

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

G. Miscellaneous Company Lectures

11. Notes taken from speech to Prudential Insurance Company, March 20, 1987; focuses on the Wisconsin approach to real estate analysis (tapes of the speech at Landmark Research, Inc. - goal is to transcribe tapes)

James A. Graaskamp
Presentation to Prudential Insurance Company
March 20, 1987

The Real Estate Appraisal Process

The Wisconsin Real Estate Program¹ is well known nationally for its emphasis on the interaction of private sector and public sector viewpoints for real estate planning and development. We have developed models, including computer simulations, that transform development and private sector profit analysis into scenarios for tax bases and equilibrium conditions reflecting public sector interests.

Appraisal values are benchmarks from which an "issue" is decided. In other words, the determination of appraisal values cannot be seen in a vacuum - there is a context or particular problem to which the appraisal value is the answer. Many of the failures of the appraisal process really reflect failure on the part of those who are buying appraisal services to ask precise enough questions in order to get better answers to the specific problem.

In order to sharpen the focus of the real estate appraisal problem, four specific questions must be answered. These are:

1. What is the appropriate definition of value?

2. What property interests must be determined?
3. What are the ground rules or assumptions underlying the exercise?
4. What ground rules must exist for the protocols or arrangements to maintain appraisal independence?

As an example, we represented the Quakerbridge Mall in Princeton Township before the local tax assessor board. The issue before the tax board was to what extent the value attached to the Quakerbridge Mall represented land and building values. Such land and building values were taxable under the local property tax, but values attached to the development which were not land and property values were not taxable. We argued that a significant part of the value of the Quakerbridge development represented a "franchise" among merchants at the Quakerbridge Mall to jointly retail products and that the value of this franchise was not taxable under the local property tax code.

On the other hand, the local tax office argued that a \$15 per square foot value for Quakerbridge Mall property compared to a \$9 rental in surrounding shopping malls largely reflected a monopoly rent position for the superior location of the Quakerbridge Mall. We were successful in getting the local tax board to recognize in principle the franchise argument. As a general matter, an outgrowth of Federal income tax reform is that the welfare burden has been squarely pushed back to the local level. As a result, I

expect real estate taxes to rise in many areas of the country where the communities are sensitive to welfare type issues.

In looking at different property interests in a particular context, the problem is to determine the productivity attributes of the property in question. How are these different attributes relevant to the evaluation of the overall property? For example, in the case of the Quakerbridge Mall development, the developers had electric generators which they owned and used to sell electrical power to the tenants on the property. For purposes of the tax assessor's office, the capitalized value of this income was not real estate value taxable under the local tax codes.

In looking at the productivity attributes of properties, one has to consider the alternative uses or courses of action for an available property. This is an area that in standard appraisal theory receives very little attention. I would distinguish between several levels of analysis in addressing this question.

First, there is the physical or static uses of the property in its current state of development. Second, there is the legal framework or zoning framework within which the property currently exists. Here please distinguish between the law itself and the way in which the law is administered in a particular political context. Specifically, 90% of the law is "the arrogance with which it is administered" and only 10% is the law itself. The third level of analysis is the "dynamic attributes of the property" including

prestige, aesthetics and various other subjective factors important in determining the value. The fourth level of analysis involves looking at the linkages. These involve the network of relationships operating at the property. Influences in this area include the interrelationship between households and schools, the relationships between industrial plants and their sources of supply and labor markets, etc. An example would be the demographic ties of residential areas to shopping centers. The optimal location for a filling station might be on the right-hand side of an intersection on the far side of the stop light on a major highway on which commuters are returning home from work. Studies have demonstrated that such a location involves superior business for filling stations, but some of these linkages are quite subtle and intricate.

