

ARE 528 REAL ESTATE MANAGEMENT

The Management Plan Part II

Chapter Four (pages 73-95)
Part two - Techniques of Real Estate Management
Real Estate Management textbook by Downs, J.C.

Presented by Bakr Fahad Al-Hajri 773470



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Outline

Introduction

Regional Analysis

Neighborhood Analysis

Property Analysis

Market Analysis

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Analysis Alternates

Proposed Property Analysis

Rental Schedule Income and Expenses Projections Operations

Investment Analysis

Summary



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Market Analysis

- ❖ Although a general real estate market does exist, the property manager must identify many smaller markets in order to design a management plan for a specific property.
- These individual markets include commercial space markets, retail store markets, apartment markets, and single-family residence markets.
- When forming a management plan, the manager first must place the property in its correct submarket and then evaluate the property by the standards of that market.
- This process is market analysis.



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Market Analysis – *Measurement of Market*

- Individual real estate markets are easy to identify but difficult to analyze.
- There are three reasons for this.
- First, there is no exact unit of measurement in real estate.
- ❖ In the grain market, for example, measurements are in terms of bushels, with each bushel equal to every other bushel.
- Or, in the stock market, a share of stock in a given issue is identical with every other share in the same issue. nut in real estate, this is not the case.
- But in real estate, this is not the case. One apartment may differ greatly from another.



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Market Analysis – *Measurement of Market*

- Even within the commercial space market, with its various measuring devices (rentable square foot, usable square foot) and types of measurements (New York method, BOMA method), no universal standard exists.
- ❖ The second problem in analyzing a real estate submarket is that there is no trading center.
- ❖ In the grain market, there are the boards of trade; in the stock market, trades are made on central exchanges.
- However, rentals are not made at a central location but are made in real estate management offices and landlords' homes throughout the nation.



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Market Analysis – *Measurement of Market*

- This scattered trading results in the third major difference between income real estate markets and other markets: there is no systematic recording and reporting of sales, i.e., rents.
- When a bushel of corn is sold at the Chicago Board of Trade, the sale is recorded immediately and relayed internationally.
- When a share of stock is sold, the transaction immediately is transmitted on the ticker tape.
- ❖ In the real estate market, however, there is no complete recording of rental rates by an organized agency, and transactions are considered the confidential business of the individual lessor and lessee.
- Even recording the deeds of sale often does not require disclosure of the exact consideration in transactions.



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Market Analysis – *Measurement of Market*

- While the process of analyzing the market is complicated by these three factors, it is possible.
- An examination of the residential real estate market illustrates the working technique.
- ❖ It must be realized that there are virtually scores of submarkets even within this market; the major categories are the multistory apartment, the walk-up apartment, the garden apartment, the duplex, the row and townhouse, and the single-family dwelling.
- Also, these submarkets vary from neighborhood to neighborhood. A manager with a specific property to supervise must decide into which category the property's space belongs.



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Market Analysis – *Measurement of Market*

- With the general classification made, the market analyst must further define the submarket by size and character.
- ❖ For example, if an apartment building contains one-, two-, and three-bedroom apartments, the submarkets for each of these classifications must be analyzed individually, since each will have a separate supply-and-demand factor and a different price range.



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Market Analysis – *Measurement of Market*

- The following questions pertain to each market:
 - How many units are available within the area?
 - What is the average age and character of the buildings in which they are located?
 - What is the average unit in this specific market (regarding layout, equipment, size, and amenities)?
 - ❖ Based on facts obtained from the neighborhood analysis, is there an increase or decrease in the number of families within the area who are prospective consumers of this particular unit type?
 - What is the current price of the average unit, both monthly and per square foot?
 - What is the occupancy level of all units of this type above, below, and corresponding to the average?
 - What was the price and occupancy level a year ago? What is the trend of each?
 - How do these trends compare with real estate market trends in general?
 - How do vacant units in the area compare for size, age, condition, amenities, and price?



Market Analysis – Analysis of Comparables

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- ❖ The study of the neighborhood in which a property is located is not an end in itself; it provides the property manager with the information to study that particular building's relationship to the neighborhood and, especially, other buildings.
- Once familiar with the neighborhood buildings, including their character, age, and desirability, the manager can compare a particular building to others in the neighborhood and note qualities that rank it above or below the average.

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Market Analysis – Analysis of Comparables

- A market survey is a process of gathering information about specific, comparable properties and comparing it to data concerning the subject property.
- Through the survey, the property manager learns what the other buildings offer, and then evaluates the subject property's advantages and disadvantages accordingly.
- ❖ A worksheet such as the one in next figure designed for residential properties, should be completed for this survey.



Market Analysis – Analysis of Comparables

	Market Survey Worksheet	Subject Area Competito						npetitors			
ľ	Name of Property										
ı	Location Rating										
ı	Age										
_[Percentage of Occupancy										
=	Overall Condition and Appeal										
וַעַ	Amount of Security Deposit										
=[Minimum Length of Lease										
שַ	Children Allowed										
糽	Unit Rates	Rate	Per SF	Rate	Per SF	Rate	Per SF	Rate	Per SF	Rate	Per SF
Maliayellell	Efficiency										
9	One-Bedroom										
2	Two-Bedroom										
וַנ	Appliances		•				•		•		
9	Furnished										
Estate	Unfurnished										
Ű	Utilities Included										
=[Parking										
בן בי	Recreational Facilities										
2	Clubhouse										
	Pool										
	Tennis Courts										
	Sauna										
	Exercise Facilities										
	Other Inclusions										



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Market Analysis – Analysis of Comparables

- Most important, the analysis of the property location must relate both to competing building within the neighborhood and to the larger metropolitan area in which the neighborhood itself is located.
- All of these factors are needed to form a sound management plan.
- ❖ In the real estate profession, no term is more significant than location, yet it is difficult to define in relation to a specific property.
- Location has one meaning for industrial property, another for commercial property, and still another for residential property.
- ❖ To generalize, however, location refers to the comparative advantages of one site in consideration of the factors listed in the next figure.

