discover:
1. An anxiety or dissatisfaction about their present location which is sufficient to trigger a move if someone can remove the anxiety or element of dissatisfaction.
 2. A sub-group not being served at all by existing alternatives - a gap in the supply.
 3. By creating a unique product for which there was no demand until it was displayed, such as Disneyland.
 4. It is easiest to find a dissatisfaction, more difficult to define a unmet gap in the competitive supply, and very rare to invest something for which there was no real measure of need until demand was created for it.
- E. REal estate is just beginning to discover the use of consumer research in the development process and it is appalling how lenders and developers assume a market exists for any product simply because a previous similar building was successfully marketed.
1. Banks will require insurance costing 2-3% of project costs each year in case it should burn down without spending a dime to discover if it will rent up.
 2. A few successful developers employ clinical psychologists to analyze motivation and develop subconscious appeals to different buyer groups.
- IV. Some of the best market research relative to consumer behavior and real estate psychology is being done for contemporary shopping center development and recreational properties.
- A. Consider a shopping center design and the subtleties built into the structure.
1. Ease of approach with a minimum number of left turns all of which are controlled.
 2. Perception from a distance of shopping center layout and location of major tenant.
 3. Number of lanes needed for moving 2500 cars an hour on and off the premises.
 4. Perimeter loop circulation.
 5. Traffic lane by buildings is deliberately cornered and otherwise impeded to reduce speed to a minimum and discourage use for circulation.
 6. Free standing perimeter structures for traffic generators like drive-in banks, gas stations, and TVA outlets which may also have different hours from those of the center due to regulation or nature of business. (movies, and bars)

- B. The change in shopping center materials from industrial to domestic
 - 1. Scale and texture of material
 - 2. Smaller masses of material
 - 3. Softening of floors with carpeting
 - 4. Illumination of claustrophobic low ceilings
 - 5. Auditory gauze of fountains

- C. The elimination of psychological barriers inherent in:
 - 1. Store fronts and closed doors
 - 2. Vacant store fronts
 - 3. Closed enterprises (standard hours, minimum staff and minimum inventory requirements)
 - 4. Grouping shops to stimulate horizontal and vertical movement

- D. Toughest psychological problem in a shopping center is motivating people to move vertically by stair, elevator, ramp, or escalator.
 - 1. Stores used for checkpoints - candy shops
 - 2. Motivators such as live music or the scent of fresh baked cinnamon rolls
 - 3. Softening the change with partial changes in level with ramps and terraces.

- V. Marketing is a basic determinant of every time cycle in real estate:
 - A. Project concepts must be marketed to government planners and legislative groups.
 - B. Space must be marketed to tenants
 - C. Complex must be marketed to ultimate consumer
 - D. Property management must try to hold good tenants and attract new ones
 - E. As project ages the marketing strategy changes in a constant trade-off between restyling to maintain rents as opposed to price cutting to stabilize occupancy.