These different layers of analysis set up the alternative uses and in particular the most probable or best use for the property in question. Such an analysis points to a "best buyer." This approach is in contrast to traditional appraisal theory where the underlying assumption is a continuum of alternative uses which are available with relatively small changes in the relative price of the property. So, in practice there is a big difference between this kind of "best buyer" analysis and the more traditional appraisal analysis which downplays differences in buyers and property uses.

There are at least three approaches to determining value in the real estate appraisal process. These are (a) truth, (b) chance or statistical analysis, and (c) beauty. The "truth" approach illustrates the point that in comparing different types of properties to produce an appraisal on a particular site one has to wade through many different types of data, much of which is irrelevant in determining comparative values. As an example, consider the difficulties we had in putting a value on different cranberry bog sites on a particular assignment. We found that our difficulties in "wading" through the data disappeared when we discovered that the relative values of the different sites were tracked by production of cranberries per acre - an unsurprising result for economists.

In the second approach, a statistical analysis for appraisals admits that you can be wrong. There is both a mean and a variance. This exercise involves data collection and meaningful measurement.

The third approach is called "beauty." This is a fall back approach where lacking strong statistical evidence one can at least utilize an approach which is aesthetically appealing and has some predictive powers.

In contrast to these three philosophical approaches to appraisal theory, we embrace the modern or Ratcliff approach. This means determining the appraised value of a particular property by looking

at the market values of comparable properties. So the first line of attack here is to directly observe comparable market values. A second approach involves going around and talking to potential buyers - one might call this the interview or sampling approach. The third line of attack is the market value approach which involves a "thought experiment" on the part of the appraiser. The appraiser asks the question: "What would buyers do if they were as smart as me?" Depending on how much information is available, the appraiser will choose for value one of these three lines of attack and go with that approach.

Turning to the subject of open-end funds, we apply this appraisal methodology to the problem of determining fund values. We characterize the objectives of the appraisal process as envisioning three "hopes." The first hope is that the appraisal process will determine appropriate entry and exit values for investors getting in and out of the portfolio at a particular point in time. A second hope is that appraised values might measure value enhancement between two points in time. A third possible objective might be to measure how much upside or downside could be achieved or was actually accomplished by fund management.

The appraiser is unable to deal with all these issues. Appraisal methodology is much more of an art form and much less a science. There is no way that appraisals can determine quarterly changes in values with any kind of precision. The ability of in-house

committees to override appraisals basically means that the notion of outside "independent" appraisals is a fiction and not a reality. This process has produced open-ended fund values running ahead of true independent appraisals.

An important area where more careful appraisal work can be done is the area of leasehold values. As market conditions change and existing leases are out of line with currently prevailing market rents, there are opportunities to buy out existing lease holders at a profit. Most appraisals do not do a very good job in this area, nor have appraisal clients been willing to pay for a careful job.

Such analysis of lease-hold values has traditionally been performed by appraisers. Fair market value might be "encumbered" by lease hold interests or high coupon mortgages with substantial prepayment penalties. Since this analysis is not currently being done carefully, appraised values for open-end funds do not reflect the true exit value. The reason is primarily not the fault of appraisers, but because the client - the open-end funds - are not specifying the true appraisal purpose.

We need to stress the role of aggressive property management in enhancing portfolio returns. My viewpoint here is microeconomic: i.e., at the level of individual properties and property groups.

A component analysis of value distinguishes between five subcomponents of present value. These subcomponents are: (a) the present value of all income streams under contract; (b) the present value of debt reductions; (c) the present value of property if resold at the end of the contract - net of any outstanding obligations; (d) the present value of net income realized under the assumption of lease renewals - absorption assumptions, vacancy rate assumptions, etc.; and (e) finally, the present value of increases or decreases in purchase value relative to the original purchase price at the assumed point of sale.

I would argue that these different components of value reflect different types of risks and are subject to different types of uncertainties. For example, a resale assumption 10 years down the road may be more certain than near term income projections. This is because of the difficulty in forecasting near term factors as well as the heavier discount to be applied to values 10 years out. These different types of values are subject to different discount factors.

