Changing Structure
by
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Capital flows into real estate through a changing structure. REITs exemplify the current change by virtue of this decade's sharply increased flow of funds through that form of investment, especially through the increasing average size of REITs. Thus, institutional arrangements change giving a changed structure.

The Homer Hoyt Institute has, as an investor, benefitted from this changing structure. The Institute’s investment results have been outstanding through a better understanding of the system and through the Hoyt Model.

In a sense, the Hoyt Group is a "think tank." The think part refers to the orderly aspect of logic by which conclusions are reached. The tank reference refers to being a reservoir or place where such logic is stored - and in the vernacular of current usage, applied, i.e., a think tank is where research is used to reach conclusions by developing and applying the state of the art.

The Weimer School of Advanced Studies in Real Estate and Land Economics, as the salient component of the Hoyt Group, has a distinct scientific character to it. The Fellows are social scientists bent upon advancing the state of the art.

Yet, in the Hoyt tradition, the Hoyt Group focus has been on the applied - understanding the detail of structure as in analyzing REITs with the result of reaching learned conclusions.

If we focus on western intellectual tradition, the point of departure is only half a millennium ago, the Renaissance. Homer Hoyt, himself, preferred to go back to the age of "the" Homer, i.e., the ancient Greek civilization. But, for practical purposes, let's deal with the epochs since the Renaissance.

Consider focusing on detail as a means to seeing the big picture, in light of the following quote:

"Leonardo was the discoverer: the man who saw in the detail of nature the meaning which had been missed for centuries. He approached the world through his drawings, and showed nature's lineaments beneath the surface of his pigments. His new vision pierced to the structure of things which lay hidden behind outward appearances; he was concerned with the bone underneath the muscle as much as with the rendering of the skin color.

Was Leonardo a scientist? He found nothing that we should now call a scientific theory, because he lacked the gift to isolate those abstract concepts - gravitation, momentum, energy - in which science seeks the unity under the chaos of natural phenomena. His mind leaped to the concrete and the particular.

Yet, to an age still dominated by the traditional categories of Aristotle and St. Thomas Aquinas, he brought the right mind. When almost all thinking was still guided by universal and a priori plans of nature, he made a single profound discovery. He
discovered that Nature speaks to us in detail, and that only through the detail can we find her grand design."  

Grand Design

It is the grand design to which we now turn. The design is one of a changing structure in which man does the changing.

The bulk of this think piece, "Changing Structure," has been thus far read with "changing" as an adjective, i.e., it modifies the noun, structure. But "changing" may also be read as a verb, i.e., the action word which is altering the character of the structure.

The title "Changing Structure" was intentionally made as a Vasarely-like art form. Without moving, one may see the same work of art in different ways. Most of us spend most of our time dealing with changes in changing structures with "changing" as an adjective. We want to understand the current structure.

This brings us back to Leonardo and the paragraph immediately following the previous quote:

"This is the discovery at the base of modern science, all the way from atomic structure to genetics. In the nature of things, this discovery had to be made by an artist. The Renaissance painters before Leonardo had already taken the first step in it; they had shown that the detail of nature marks one scene from another and gives meaning to each. What Leonardo did was to take this discovery from the studio into the laboratory. He made the artist's eye for meaningful detail become part of the essential equipment of the scientist."

A Philosophy of Science

One may look at science as a higher form of knowledge. There are lesser forms of knowledge such as that based on intuition or anecdotal evidence.

The distinguishing characteristic of scientifically-produced knowledge is a greater reliability than that associated with lesser forms. The relevance of the reliability is the validity of the research conclusions, i.e., the output of the think tank.

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2Victor Vasarely's kinetic work allows the viewer to see different pictures without the viewer changing position. This is in contrast to the work of Jaacov Agam in which the viewer sees a different image by changing the viewer's position.
The mission of all this is to improve the world in which we live. One way to do that is to alter the structure.

One may argue that "the Renaissance was the beginning of modern capitalism. But, capitalism, itself, has changed during the last five centuries. So, too, has the societal structure within which it operates.

One way to view these changes is to deal with the waves of change, such as the agricultural revolution, the industrial revolution, and now the information revolution. In each of these waves of change, there emerges new problems and changing structures.

Three Levels of Meeting Problems

There are three levels of meeting problems. They may be called curative, preventative, and perfective.

Curative. The curative level refers to actions taken to change a condition through a curative effort. Setting a broken bone or using antibiotics are illustrations of curing some medical problems.

