

# Better Answers to the Same Old Questions

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*Although “location, location, and location” has been the mantra that has ruled the real estate profession for many years, technology and business globalization have greatly expanded our view of where we work and play. In many cases, workers are not required to physically be “on site” to successfully do their jobs. We are purchasing more items via the Internet, or at least using this resource for comparison shopping. And with the price of gasoline, we are eating at home more often and traveling less for entertainment. Even though the U.S. population continues to grow, there may not be the need for as many commercial buildings as we have utilized in the past, and for that matter, we are already seeing increasing vacancies among all commercial property types. More importantly, for those commercial properties that we are purchasing or developing, expectations are higher with respect to usage as well as investment returns. Given the slow economic and investment environment we are seeing today, it is more important than ever that commercial real estate investors have a good understanding of the fundamentals associated with a property and of the market in which they are investing....*

Since the first dollar into a deal is usually equity, real estate developers can't help but wonder how the market will receive their product. When borrowed money is added to the equation, even more questions are asked about the return on investment. Is this market seeing positive growth, and will it continue to do so? Can rental growth be expected during the holding period? How secure is the income stream? Is the purchase price of the property reasonable, given the demographics of the area? What are the reversionary prospects of the property?

During the past 3 years, technology has expanded and Internet websites have been developed to a level that now allows for providing more accuracy in market analyses than ever before. Easily navigated websites, coupled with geographic information systems (GIS), now allow for the creation of customized analyses that rely on data specific to a geographic market area. In the past, demographic data were obtained using concentric radii that ignored cognitive and physical boundaries, but today, analysts can consider such features in establishing the market area for a particular property. These kinds of analyses, which can be developed for retail, office, industrial, self-storage, and even hotel sectors, are quite valuable to institutional and private investors when making investment and development decisions. Further, with sustained high oil prices, real estate markets may be impacted as consumers and businesses adapt to increasing transportation costs, not only by consolidating trips, but also by using more on-line outlets. Outcomes may include highest and best use changes for improved properties in convenient locations, accelerated obsolescence for certain properties in less transportation-convenient locales, impacts on suburban development in transportation-convenient located nodes, or redevelopment of urban locations.

One tool increasingly used by consultants, appraisers, and other real estate professionals to assist with such market studies is the Site to Do Business® (STDB). Data in the STDB® (<http://STDBonline.com>) are based on the most recent decennial census and updated on an annual basis. The service provides a wide array of demographic, income, employment, and housing data citing the most recent census, the current year and a 5-year projection. A good example of the application of this tool is in the analysis of self-storage market areas. After familiarizing oneself with the market area, the analyst can construct

the polygon boundaries of a market area by considering physical and cognitive boundaries, and then can overlap a 10-minute drive time on the boundaries to determine their reasonableness. Similar drive times can be estimated for competition within the market area, and the overlap of the competitor into the subject's market area can then be estimated.

With this information, the real estate analyst can allocate a portion of the competitors' rentable area to the subject's market area. At the end of the analysis, the analyst has a figure that approximates the total rentable area of the self-storage products competing as supply within the market area. Next, data that reflect demand factors such as the nature of the housing stock and proximity to commercial space (particularly to office properties, universities, and military bases) are gathered so the analyst can develop an estimate for the aggregate demand within the specified market area, both currently and into the future. Of course, every economist's favorite activity is analyzing the supply-demand relationship, and this is the optimal way to evaluate whether or not a market is over-built, undersupplied, or in equilibrium.

