Spring 1995

Special Insert to ASI News

THE ROLE OF STANDARDIZATION IN THE INFORMATION REVOLUTION AND REAL ESTATE ANALYSES

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The changing of the character of real estate analyses as a result of the information revolution is the subject of a companion article.[1] The pace of change in real estate analyses and decision making will, in some measure, depend upon progress in standardization of information and its processing.

Standardization also was a key component in the industrial revolution. It was an essential element in mass production. In the industrial revolution, it wasn't simply that a firm manufactured each product so that one was the same as another, nor that parts of products were interchangeable; it was also that the components of the machines used to make the products -- the screws, belts, ball bearings and other parts were standardized, which lowered the cost of manufacturing the machines.

In an information revolution, the standardization is in the software, not just the hardware. Standardized software involves a common or transmutable "language;" shared procedures or models for problem-solving; and agreed upon definitions for the data required as inputs to these models. Definitional standardization is thus the start.

Definitional standards are the basic initial ingredient in the creation of dependable, uniform data that can be used in various real estate decision-making models. History has provided blueprints for the development of standards, but their promulgation often has been driven by economic necessity and the threat of government regulation. The best example is the standards for the accounting profession, which were the result of the stock market crash of 1929, that led to the Securities Act of 1933 and the Securities and Exchange Act of 1934, and caused the accounting profession to establish the Financial Accounting Foundation, the Financial Accounting Standards Board, and the Financial Accounting Standards Advisory Council. These organizations, in turn, produced the accounting standards referred to as Generally Accepted Accounting Practice (GAAP). FASB issues the pronouncements of standards, and modifies and interprets existing standards. The SEC, as well, may choose to provide standards for the accounting and investment banking professions. The SEC, however, has generally chosen to assume an oversight role by adopting the standards defined in GAAP and has brought new concerns to the attention of the Emerging Issues Committee of FASB.[2]

As an aside, GAAP poses some problems for real estate because of the peculiar characteristics of real estate, especially its long life and volatility in value during that life. This often makes the historical cost basis misleading. Also, accounting standards for depreciation may not accurately reflect the economic loss of value at a point in time.

Over a half century later, a similar process occurred when the appraisal profession, in response to the threat of imminent government regulation, formed an Ad Hoc Committee on Uniform Standards and, in 1987 established an Appraisal Foundation comprised of 50 affiliated organizations. The Appraisal Foundation developed the Uniform Standards of Profession Appraisal Practice (USPAP) and, in 1989, formed an Appraisal Standards Board (ASB) that is charged with

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[1] "The Information Revolution and Real Estate Analyses" Prints available from the Homer Hoyt Institute, 760 U.S. Highway One, Suite 300, North Palm Beach, FL 33408. See story Page 3.

[2] Donald E. Kieso and Jerry I. Weygandt, Intermediate Accounting, 7th ed., John Wiley and Sons, N.Y., 1992, pp. 7-23.

formulating, revising, and interpreting the standards; the ASB, in turn, adopted USPAP. The real estate professions working together with Congress led to the Financial Institutions Reform, Recovery and Enforcement Act of 1989. FIRREA recognizes USPAP as the generally accepted standards and confirms the authority of the Appraisal Foundation to promulgate and revise the standards.

Even more recently, another evolution in standards is occurring, spurred again by economic circumstances, but not by the threat of government intervention. In a recent article, Blake Eagle discusses the Institutional Real Estate Clearinghouse, formed early in 1994 by representatives from 26 investment houses. The Clearinghouse is to establish a secondary market for "primarily pension-owned and privately placed shares of commingled real estate funds." The Clearinghouse will provide "timely and regular delivery of standardized real estate portfolio level information for use in the investment analysis and pricing of private real estate securities."[3] A joint committee of NCREIF, PREA and NAREIM has charged a task force with the establishment of standards for reporting and disclosure of investment and performance information, which will be made available through the Clearinghouse. The significant difference between this model and the accounting/appraisal models is that the users of the information are playing a significantly greater role relative to the providers of information.

Obviously, there is a need for broad-based cooperation in the development of definitional standards, including providers and users as well as processors. Experience has shown that standards are as much politically created as they are derived from theory. Thus, while academia has a role in getting the best standards, reality sets constraints.

The better the standards reflect the economic need of the business community, the more useful they will be to business practice. But, there are different segments of the business community and differences in interests within the segments, as well as among them.

As an example, standardization in the REIT industry has been hampered by differences among REITs as to the definitions they prefer. Now, there is an agreement, soon to be released.

The big issue is, who will determine the major standards in real estate analyses? In manufacturing, with automobiles as a prime example, each manufacturer while adopting some standards still has different knobs and other devices for windshield wipers, cruise control, and the like, so that it takes a long time for the market discipline to bring them into line. The relevant question for real estate analyses is, what market disciplines will bring suppliers of information into line in order to facilitate better real estate analyses? We believe that users of the information, researchers, analysts and investors have a critical role to play. Certainly all interested parties need to voluntarily resolve this issue of setting standards before a future market crisis precipitates the solution. If history has taught us any lesson, it is that such a crisis will occur.

The creation of standards is a long-term continuous effort that involves industry input and academic research. The results should be standards that represent "best" business practice, with "best" having ethical as well as risk-return aspects. Ironically, the creation of definitional standards may be hindered today because they are being developed by voluntary association of professions, government agencies, firms and individuals who are motivated by narrow interests of suppliers of investment product rather than by those who will reap the positive benefits from the information revolution. These characteristics and pace of the impact of the revolution is thus predicated on what those who will benefit most will do. But, are they organized to do it?