An important area of possible reform involves the protocols or exchanges of information between appraisers and their clients. These protocols need to be altered so as to allow appraisers an independent viewpoint.

A sensitive area is the case where a client taking over a shopping center with a program of attack to remanage it might well want to use their own program changes in projecting income, rents, tenant structure, etc. Should an appraiser in this situation use the program changes of the client or should he treat the structure under existing arrangements? On the one hand, the appraiser may do a disservice if he takes his own view. It would seem that he needs to look at the current contracts and then look at adapting the new property management scheme. On the other hand, appraisers are not paid to be property management advisors.

Appraisers needed to back off from acting in the role of the auditors. There is nothing wrong with an appraiser accepting a floppy disk with lease rental projections and other types of information from the client open-end fund. If the appraiser is given an information base with false data, that is not his problem. The appraiser should not be an auditor. He should identify the data sources and information used and go from there. The appraiser should not be in the position of having to certify the authenticity of various information available to him nor should he have to reproduce this information from scratch.

Real Estate Investment Analysis

I would like to address the area of real estate investment analysis from a fairly microeconomic viewpoint. In managing and acting as an investment advisor for several small real estate funds, I am

essentially acting as a "stock picker" in the real estate investment business. My role here contrasts with some of the larger commingled funds which have emphasized diversification. From this viewpoint, I categorize real estate as a "growth stock" and additionally as a "special situation." My viewpoint reflects a securities analysis perspective. Three important elements of this viewpoint include: (a) looking for growth opportunities; (b) the working capital needs required to exploit these opportunities and (c) the exploitation of a short-term monopoly position. The latter elements might be present through zoning ordinances, the political power structure or other elements.

Real Estate Portfolio Analysis

The two key elements to my approach to portfolio analysis are "monopoly" and "spread." My approach to portfolio analysis is distinctly microeconomic, but many of the same issues are dealt with at a more macroeconomic level. By monopoly elements, I mean those elements that would make for a favorable rental outlook and growth over a near term horizon. I recognize that over the longer term, competitive forces would tend to undercut monopoly type rents but I would argue that these are a decisive factor in making portfolio decisions on individual properties near term. My notion of spread elements include the whole area of financing and a wide variety of financial measures one would need to identify these elements.

One needs to pay attention to the political environment in which real estate investments were made. For example, I am very concerned about the high number of pregnancies to teenage women without job skills in urban areas. I am especially concerned that the educational opportunities in many of these areas are inadequate and that as a result we are raising a generation of people who will be frustrated by the lack of opportunities. I would not hold real estate investments in Mississippi, Louisiana or certain parts of Texas - areas where a lack of concern about providing educational opportunities to low-income people is particularly striking.

This is an illustration of "systemic risk" - in contrast to the more usual co-variance based macro-type analysis.

One of the advantages of being a relatively small player, is the sharp diseconomies to scale in the area of property management. In other words, the property management area yields large returns to activist management. This type of activist management is more difficult in a portfolio where the manager is responsible for literally hundreds of properties. The other difficulty of maintaining this type of activist management in a large organization is the incentive schemes offered to property management as opposed to the value added in this area. It might well be that individuals with above-average skills in this area may tend to be attracted to smaller firms where their contributions to value will be highly rewarded.

My approach to risk management began with a viewpoint from an insurance standpoint. In other words, the job of risk management is a job of insuring oneself against overly large exposure to risk of various types. Since most lease agreements tend to smooth out rental income, the amount of systemic risk impinging on real estate from a business cycle perspective is manageable. Most of the systemic risk exposure for real estate is of a longer cycle variety - for example, my earlier example of social unrest as a risk for real estate in urban areas without adequate educational systems. Once you had decided upon the rent, negotiations about lease agreement terms are really negotiations about risk management. Other ways of controlling risk are by altering the terms of debt financing or, alternatively, the mix of debt and equity investment. As another example, in a land contract, it is possible to buy the "equitable" title and not the legal title. This can be used as a device to hedge downside risk for land values.