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Market Analysis - Analysis of Comparables

- ❖ Although some factors (such as convenience to educational facilities) are specific to the Locational analysis of residential real estate, all of the concepts are either directly applicable or adaptable to analyzing retail, commercial, or industrial real estate.
- With all this information, the manager now is ready to analyze alternate ways in which the property could be managed, then select the one that maximizes the owner's objectives.



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Analysis of Alternates

- ❖ A property's management ideally begins when the improvements are new. Most properties, however, have been supervised by others before they are managed professionally.
- ❖ The procedures just outlined are undertaken with the assumption that the building will be operated on an "as is" basis.
- ❖ That is, the original design will be retained, and the owner can expect a good return from the building in its present form and condition.
- ❖ But if it is discovered that the building no longer fulfills the requirements of its location, it may be profitable to alter its accommodations to meet current market trends and obtain the highest possible net return for the owner.
- This is what is meant by analysis of alternatives.



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Analysis of Alternates

- ❖ If the building, in its present condition, is not producing the maximum yield consistent with the owner's objectives, two alternatives should be considered: (1) rehabilitation and modernization, or (2) alteration.
- ❖ Rehabilitation is the process of renewing the equipment, surfaces, or materials within a building; it means correcting deferred maintenance without changing the building's basic plan, form, or style.
- The manager will modernize the building as it is rehabilitated.
- Original equipment will be replaced with similar features of modern design, since it is not feasible to merchandise a property with equipment or facilities that are below acceptable standards.



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Analysis of Alternates

- Rehabilitation and modernization lengthen a building economic life within its present design.
- ❖ However, it might be desirable to change the function of the property, in which case alteration, or converting the structure's use, would be necessary.
- ❖ If the property analysis or market analysis indicates that improvements are needed, the decision should be based solely on economic feasibility (if not ruled out by physical limitations).
- ❖ The funds must be allocated, a budget of income and expenses created, proper amortization of debt service computed, and the probable cash flow (net return) established.
- ❖ If the proposed project is profitable financially, the management plan should reflect this.



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Analysis of Alternates

- Consider a building with three- and four-bedroom units in a neighborhood composed of single adults and couples without children. The market analysis should indicate to the property manager a possible need to convert the apartments to smaller units.
- ❖ A complete financial analysis would be required to determine if the conversion would increase the owner's profit.
- ❖ This type of alteration involves property that is functionally obsolete.



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Analysis of Alternates

- ❖ A second type of alteration is intended to increase the earnings of a building, weather functional alteration is necessary or not.
- To illustrate, assume:
 - 1. that a building contains one-, two-, and three-bedroom apartments in an area in which this unit mix is the highest and best use;
 - 2. that the main floor of this property contains a spacious Spanish-motif lobby and three stores;
 - 3. that the apartments in the building are presented to prospects in the most attractive condition; and
 - 4. that the values of the units have been increased to their maximum.



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Analysis of Alternates

- ❖ In this case, management could not raise rents without losing tenants to more desirable buildings.
- ❖ By spending \$10,000, however, management could reduce the size of the lobby and install two more stores in the inefficiently used space and, at the same time, increase its visual desirability.
- This alteration would require complete plans and specifications of the work to be performed.



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Analysis of Alternates

- Competitive estimates then could be obtained for the total cost of the necessary work, plus amounts to be spent for furnishings and decorations.
- ❖ The property manager would analyze the income possibilities afforded by the new stores) as well as estimate the increased rental schedule attributed to the improved lobby.
- ❖ Also, there should be a determination of the extent to which the changed structure would affect the property's operating expenses.



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Analysis of Alternates

- When these procedures have been performed, the manager's decision to proceed will be based on one of two assumptions:
 - 1. that the expense of the change could be completely amortized within a stated period; or
 - 2. that the increased value of the property after alteration would justify the expense.
- For the first premise, assume that the manager represents an owner who has no thought of selling the property.
- In this case, complete amortization within a stated period (during which an adequate return is produced) would be advisable.
- However, if the owner's objective is to raise the selling price of the property, the decision to alter depends on the equity that will result from the expenditure.



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Analysis of Alternates

- ❖ A growing trend is the conversion of rental projects to the condominium form of ownership.
- The manager of a rental property considers condominium conversion as an alternative when the rental market is weak, when high financing costs create negative cash flows, or when rent controls restrict the ability to raise rents in order to meet rising operating expenses.



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Analysis of Alternates

- ❖ In analyzing the conversion of an existing rental building into a condominium, the property manager must conduct a formal appraisal of the project and a feasibility study of the conversion.
- The value of the property as a rental project is compared with its value as a condominium.
- ❖ If this comparison reveals that the Property would yield a higher net return if the units were sold individually than if sold as a rental project in one piece, the conversion should be pursued.
- This would require arranging financing commitments, adopting a plan for marketing the units, and obtaining legal counsel to draft the documents that legally create and subsequently govern the condominium.