Preventive. The preventive level refers to actions taken to prevent a condition from occurring. Inoculations against whooping cough, tetanus, and diphtheria are actions taken to prevent specified illnesses from occurring.

Perfective. The perfective level refers to providing an institutional arrangement or structure in which the operation of the system precludes the adverse conditions or sets up an automatic counter action. Eating the right foods, getting adequate sleep and exercise, and applying good judgement in a broad range of behavioral situations are actions which set up conditions in which the body is not put to excessive strains and which enable the natural systems to deal with many adverse conditions which might otherwise cause a problem.

Altering the structure can be a preventive measure. It can also be a perfective measure.

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Altering the Structure

The first step in altering the institutional structure is a little like Gretzky plays hockey. He goes to where he expects the puck to be not to where it is. This presupposes that one knows or has reason to believe one knows how events are going to unfold.

In an earlier article entitled "The Information Revolution and Real Estate Analyses," there is a discussion of change methods of real estate analyses attributed to the information revolution. That thinking is extended in a new memo entitled "Vision Enhanced." A copy of that is provided in Exhibit I.

Perhaps as "think tankers", we should be looking at the institutional changes which are taking place. Who are the players in the real estate market today as compared to an earlier period? Did people and/or institutions experience the brunt of the downturn? Is there an institutional memory? In other words, are the REITs going to push real estate prices and production back up to precipice levels which will precede another fiasco?

Perhaps a new information structure will prevent the reliving of history. Will there be sufficient information on local markets to deter the REITs from making the mistakes of overpaying and overbuilding? Will the REIT management know enough about the economic environment changes to realize that the growth component of their business may not go on unabated and that there will be an acceptance as well or recognition that franchise value will decline when real estate market conditions so determine.

The questions for us is, what should we be researching? The REITs are only an example.

The two-rate land value tax recently went into a close call in Allentown, Pennsylvania. The system madness of producing the wrong incentives is exemplified by taxing the upgraded improvements in the cities when you want to encourage the upgrading.

The tax subsidies to induce industrial location is another case of misdirected public policy. In this case, transfer payments are made to firms to locate in communities where they would have located anyway. Society gets no net gain from the structure.

Perhaps we ought to formalize the think tank operations of the Hoyt Group as a body to explore what are the research issues for enhancing the quality of life in our society.

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Some Think Tank Structure Dimensions

The centerpiece of the Hoyt Group operations is, of course, the Weimer School of Advanced Studies in Real Estate and Land Economics. From a think tank perspective, one might ask, "how does a school fit in with a think tank?"

As it turns out, the Rand Corporation set a precedent. "...Under the auspices of the Rand Graduate School, it conducts a number of programs that provide advanced study for students in the social sciences..." 7

We are accustomed to describing the Hoyt Group operations as being focused on the Weimer School which, over the past fifteen years, has developed a remarkable network of fellows at the leading edge of real estate and land economics. The Homer Hoyt Advanced Studies Institute is simply the corporate housing of the Weimer School. The Homer Hoyt Institute is, itself, the support organization for the Weimer School. And, it has a wholly-owned subsidiary, Hoyt Advisory Services, to serve as an R&D unit and handle contract research not appropriate for a not-for-profit, i.e., the Homer Hoyt Institute.

Some people familiar with the Hoyt Group, a term easily used to identify three corporate entities with the Hoyt name (Homer Hoyt Advanced Studies Institute (HHASI), Homer Hoyt Institute (HHI), Hoyt Advisory Services (HAS)), have simply identified the organization as a "think tank."

It is a little like the public calling Howard Johnson, HoJo, or International House of Pancakes, IHOP. That wasn't the name which came out of the company - it came from those who had familiarity with the establishment and identified it as they saw fit.

Perhaps we ought to focus on the think tank moniker. It is much easier for the public to understand and would fit well with the HHASI development plan (see Fall 1997 issue of the ASI newsletter).

It's what we already do. The Homer Hoyt Institute has, for years, held research roundtables to identify the areas most worthy of support. The Weimer School inaugurated a third session in 1986 to focus on research by property type, then by type of decisions reached. Perhaps this think tank focus would contribute to a changing structure in which the Hoyt Group could do much to, as previously noted, "explain what are the research issues for enhancing the quality of life in our society" and operate as a catalyst beyond the research of the Hoyt Group.

Furthermore, picking research on the basis of fashion, or data, or technique available is kind of like looking for a lost article where the light is best. Let's figure out what we need to know to make some good guesses at where the hockey puck will be, as well as how we might better organize to do it.