I am an advisor to the Wisconsin Investment Board, a new real estate investor. They have put about \$300 million in recent years into real estate - mainly in joint ventures with Equitable, Lincoln Property Company, and other larger institutions. Our preference for this approach stemmed in part from the fact that they have a new real estate department who are getting "up to speed" and so we are inclined to go, at this point, with relatively safe real estate investments.

My preference is to sell losing real estate investments fairly quickly, other things being equal, because of their propensity to eat up a lot of resources in "workout" activities. Banks have been dumping real estate in part because real estate losses are a negative from the viewpoint of bank analysts who are looking at banks as candidates for merger transactions.

Declining trade deficits over time are likely to hurt the retail sector. I like industrial real estate at this point particularly in lower wage areas that will be competitive in an international environment. I like the Southwest part of the country at this juncture because of their competitive wage structure. I would not be inclined to bet against the Midwest on a regional basis at this point - although upcoming wage negotiations would tell a lot about whether the Midwest could make the downward adjustments to real wages necessary for them to compete in world markets.

- Edited from tapes and notes
prepared by Patrick J. Corcoran
and others.

MEMORANDUM FOR MICHAEL W. KERAN

March 24, 1987

FROM: Patrick J. Corcoran

SUBJECT: Summary of Grasskamp Seminar - *Presentation to Prudential Insurance Co.*
March 20, 1987

Professor Grasskamp broke his talk into three subject areas. The first was the real estate appraisal process; the second was real estate investment analysis and the third was applications of modern portfolio theory to real estate analysis.

The Real Estate Appraisal Process

At the outset, Professor Grasskamp, noted that the Wisconsin Center for Real Estate was well known for its emphasis on the interaction of private sector and public sector viewpoints on real estate planning and development. They have developed models -- even computer simulation models -- that transform development and private sector profit scenarios into scenarios for tax bases and equilibrium conditions reflecting the public sector interest.

He stressed that appraisal values are benchmarks from which some issue is decided. In other words, the determination of appraisal values cannot be seen in a vacuum -- there is a context or particular problem to which the appraisal value is the answer. Specifically, he felt that many of the failures of the appraisal process really reflected the failures on the part of those who are buying appraisal services to ask precise enough questions in order to get better answers in the context of the specific problem.

In order to sharpen the focus on the real estate appraisal problem, four specific questions must be answered. These are:

- (A) What is the appropriate definition of value?
- (B) What property interests must be determined?
- (C) What are the ground rules or assumptions underlying the exercise?
- (D) What ground rules must exist for the protocols or arrangements to maintain appraisal independence?

As an example, Professor Grasskamp cited his role in representing the Quakerbridge Mall in Princeton Township before the local tax assessor board. The issue before the tax board was to what extent the value attached to the Quakerbridge Mall represented land and building values. Such land and building values were taxable under the local property tax but values attached to the development which were not land and property values were not taxable. In his appeal, Professor Grasskamp argued that a significant part of the value of the Quakerbridge development represented a "franchise" among merchants at the Quakerbridge Mall to jointly retail products and that the value of this franchise was not taxable under the local property tax code. On the other hand, the

local tax office argued that a \$15 per square foot value for Quakerbridge Mall property compared to a \$9 rental in surrounding shopping malls largely reflected a monopoly rent position for the superior location of the Quakerbridge Mall. Professor Grasskamp was successful in getting the local tax board to recognize in principle the franchise argument. As a general point, he noted that an outgrowth of the Federal income tax reform was that the welfare burden had been squarely pushed back to the local level. As a result, he expected real estate taxes to rise in many areas of the country where the communities were sensitive to welfare type issues.

