JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

G. Miscellaneous Company Lectures

6. "Real Estate Seminar", sponsored by First Chicago Corporation, November 6, 1973

REAL ESTATE SEMINAR

First Chicago Corporation

Livingston House, Lake Forest, Illinois

November 6, 1973

Presented by Professor James A. Graaskamp

I. Some Basic Real Estate Attributes and Definitions

A. A space-time interface of land (public resource), people (cultural preference) and artifacts (improvements)

B. Convert neutral forces to identified decision makers - consumer, producer, and society with the planner as the arbitrator.

C. Some implications of this definition of the Real Estate process:
1. Land is an exhaustible resource and therefore a public utility.
2. Business of Real Estate is the process of converting space-time to money-time.
3. Real Estate Business is a service industry using manufactured products.
4. The space-time service product is the social terrarium and therefore a public utility.
5. The money not the Real Estate is the only private property.

D. The legal concept of private Real Estate
1. Private property the residual after subtracting public rights.
2. In a service industry there is no ownership of a product - only control of a customer.
3. Twentieth Century Real Estate equity is a degree to which one controls disbursements of a captive customer.

E. Feasibility is a nonfinancial concept of matching artifact and service to a context of public priorities and customer needs.

F. Real Estate investment is "buying" a set of financial assumptions derivative of a feasible solution.

G. Risk is the variance between assumptions taken and realizations achieved, between proforma estimates and P and L realized.

II. The Systems Approach to Management and Feasibility Analysis

A. A general concept of the management process converted to Real Estate semantics

Column 1	Column 2
Values, objectives, policy	Strategic format
Search for opportunity alternatives	Market trend analysis
Selection of an opportunity	Merchandising target with monopoly character
Program to capture opportunity	Legal-political constraints
	Ethical-aesthetic constraints
	Physical-technical constraints
	Financial constraints
Construction of program	Project Development
Operation of program	Property Management
Monitoring and feedback	Real Estate research

B. Strategic format for developer-investor taking an active management role
   1. Development role assumed (see attached mimeos)
   2. Major objective
   3. Key determinants of economic success
   4. Elements of cost/price relationship where developer has some control
   5. Elements of greatest variance or slippage
   6. Devices for minimizing maximum potential loss
   7. Devices for maximizing control
   8. Developer skills or personnel of critical importance
   9. Marginal components of cost/price/profit centers

C. Strategic format for the passive investor (ie. mortgage lender)
   1. Pleasure, pain and bail-out theory of mortgage finance
   2. Incentives and the time line of financial events
   3. The ethical-aesthetic constraint for the lender

III. Real Estate Finance is the Conversion of Space-Time Events to Money-Time Events in Terms of Outlays and Receipts.

A. Elements of a project financial model
   1. Time line of financial events for investor
   2. Profit centers available within time line
   3. Capital budget
   4. Operating pattern of receipts and expenditures
   5. Financing package
   6. Basic tax strategy
   7. Selected measures of yield comparison
   8. Selected measures of risk qualification

B. A basic cash flow model defines one alternative outcome
   1. Analysis searches for capacity for variance (see CLU mimeo)
   2. Decisions relate to acceptable degree of variance
   3. Front door and back door approach to financial feasibility

C. Selected measures of risk
   1. Expense and default ratios
   2. Ratio of overruns to stand-by capacity
   3. Payback ratios

D. Selected measures of yield
   1. Retrospective vs. prospective (average vs. marginal rates)
   2. Cash on cash
   3. Definition of the profit center frame
   4. Problems in defining long term average yield
   5. High yields are made in the short run as a return to management not capital.

E. Cash flow density models as an analytical tool for lenders (see Pyhrr mimeo)

IV. The Risk Management Approach to Feasibility and Packaging

A. Identification of elements of variance in assumptions
B. Estimating consequences to determine significant exposures to loss

C. Selection of a risk management device meeting decision maker policies
   1. Avoid
   2. Reduction of the unknown through research
   3. Reduction of variance forecast errors through combination
   4. Reduction in severity by limits on scale
   5. Shift of risk by contract
   6. Limitation of risk of maximum loss by contract
   7. Hedging of time trends by contract

D. Distinguishing between static risks and dynamic risks for purposes of control
   1. Static risks can only cause a loss and should be controlled mechanically.
   2. Dynamic risks can produce a profit or a loss and should be controlled through management incentives.

