

# REAL ESTATE FINANCE

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## How Much Information Is Enough?

Let's define information as both data (rent, recent absorption, prices, etc.) and third party analysis (projected MSA growth rates, REIT earnings estimates, etc.). As real estate investors, we are getting more information than ever; and, it is about to get much "better." Consider the semi stealth operation known as the realm. Go to the web site and you will find almost unbelievable promises. In fact, it is so good; it almost reminds one of Teleres.<sup>1</sup> But don't be lulled to sleep. The "who's who" of venture capital is supporting this group. They will have more products joining the flock of neat new information providers that pikenet.com keeps us up to date on.

To deal with the question of how much information is enough, consider the basic determinants of real estate values. Most of the investment information we get falls into one of three categories:

1. MSA health and development—The information ranges from measures of relative concentrations in the fast growing industries to the various regions appeal to America's ever-changing climatical preferences.
2. Submarket or Neighborhood—Is the particular area where the MSA's leaders will increasingly want to live and work? If so, the submarket may outperform the MSA.
3. Property "features, functions and benefits" (FF&B)—Does the building have the right ceiling clear, elevator speed, views, etc.? If so, it wins within the neighborhood.<sup>2</sup>

More, better, faster is good stuff, but information in all three categories is measured with error. Most regional forecasters agree that is better to be in San Jose. However, Dismal Sciences, DRI, and WEFA are not perfect forecasters as evidenced by the fact that they don't agree on even the rank order of MSA growth rates. After all, their respective MSA forecasts must add up to their

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national economic forecasts and no one has been perfect on national forecasts. On sub-markets, geography creates more measurement problems. We don't agree on the definitions of where sub-markets end; and, even if we did, the leakage across sub-markets is very difficult to measure. In the hottest neighborhoods in hottest MSAs, there are loser properties. While we now have great on line photography for subject and competing properties, we don't agree on the best FF&B. Beauty is in the eye of the beholder and the increasingly important dot.com CEO looks with different eyes than the old economy CEO. We can't even agree on the less aesthetic more technical issues such as the exact value of alternative locations on the fiber optic backbone for telehotels.

Most of these measurement issues are not new. Recognizing the "measurement with error" problem, the traditional appraiser thought he or she was doing a good job if 95% of the time they were within +/- 10% of the actual trade price.

So, in the New World, how much more information delivered instantaneously, do we need? If it is free (or very cheap), the answer is easy. However, nothing is ever totally free, there is always an opportunity cost in terms of time. In a time constrained environment; one gives up looking at other things to focus more intently on easily available information.

What matters most for investors is not slightly better ever more exhaustive work with an ever-larger number of elements. It is not a matter of more accurately determining if the IRR on a prospective five-year hold will be 10.5% or 11% under certain assumptions. Rather, it is whether real estate is a better bet than stocks and whether a particular piece of property is a better bet than another piece of property. These relative performance issues are what separate good investors from average investors.

As we look more exhaustively at something that is never measured without error, we may miss the major changes in the economy. What such changes will mean for relative values is what really counts. How many of Pike's list of thousands of real estate web sites focus on the big changes vs more/faster detail information?

Institutions could do better by admitting the traditional +/- 10% on value and worrying more about systematic exposures to big changes. After all, as long as the multiple measurement errors are unbiased, they will tend to cancel out. Systematic exposures to the real estate ramifications of major changes don't usually cancel out

## ENDNOTES

<sup>1</sup>This early 1990s company financed by Argon and Dow Jones likewise promised to put all real estate information at the investor's fingertips in a compatible, easy to use format. It didn't do so well.

<sup>2</sup>All three categories of information are presented on-line with strong GIS linkages so you can see the winners on your map of choice.

**Mike E. Miles**  
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