In looking at different property interests in a particular context, the problem is to determine the productivity attributes of the property in question. How are these different attributes relevant for the evaluation of the overall property? For example, in the case of the Quakerbridge Mall development, the developers had electric power generators which they owned and used to sell electrical power to the tenants on the property sight. For purposes of the tax assessor's office, the capitalized value of this income was not real estate value taxable under the local tax codes.

In looking at the productivity attributes of properties, one has to consider the alternative uses or courses of action on an available property. This is an area that in the standard appraisal format receives very little attention. Professor Grasskamp distinguished between several levels of analysis in addressing this question. First, there is the physical or static uses of the property in its current state of development. Second, there is the legal framework or zoning framework within which the property currently exists. Here he distinguished between the law itself and the way in which the law was administered in a particular political context. Specifically, he said that 90% of the law was "the arrogance with which it was administered" and only 10% was the law itself. The third level of analysis was the "dynamic attributes of the property" including prestige, aesthetics and various other subjective factors important in determining the value. The fourth level of analysis involved looking at what he called the linkages. These involved the network of relationships operating at the property cite. Influences in this area could include the interrelationship between households and schools, the relationships between industrial plants and their sources of supply and labor markets, etc. Another example would be the demographic ties of residential areas to shopping centers. As an example to illustrate some of the subtleties involved, he cited the example of a filling station. The optimal location for a filling station was on the right-hand side of an intersection on the far side of the stop light on a major highway on which commuters were returning home from work. He argued that studies had demonstrated that such a location involved superior business for filling stations but he used the example to point out that some of these linkages are quite subtle and intricate.

These different "layers" of analysis set up the alternative uses and in particular the most probable or best use for the property in question. Such an analysis points to a "best buyer." This approach is in contrast to traditional appraisal theory where the underlying assumption is a continuum of alternative uses which are available with relatively small changes in the relative price of the property. So, in practice there is a big difference between this kind of "best buyer" analysis and the more traditional appraisal analysis which

downplays differences in different types of buyers and different types of property uses.

Professor Grasskamp used three analogies to illustrate some pieces of the real estate appraisal process. He called these three pieces (a) truth, (b) chance, (c) beauty. The "truth" approach he used to illustrate the point that in comparing different types of properties to produce an appraisal on a particular cite one had to wade through many different types of data, much of which was irrelevant in determining comparative values. As an example, he described the difficulties he had in putting a value on different cranberry bog cites on a particular assignment. He found that his difficulties in wading through the data disappeared when he discovered that the relative values of the different sights were tracked by production of cranberries per acre -- an unsurprising result for economists.

In his second approach, Professor Grasskamp pointed out that a stochastic approach to appraisals admits that you can be wrong. There is both a mean and a variance. His third approach was what he called "beauty." This was a fall back approach where lacking strong statistical evidence one could at least utilize an approach which was aesthetically appealing and had some predictive power.

In contrast to these three philosophical approaches to appraisal theory, Professor Grasskamp embraced the modern or what he called the "Radcliffe" approach. This meant determining the appraised value of a particular property by looking at the market values of comparable properties. So the first line of attack here was to directly observe comparable market values. A second kind of approach involved going around and talking to potential buyers -- one might call this the interview or sampling approach. The third line of attack on the market value approach involved a "thought experiment" on the part of the appraiser. The appraiser asked the question: "What would buyers do if they were as smart as me?" Depending on how much information was available, the appraiser would choose one of these three lines of attack and go with that approach.

Turning to the issue of open-end funds, Professor Grasskamp applied this appraisal methodology to the problem of determining open-end fund values. He characterized the objectives of the appraisal process as envisioning three "hopes." The first hope was that the appraisal process would determine appropriate entry and exit values for investors getting in and out of the portfolio at a particular point in time. A second hope was that appraised values might measure value enhancement between two points in time. A third possible objective might be to measure how much upside or downside could be achieved or was actually accomplished by fund management.