E. Monopoly is a major real estate risk management device
   1. Profiling the merchandising target
   2. Naming the prospect
   3. Tailoring the product
   4. Flexibility for recycling to another target

V. Implication of Current Trends Affecting Real Estate

   A. Control of new land development plus control of auto transit means recycling of intown sites.
   B. Energy crisis will redefine linkages to utilities regionally as well as locally.
   C. Energy crisis will alter expansive character of current leisure time marketing to reduce dependency on hardware.
   D. Energy crisis will mean redefinition of the auto and all auto dependent forms of land use.
   E. Trend toward condominium and homeowners association means success of hardware is tied directly to success of group organization software.
   F. As real estate becomes recognized as a service product, fee ownership declines in significance.

1	LAND CONTROL	SALE OF UNIMPROVED PROPERTY	SALE OF UNIMPROVED PROPERTY WITH SOME DEVELOPMENT PLANS & APPROVALS	SALE OF IMPROVED LOTS OR BUILDING PADS TO BUILDER/ DEVELOPER OR FINAL USER	SALE OF VARIOUS BUILDING IMPROVEMENT TO INVESTORS / PUBLIC HOUSING AUTHORITIES / FINAL USERS
DEVELOPMENT ROLE ASSUMED	LAND SPECULATION simply hold or "land bank" interesting property	"PACKAGING" DEALS conceptualize development plan or land use --- acquire broader public approvals such as zoning -- perhaps include arranging financing or structuring the deal.	LAND DEVELOPER undertake and complete land development phase --- install roads, utilities, common improvements, survey and subdivide for sale.	BUILDING DEVELOPER undertake and complete various building improvements --- offer and consummate sales.	PROPERTY MANAGER "season" income stream, share mgmnt. income appreciation
MAJOR OBJECTIVE	capture the "spread" between raw land purchase cost and wholesale price created by "macro" market trends — anticipate major trends.	create a spread or add value by bringing an important trend to focus on a specific site or into focus as a potential project. Shift buyer's perception through description, analysis, various "enabling" factors	create a spread or add value by virtue of completing improvements that further shift buyer's perception of utility and make sites available for construction	create a spread or add value through completion of building improvements that further shift buyer's perception of utility/value and make buildings available for occupancy/ownership	manage the income stream efficiently to score operating surpluses & establish value
KEY DETERMINANTS OF ECONOMIC SUCCESS	1) ability to accurately forecast a trend 2) ability to select and control attractive land	1) ability to complete a convincing study of economic feasibility 2) ability to obtain key public approvals in timely fashion 3) ability to perform at "conceptual selling" --- conceiving deals and convincing buyers of the eminent utility and value of the land	1) ability to efficiently complete various improvements 2) ability to efficiently (and tastefully) market improved building sites	1) ability to efficiently complete various building improvements 2) ability to efficiently (and	1) ability to create a spread between operating expenses and revenues through efficient mgmnt.
THOSE ELEMENTS OF THE COST / PRICE RELATIONSHIP OVER WHICH THE DEVELOPER HAS SOME CONTROL (major tasks to be completed or costs to be incurred --- specific problems of estimating, analysis, evaluation)	1) land control 2) carrying costs 3) legal expenses 4) appraisal ("as is" or liquidation value — a simple forecast of resale value)	1) feasibility determination: · site or physical determinants · regulatory or political factors · market determinants · "reappraisal" or investment valuation (what's the deal worth if we do it VS. what's the deal worth if we get out now?) 2) obtain basic public approvals (zoning) 3) arrangement of financing (takeout) 4) legal costs · public approval - related · deal structure/conveyance - related 5) additional carrying costs	1) obtain specific public approvals 2) negotiate and secure various contracts within budget 3) stage/manage/control development on time, within budget & quality standards 4) arrange interim financing - land development loan 5) stage/manage/control the marketing of improved lots or building sites 6) obtain sales approval, registration, etc.	1) obtain construction permits & approvals 2) negotiate and secure various contracts within budget 3) stage/manage/control construction effort on time, within budget & quality standards 4) arrange interim and long-term financing (construction loan and mortgage) 5) stage/manage/control the marketing of various building improvements 6) obtain sales approval, registration, etc.	1) operating expenses 2) occupancy (market rents)?

