

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

F. Miscellaneous Professional Associations

14. "A Business Forecast for 1983", presented to
NAIOP, November 16, year not given

NAIOP
November 16 Seminar
Radisson South Hotel

A BUSINESS FORECAST FOR 1983

I. Introduction

- A. Enthusiasm of current students for the Minneapolis real estate market as a result of our field trip on November 5 and 6, including visits with United, Opus, Boisclair, John Kerwin, Chuck Krussell, Bob Engstrom as well as all the saloons between Grandma's, St. Anthony's, and Minnetonka.
- B. And our former students are equally excited about the professional opportunity presented by NAIOP.
- C. Thus I am very flattered to have been invited to initiate your seminar for today.
- D. I would like to structure my remarks around the following topics:
 - 1. Some basic premises for the economy and enterprise priorities
 - 2. The evolution of real estate development strategies
 - 3. The evolution of strategic concerns of real estate educators and students

II. A Business Forecast and Enterprise Priorities

- A. Unlike the recession of the mid-70's there is risk capital available at a price and interest rates will fall slightly further for a time.
 - 1. According to the Wall Street Journal on the 14th, the federal reserve officials took a hard line in pursuit of 3 or 4% inflation and thus higher interest costs as part of monetary policy.
 - 2. Others doubt that the fed will be able to resist political pressure to take inflation rather than holding ^{down} the volume of money, therefore causing costs and prices to rise. There have been more price increases than decreases in the last 15 months in basic stuff like chemicals, steels, and building materials are showing some price increases.
- B. Forecasting in turbulent times is difficult in terms of the outcome but is predictable in terms of the risk management moves of each enterprise which is a potential tenant or customer for your service.
- C. Turbulent times require a return to fundamentals housing an activity to increase its efficiency.
- D. In turbulent times every enterprise must emphasize liquidity, productivity, and coverage of future costs.
- E. Manage for liquidity not earnings. Stock market price/earnings ratios are low because the stock markets value cash flow. Inflation has distorted sales prices and costs so that liquidity, unlike reported earnings, is a more reliable measure of financial stability and the balance sheet rather than the P & L sheet is the sign of financial

strength. How much working capital does a business need to survive 120 day panic.

- F. Pursuit of liquidity for the next ten years suggests tenants:
1. Will use less space per person
 2. Fewer tenant improvements per employee
 3. Shorter term leases with more flexible assignment
 4. Refusal to invest in tenant improvements
- G. Survival includes increasing activity on four resources - capital, crucial physical assets, time and knowledge.
1. The basic management question is "What do we in the organization do? What do I do that helps you in doing what you are being paid for?"
 2. Those who have specialized in medical buildings have demonstrated how to sell buildings by improving the efficiency and the production of the office staff.
 3. To merchandise office space today, you will have to reduce tenant improvement costs so they are funded by the rents and improve tenant efficiency so that the net cost in terms of liquidity is less. This may mean more specialized spaces for storage, more centralization of computer, copy, or library resources.
- H. Drucker states there are not profits, there are only deferred costs of staying in business. The minimum cost of staying in business is the cost of capital. No longer sufficient enough to cover costs of the past, costs of the accounting model recognizing costs already paid out.
- I. Revenues in the future are difficult to predict - will they inflate 5-8% or flatten out due to over-building or under-leasing. At the same time, costs of operation can be predicted with greater accuracy because a large portion are deferred costs rather future costs.
1. Firms must double the productivity of capital within the next 8-10 years - an annual increase of about 7½%.
 2. They must be able to produce 50% more within the next 8-10 years without increasing the number of people employed, or an increase in productivity of about 4%.
- III. In that light it is useful to review basic development strategies and their implications on industrial building products.
- A. Buildings to house an activity and contribute to productivity and efficiency of a larger system or process.
 - B. Building to create a captive customer for services
 - C. Building to create a long term commodity straddle
 - D. Building to create a surrogate for an indexed bond (portfolio theory)
 - E. Building to create warrants to small business investment opportunities (overage rents, roll-overs, leasebacks, buybacks, equity kickers).

- F. Building to create vehicles for tax sheltered accumulation and distribution of wealth.
 - G. Building a high silhouette for personal or corporate power enhancement
 - H. In any of the above timing is critical and will have to reflect the new business cycle reality of short term cycles and as well as the need for liquidity and cost control.
 - 1. The business cycle is about three years in duration. One must plan the projects at the high point, build at the low point, and market on the rise.
 - 2. Short term absorption requires smaller modules - 50,000 sq. ft. rather than 200 clustered around common amenities.
 - 3. Low rise versus high rise since land is cheaper than structure and energy.
 - 4. In the absence of growth the competitive edge will be lower front end costs to the tenant to protect his liquidity as well as yours.
 - 5. More tenant participation and ownership to reduce the deferred cost of leasing.
- IV. Having just returned from a conclave of real estate educators, I can report that there are a number of significant trends toward more equitable treatment of real estate at the university level.
- A. Universities are recognizing real estate as a major industry which has both major social and economic impacts and effective demand for university resources.
 - B. Universities are balkanized into exclusive specialities but real estate educators and the industry are beginning to recognize the need for multidisciplinary renaissance men for real estate. The ULI is sponsoring the introduction of real estate courses into schools of planning, physical design and public administration since these schools produce the majority of real estate regulators. At the same time the ULI is using its education budget to cross pollinate soft issues with the tough disciplines of money in the business school or engineering.
 - C. A new trend is to require real estate analysis of all students rather than just those expecting a career in real estate. In the 1960's insurance education changed from teaching the professional to teaching the consumer how to make insurance decisions; real estate is just beginning to teach business managers how to make real estate decisions. Educated consumers will prefer professionally trained real estate services.
 - D. The industry is also beginning to realize it cannot and should not provide all of its own inbred education.
 - 1. Eight midwest shopping center development companies and the ULI have commissioned the University of Wisconsin School of Business to develop a middle management training program consisting of two- to three-day modules for both overview courses for employees who are over specialized and new to the industry to highly technical courses for experienced people requiring a specific technique.

2. The appraisal societies are developing plans to turn over all course responsibility to university-level programs.
 3. Real estate should consider creation of an American college of real estate, not unlike the model created by the insurance industry in order to both create a high standard for basic course materials and to create an MS program approved by ASCB requiring a minimum number of weeks on campus followed by a year of applied technique problems on the job followed by a month of case comparison back on campus.
 4. Industry trade groups such as yours have discovered that participation in field trips, visiting lectures on campus, and summer internships provide the prospective real estate recruit with images to which he can relate and identify a role - a critical step in winning student interest in a particular field.
- E. Over the years our program keeps adapting to the stated needs of prospective employers and the opportunities for employment. This year at Wisconsin we are adding:
1. A micro-computer lab of IBM personals so that students will understand Visicalc, word processing, and economics of computer alternatives as well as the operating procedures for timesharing on a main frame.
 2. Courses have been introduced on corporate real estate administration for private and public agencies as well as the administration of construction projects.
- F. Just as the industry must respect liquidity, productivity, and coverage of future costs, so must the student find methods to hold down the costs of current education to reduce future loan costs. Therefore there should be many opportunities to hire students as interns while still in school so that costs of education are reduced. They possess many skills which they can trade for a variety of experiences.