Professor Grasskamp asserted that the appraiser was unable to deal with all these issues. Appraisal methodology was much more of an art form and much less a science. He argued that there was no way that quarterly appraisals could determine quarterly changes in values with any kind of precision. He also argued that the ability of in-house committees to override appraisals basically meant that the notion of outside "independent" appraisals was a fiction and not a reality. In addition, he asserted that this process has produced open-end fund values running ahead of true independent appraisals.

An important area where more careful appraisal work could be done is the whole area of lease-hold values -- Professor Grasskamp argued. As market conditions change and existing leases are out of line with currently prevailing market rents, there are opportunities to buy out existing lease holders at a profit. Most appraisals do not do a very careful job in this area, nor have appraisal clients been willing to pay for a careful job.

Such analysis of lease-hold values had traditionally been done by appraisers. Fair market value could be "encumbered" by lease hold interest or high coupon mortgages with substantial pre-payment penalties. Since this analysis is not currently being done carefully, appraised values for open-end funds do not reflect the true exit value. The reason is primarily not the fault of appraisers, but because the client -- the open-end funds -- are not specifying what the appraisal should be used for.

Professor Grasskamp stressed the role of aggressive property management enhancing portfolio returns. His viewpoint here was microeconomic: i.e., at the level of individual properties and property groups. In conjunction with this intensive micro-property management, he stressed breaking components of value into various types of subcomponents. His component analysis of value distinguished between five subcomponents of present value. These subcomponents were as follows. (A) The present value of all income streams under contract. (B) The present value of debt reductions. (C) The present value of property if resold at the end of the contract -- net of any outstanding obligations. (D) The present value of net income realized under the assumption of lease renewals -- absorption assumptions, vacancy rate assumptions, etc. (E) Finally, the present value of increases or decreases in purchase value relative to the original purchase price at the assumed point of sale.

He argued that these different components of value reflected different types of risks and were subject to different types of uncertainties. For example, a resale assumption 10 years down the road may be more certain than near term income projections. This was because of the difficulty in forecasting near term factors as well as the heavier discount to be applied to values 10 years out. These different types of values would be subject to different types of discount factors.

He argued that an important area of needed reform involved the protocols or exchanges of information between appraisers and their clients. He argued that these protocols needed to be altered so as to allow appraisers an independent viewpoint.

A sensitive area was the case where a client taking over a shopping center with a program of attack to remanage it might well want to use their own program changes in projecting income, rents, tenant structure, etc. Should an appraiser in this situation use the program changes of the client or should they treat the structure under existing arrangements? On the one hand, the appraiser may do a disservice if he takes his own view. But he needs to look at the current contracts and then to look at adapting the property management scheme. On the other hand, appraisers are not paid to be property management advisers.

Professor Grasskamp argued that appraisers needed to back off from acting in the role of auditors. He argued that there is nothing wrong with an appraiser accepting a floppy disk with lease rental projections and other types of information from the client open-end fund. If the appraiser is given an information base with false data, that should not be his problem. The appraiser should not be an auditor. He should identify the data sources and information used and go from there. The appraiser should not be in the position of having to certify the authenticity of various information available to him nor should he have to reproduce this information from scratch.

Real Estate Investment Analysis

In his second session Professor Grasskamp addressed the area of real estate investment analysis -- once again from a fairly microeconomic viewpoint. In managing and acting as an investment advisor for several small real estate funds, Professor Grasskamp is essentially acting as a "stock picker" in the real estate investment business. His role here contrasts with some of the larger commingled funds which have emphasized diversification much more. From this viewpoint, Professor Grasskamp categorized real estate as a "growth stock" and additionally as a "special situation." His viewpoint really reflected a securities analysis viewpoint. Three important elements of this viewpoint included: (a) looking for growth opportunities; (b) the working capital needs required to exploit these opportunities and (c) the exploitation of a short-term monopoly position. The latter elements might be present through zoning ordinances, the political power structure or other elements as well.