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ELEMENTS OF RISK INCURRED (or places where "slippage" may occur)	generally increasing complexity, more internal variables to control, expanding management burden					
	increasing image or credibility exposure					
	1 various factors or events never materialize in a way that makes the property an attractive candidate for development 2 complete lack of analysis, planning, or other preparation for development means that property is never perceived as attractive or ready for development.	1 costs of undertaking and completing above-listed analyses, estimates (esp. if feasibility study produces unattractive outcome and development is dropped) 2 development cost shifts 3 shifts in market situation (new market or competitive standard, general economic conditions) 4 regulatory standards change 5 cost or availability of financing shifts 6 reliability of various estimates & analyses 7 lose control of land or development situation 8 public approvals denied, delayed, or conditioned	1 delay in obtaining public approvals, attachment of conditions to approval, high costs of soliciting approval, or denial 2 delay in completion of improvements 3 cost over-run on improvements 4 poor quality of finished improvements or related adverse side effects (e.g., class action suits) 5 failure to carefully estimate TOTAL cost of improvements (installation, operation/mntnce., assurances) 6 lagging market performance · slowed pace of sales · lower price of units offered · higher cost of sales	1 delay in obtaining permits 2 delay in completion of improvements 3 cost over-run on improvements 4 poor quality of finished improvements or related adverse effects (e.g., call-backs, class actions) 5 lagging market performance · slowed pace of sales · lower price of units offered · higher cost of sales	
DEVICES FOR MINIMIZING EXPOSURE, ENHANCING CONTROL						

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DEVELOPER TRAITS LIKELY TO BE STRONG DETERMINANTS OF PERFORMANCE (Key skills)	foresight, anticipation, imagination, ability to quickly size up a situation and act decisively, ability to handle land control devices and financing with ingenuity FORESIGHT, INGENUITY	conceptual ability/imagination, analytical skills/estimating ability, project evaluation/judgment, "conceptual" selling ability/persuasion structuring deals IMAGINATION, CONVINCING ANALYSIS & DESCRIPTION, SALE	ability to generate reliable estimates, negotiate and fix development costs, stage-manage-control development effort, stage-manage-control marketing effort FINALIZE OR CLOSE, EXECUTE/EXPEDITE, CONTROL, SELL	ability to generate reliable estimates and fix construction costs, stage-manage-control construction effort, stage-manage-control marketing effort SAME AS PREVIOUS BLOCK		
COMPONENTS OF COST/PRICE (what's the deal worth if we do it vs. what's the liquidation value of the deal if we get out now?)	· profit to landholder preparation { · appraisal (resale forecast) · legal fees } · land control	· profit to packager preparation { · financing commitment · structuring the deal · acquisition of public approvals · project evaluation/display } · land control	· land developer's fee implementation { · promotion/marketing · additional financing · cost of improvements } preparation { · financing commitment · structuring the deal · acquisition of public approvals · project evaluation/display } · land control	· developer's fee · implementation & sale of building improvements · preparation for building improvements · implementation of land development · preparation for land development · land control		

TRENDS?

ratio of value-added to costs is diminishing as the composite cost base builds up? — incremental cost vs. profit centers

PASSIVE ROLE — ACTIVE ROLE

entrepreneurial-intensive roles — management-intensive roles

time necessary to capture profit is diminishing (holding period shortens) and this affects capital turnover? How about "entry fee" or amount of capital needed, however?

more and more internal variables to control; more complex deals, management burden or time requirements?

Also, Graaskamp's idea on increasing "image" or credibility exposure — what are the consequences of taking [illegible] deal and failing — a lingering risk even if you escape with the dolla-