Within limits, we are free to alter our think tank structure. Your ideas on what we ought to do are welcome.

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Exhibit 1

Intellectual Property of the Hoyt Group
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Vision Enhanced: A supplement to an article titled
"The Information Revolution and Real Estate Analyses"
by Maury Seldin

Envision a PC-based decision support system for REIT investors. Eighty REITs with significant
market caps invested in core properties are pre-analyzed for value, risk, and REIT strategy in order
to enable the decision-making investor to design and/or implement investment strategies including
applications of modern portfolio theory.

Envision a seamless integration of disparate data to provide information for an analytical schematic
which applies both innovative and traditional real estate analyses to the REIT portfolios which contain
6,000 REIT properties in the database. And, envision that the rest of an institutional portfolio held
on a direct investment basis may be seamlessly integrated so that a portfolio of direct and securitized
(indirect) real estate investment may be constructed to meet an investor's strategy.

Envision that the information - data and information include both internal and external information
selected to utilize a development planning approach, i.e., a portfolio building program in which
additions and reductions of investment have been scheduled in expectation of external events which
are forecasted and monitored, and REIT and real estate performance, internal and external, are
monitored. The variables include, but are not limited to, forecasts of employment growth by SMA,
net space additions by property type, absorption, vacancies (incidence and duration), rents, and
tenancies. The results of forecasted events are synthesized into a series of indices which forecast and
monitor IRAs. Deviation of performance from forecasted values are highlighted in amber or red and
a reiterative forecasting system is imbedded in the system so that assumptions may be modified to
reflect unanticipated events and adjustments to a planned portfolio are indicated by the system based
upon predetermined criteria and such criteria adjustments as the executive decision-maker chooses
to make.

Translated, this means that the ON buttons produce a screen with queries such as "do you want to
search for REITs by value, risk, strategy?" "If strategy, which elements, aside from risk, are most
important - property type, location, payout ratio, or growth mechanism?" Individual REITs may be
selected by this and/or other criteria.

REIT information may be provided in three forms: (1) sixteen-page standard reports, (2) peer group
analyses, and (3) customized formats. The customized formats are drawn from a truncated database.
The REIT analysis is drawn from the Hoyt Model. A summary for of the Hoyt Model is presented and three monographs are provided to summarize the relevant body of knowledge. There are The Real Estate in REITs, REIT Investment Analyses, and REIT Investment Strategy. All of this is in a drill down and menu format so that the user of the "REIT Desktop Analyst" may move about the system in a user-friendly way.

The analytical components for the mirror world structure are pre-selected from proprietary data vendors and public information sources. Where competitive vendors are available, the decision maker may select from among the options. Additionally, where the analyst wishes, alternative assumptions or output numbers may be substituted.

The structure of the analyses may be to seamlessly integrate local real estate market forecasts for selected metro areas and to slice and dice market area forecasts by SMAs and submarkets to implement strategies ranging from pure plays on structural changes in economic growth to diversification strategies by property type and local economies.

Pre-existing non-REIT portfolios may be added to the system. The market analysis mirror world components may then be applied to the direct investments as well as the securitized investment.

The monitoring system from the bottom up perspective enables the executive to drill down to the property level, when these data are available, and monitor rents, vacancies, expenses, and other real estate specific activity of the portfolio. Also, to the extent that local market data are available by property type, the drill down can monitor that activity. But, most important, to the extent that any of the activities have been forecasted and the system is on-line for monitoring, deviations may be flashed to the executive.

This latest feature, coupled with a similar system for external metro area data is especially useful for the REIT executives. Within the constraints of public disclosure, such a system may be used as a marketing tool for developing investor relationships between the REITs seeking capital without heavy underwriting fees and the institutional investors, such as pension funds, who wish to place funds in real estate but operate in a financial paradigm.

Such a system would be a key competitive advantage for a real estate investment advisor who wanted to have superior reporting systems and present policy options to institutions while retaining the account as discretionary. The key is that the lay leadership of the pension funds need the information to understand the real estate investments, securitized or not, but want the separation from the individual property decisions as a protection in the capacity of a fiduciary. Such a format could present real estate portfolios in a financial paradigm.

The major difficulty of blending the two paradigms is that the risk measurement in finance is volatility based while in real estate the source, or type, of risk is of greatest concern. The real estate concepts of risk classification may be applied to non-real estate investments which would facilitate analyses of mixed asset portfolios.