Similar applications can be made for retail analyses. At the current level of fuel prices, consumers may very well alter their shopping patterns. Retail expenditure data per household for different retail segments (e.g., apparel and services, computers, automotive supplies, gasoline, groceries, drugs, household furnishings, restaurants, etc.) also can be obtained. The STDB® also quantifies the degree

to which there is leakage or a surplus of expenditures within the market area. In the event that drive times change, particularly for convenience retail shopping, investors may wish to conduct further analysis. For example, consideration is being given as to whether an older community shopping center with a food/drug anchor still fits the profile of a certain institutional investor's criteria. After looking at the property based on the current leakage surplus within the specified market area and overlaying it with a dynamic drive time analysis that considers shortened trips within the market area, the investor may determine that there is no upside potential for the property. Once the anchor leases are up for renewal, the stores may go dark. This is an example of external obsolescence that may impact a property into the future with sustained high gas prices. Conversely, there may be a property in a prime location that has been used as an office. With demand for shortened drive times, the highest and best use of this property may change if its underlying land value is worth more than the value of its office property earnings. Again, more information is always better for investors.

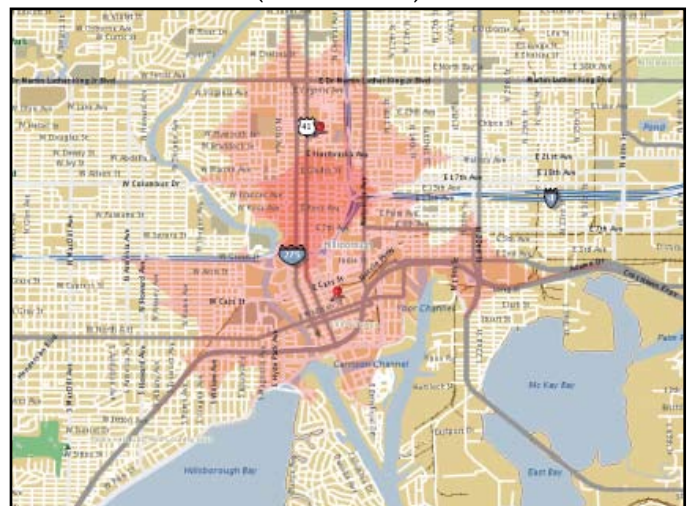
A significantly useful analysis that can be performed using these data is the determination of residual demand. This is particularly insightful for housing markets that have been impacted by a build-up of inventory in both for-sale and rental housing products. Using these techniques, demographic data can be obtained for the specific market area, and the unsold (or vacant) inventory (supply) of homes within the market area is determined (usually accomplished by boots-on-the-ground research with local planning

**Map A: Example of a Subject Market Area Using a 3-Minute Drive Time**



**Map A** illustrates the drive-time market area for a hypothetical subject site.

**Map B. Overlap of Market Areas for Two Sites Using 3-Minute Drive Times (Darker Pink)**



**Map B** shows the level of overlap from a competing property several miles away.

Source for Maps A and B: STDB®



There may be more of this in the future.

agencies, market surveys, databases, and the like). The STDB® data allow for the segmentation of the market by price points and ownership-renter data, so appropriate consideration can be given to the portion of the market (demand) that will be purchasing a dwelling or utilizing the rental market. Compilation and extrapolation of these data allow for an approximation of current absorption within the market area, and create projections of absorption and residual demand, if any, given the broader absorption trends. This is most useful information when considering whether to seed a proposed development with equity when acquiring or developing a rental property.

There are limitations by the data provided in such websites, however, particularly if certain areas have undergone considerable change since the last census. In addition, drive time analysis may require tweaking depending on the nature of the market area (i.e., urban areas with maps based on non-congested drive times that do not reflect ground travel conditions

at rush hour). A good analysis is able to take such limitations into account in providing the information and recommendations clients are seeking in order to make the best decisions possible.

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*RERC is pleased to be able to provide this type of analysis to our clients for all major property types and in any market*

*nationwide. We have been at the forefront of developing various applications of the tools currently available, and would be happy to talk to you about your analysis needs. Please contact RERC Managing Director Kent Steele, CRE, FRICS, MAI, at [ksteele@rerc.com](mailto:ksteele@rerc.com) or 630-430-3865, or RERC Regional Director Edward de Laurier, CRE, FRICS, CCIM, MAI, at [edelaurlier@rerc.com](mailto:edelaurlier@rerc.com) or 904-280-1133 for more information.*