The Homer Hoyt Institute as a REIT investor, as well as a major force for improving the quality of real estate decisions, is planning to facilitate the effort by a research roundtable. The roundtable intends to develop the process for getting the best standards designed. Implementation is an industry matter and becomes the second step. This article is an open invitation to industry representatives to indicate their interest by contacting the Institute.

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[3] Blake Eagle, "The Clearinghouse," Real Estate Finance, Volume 11, Number 1, Spring, 1994, p. 10.

Information Revolution Alters Real Estate Analyses

The information revolution affords top-level managers a hands-on view of summarized detail through which to manage, according to Maury Seldin in a current article on the impact of the information revolution in real estate analyses. "What is making the difference now," he writes, "is the ability to store and process humongous amounts of information electronically." This enables the topsight viewer far more substantial and versatile decision-making tools in practice than even the most technically far-sighted prognosticator would have imagined a generation ago. It is altering the way real estate analyses are being conducted.

Real estate analysis has been aided by not only the structure, process, and presentation of numbers, but also to a great extent by maps, architectural drawings, and geographic information systems. Computer systems have become sophisticated to the point of bringing text, numbers, photographic data, and graphics (maps, charts, site plans, etc.) together as interrelated objects that can share data and be organized in a meaningful way to generate reports. "As a result, real estate information may be processed, transmitted and presented showing geographic location, photographs, spatial attributes of construction (including detailed pictures), financial statements and marketability and feasibility results in words and numbers."

Seldin also praises the versatility of current and coming technology continuing, "... on-line adjustments may be made such as a monitoring of changed information reports and a real time processing of the new data's impact upon the analytical results."

Today's real estate analyst or investor can rely to a large extent on processed information that the computerized systems deliver. But, Seldin cautions that there is no substitute for his/her ultimate judgment in the human processing step that arrives at the final decision. "In this era," he notes, "...econometric models use historic information to quantify the relationships among the variables and then forecast the future based upon the continuation of past relationships." Information has taken us to knock on the door of the 21st century, but robotized top-level decision making in the real estate investment and asset management arenas is not yet upon us: "...judgmental models may lack the rigorous quantification of historical relationships; they judgmentally insert the best estimate to quantify the variable and proceed with the analyses...The art in the judgmental model is to be roughly right, rather than rigorously wrong."

Some applications of the New Technology the article points to are: Site Developability, Building Development, and Asset Management. The Hoyt Group through Hoyt Advisory Services is working with Teleres and Express Star in advancing the information revolution in real estate decision making. The January 19-23, 1995 session of The Weimer School included speakers Jeffrey Maier, President of Datalytics (Teleres), and Michael Stewart, President and CEO of Express Star who addressed their organizations' involvement.

The article, entitled The Information Revolution and Real Estate Analyses appears in the April, 1995 volume of Real Estate Issues. A preprint was distributed to attendees at the January, 1995 session of the Weimer School. Copies are available on request.

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Weimer School Commencement Address
January, 1994 Session

"Don't go!" was the advice Bob Hope gave in a commencement address several years ago. "We wouldn't, now" is what the Weimer School commencement speaker, Dr. Maury Seldin, Professor Emeritus of The American University, said regarding entering an academic career in the present academic and political environment.

It wasn't campus political-correctness mania, nor an ebb of resources. Rather, Dr. Seldin offered, "It is important that we do something useful with our lives." He referred to professional activities of faculty members at universities across the country, that they should make a societal contribution as well as directly touching the lives of some people: "...the system for rank and tenure underrates the teaching, underrates community service, and most perversely underrates research which may have applicability."

Dr. Seldin further mentioned science and engineering issues he had previously discussed at the tenth anniversary of the Weimer School. He referred to Author Herman Hesse who says in the foreword to his book The Glass Bead Game , "(The spiritual idea in the glass bead game)...has more than a little in common with intellectual and cultural institutions of the sixties as well as the current decade to the extent that they have become autonomous empires cut off from the social needs of mankind and cultivating their own 'Glass Bead Games' in glorious isolation." The concept that some people focus on research as if it were an end to itself is much the same as players of the glass bead game have done in confusing the game with reality. In the game, players concentrate on glass beads which represent concepts used to build to greater goals. In the book, the proficiency with the glass beads *becomes* the goal. The beads turning into goals, like research-goal driven research, operates to the detriment of society's actual greater goals.

Dr. Seldin then counselled graduating Fellows to be alert to innovations which would alter the system by which the teaching function was traditionally performed.

The Homer Hoyt Institute, support organization for The Weimer School, is itself undergoing substantial change. Dr. Seldin noted the increased focus on dissemination of research with a decrease in research support. "Hopefully those who benefit from the knowledge will contribute to research funding... Project funding has diminished because income has diminished." Seldin also noted a strong shift in the focus of the Institute's research toward REITs, through which basic investment strategies and analyses are being further investigated. The Institute will also continue with market research and methodology for various types of land use analyses. Through this process, the intent remains to assist fellows and others in their professional missions. "But," Dr. Seldin reminded the attendees, "the means are changing."

The conclusion of Dr. Seldin's remarks included a rally cry to embrace new methods and technology: "...we should not be fighting today's battles with strategies more appropriate to wars of an earlier era. The rapidly changing environmental circumstances in which we carry on our professional missions are such that we should keep an eye on what it really takes to do something useful to society... Focus," he ended, "should be on those accomplishments which can make a difference in truly improving the quality of real estate decisions."

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