Real Estate Portfolio Analysis

The two key elements to Professor Grasskamp's approach to portfolio analysis were what he called "monopoly" and "spread." His approach to portfolio analysis was distinctly microeconomic, but it was interesting because many of the issues that are often dealt with at a more macroeconomic level, Professor Grasskamp attempted to deal with at the microeconomic level. By monopoly elements, Professor Grasskamp appeared to mean those elements that would make for a favorable rental outlook and growth in rental outlook over a near term horizon. He recognized that over the longer term, competitive forces would tend to undercut monopoly type rents but he argued that these were a decisive factor in making portfolio decisions on individual properties near term. His notion of spread elements included the whole area of financing and a wide variety of financial measures one would need to identify these elements.

Another important element of Professor Grasskamp's view was his attention to the political environment in which real estate investments were made. For example, he was very concerned about the high number of pregnancies to teenage women without job skills in urban areas. He was especially concerned that the educational opportunities in many of these areas were inadequate and that as a result we were raising up a generation of people who would be frustrated by the lack of opportunities. His bottom line from this analysis was that he would not hold real estate investments in Mississippi, Louisiana, or Texas -- areas where a lack of concern about providing educational opportunities to low-income people was particularly striking. It was this latter example that Professor Grasskamp

called an illustration of "systemic risk" — in contrast to the more usual covariance based macro-type analysis.

One of the advantages of being a relatively small player, as Professor Grasskamp pointed out, were the sharp diseconomies to scale in the area of property management. In other words, the property management area yielded large returns to activist management. This type of activist management would be more difficult in a portfolio where the manager was responsible for literally hundreds of properties. The other difficulty of maintaining this type of activist management in a large organization was the incentive schemes offered to property management as opposed to the value added in this area. It might well be that individuals with above-average skills in this area would tend to be attracted to smaller firms where their contributions to value would be highly rewarded.

Professor Grasskamp's approach to risk management began with a viewpoint from an insurance standpoint. In other words, the job of risk management was a job of insuring yourself against overly large exposure to risk of various types. Since most lease agreements tended to smooth out rental income, the amount of systemic risk impinging on real estate from a business cycle perspective was rather small. Most of the systemic risk exposure for real estate was of a longer cycle variety — for example, his earlier example of social unrest as a risk for real estate in urban areas without adequate educational systems. Again, reflecting a strong microeconomic viewpoint, Professor Grasskamp pointed out that once you had decided upon the rent, negotiations about lease agreement terms were really negotiations about risk management. Other ways of controlling risk were by altering the terms of debt financing or, alternatively, the mix of debt and equity investment. As another example, in a land contract, it was possible to buy the "equitable" title and not the legal title. This could, in effect, be used as a device to hedge downside risk on land values on real estate investments.

Professor Grasskamp discussed his advisory activities with the Wisconsin Investment Board, a new real estate investor. They have put about \$300 million over several years into real estate — mainly in joint ventures with Equitable and other larger institutions. His preference for this approach stemmed in part from the fact that they have a new real estate department who are getting "up to speed" and so he was inclined to go, at this point, with relatively safe real estate investments. In response to questions, he indicated his preference for selling losing real estate investments fairly quickly, other things equal, because of their propensity to eat up a lot of resources in "workout" activities. In some discussion, he noted that banks have been dumping real estate because real estate losses are a negative from the viewpoint of bank analysts who are looking at banks as candidates for merger type transactions. Interestingly, Professor Grasskamp picked up on the point that the prospect of declining trade deficits over time was likely to hurt the retail sector. He liked the industrial real estate properties at this point particularly in lower wage areas that would be competitive in an international environment. He was inclined to like the Southwest part of the country at this juncture because of their competitive wage structure. He also indicated that he would not be inclined to bet against the Midwest on a regional basis at this point — although he thought that upcoming wage negotiations would tell a lot about whether the Midwest could make the downward adjustment to real wages necessary for them to compete in world markets.