

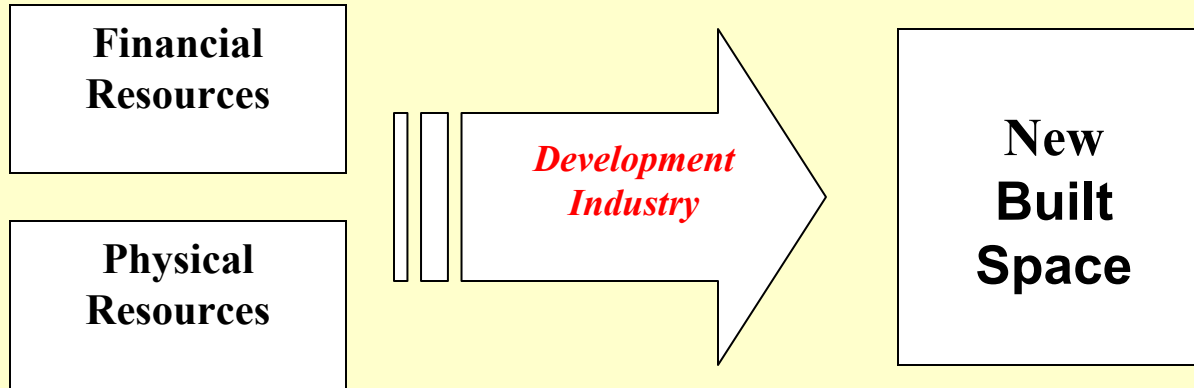
# Chapter 2:

## The Real Estate System

# The Real Estate System

1. The development industry
2. Overview of the R.E. “system”
3. The “4-Quadrant” model (4QM)
4. Using the 4QM to understand “boom & bust” cycles in R.E.

# 2.1 The Commercial Property Development Industry



# The Development Industry

Development is a ***creative***, entrepreneurial process characterized by...

*Vision*

*Greed*

*Cooperation*

*Risk*

(All the most *entertaining* features of American capitalism.)

# Development (cont.)...

- **Cooperation:**
  - Between *public* & *private* sectors;
  - Between *developers* & *financiers*.
- **Risk:**
  - Even an economy in recession needs an *existing stock* of built space.
  - *New* space (need for development) results only from economic *growth* &/or *change*.

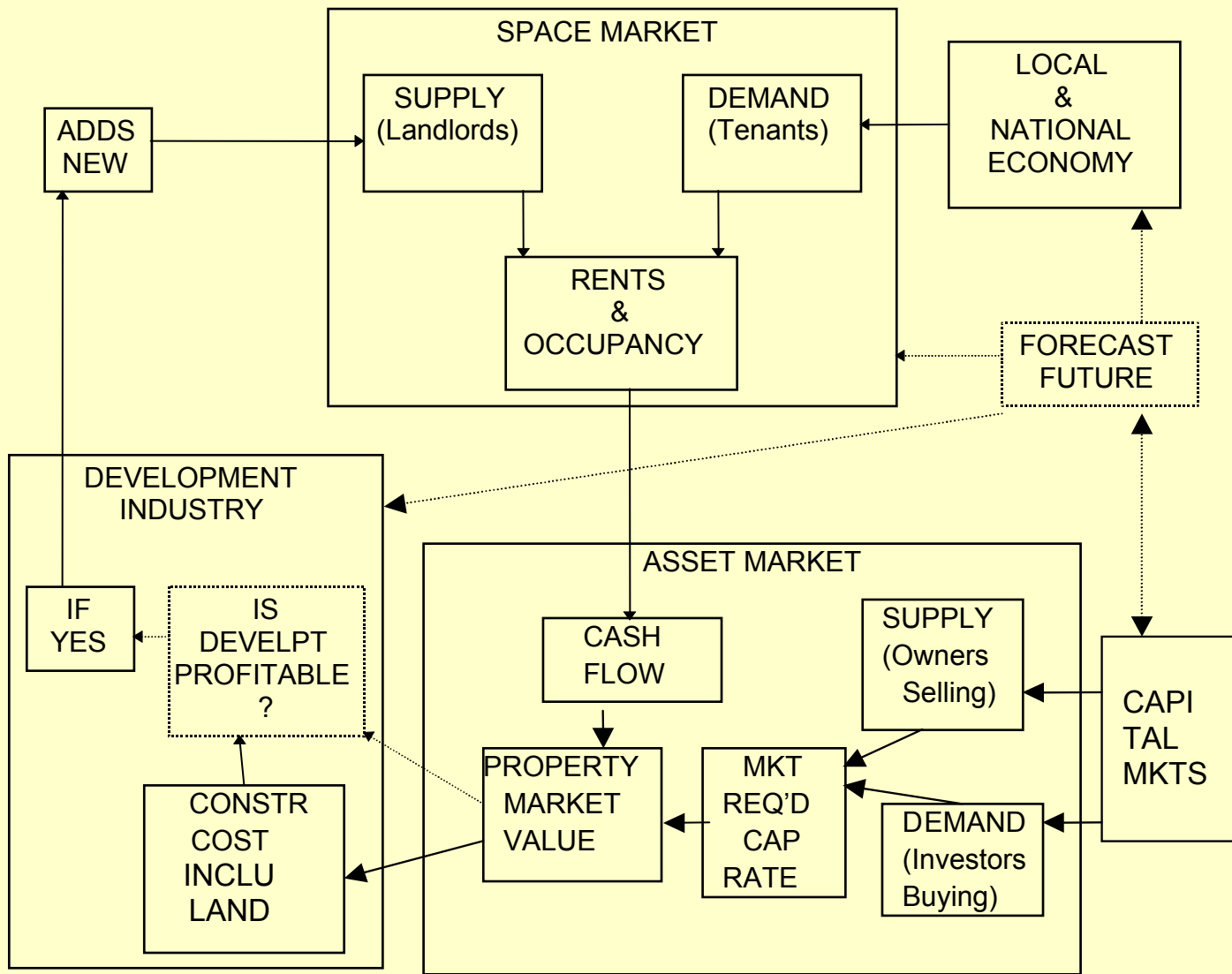
# Development (cont.)...

*R.E. Development is therefore dealing with the dynamic “cutting edge” of the physical built environment.*

This makes development ***the most cyclical*** branch of the real estate industry...

## 2.2 The Real Estate System

Exhibit 2-2: The “Real Estate System”: Interaction of the Space Market, Asset Market, & Development Industry



—————> = Causal flows.

.....> = Information gathering & use.



# “Negative feedback loops”...

Mechanisms within a system that tend to *dampen* the changes in the system, helping to keep it in control, preventing it from spiraling out of control.

# *Example:*

A **thermostat** puts a negative feedback loop into a heating and cooling (HVAC) system in a building.

- When the temperature in the building gets too low, the thermostat triggers the heater.
- When the temperature in the building gets too high, the thermostat triggers the air conditioning.

The result is that the building temperature remains “under control”, within a comfortable temperature range.

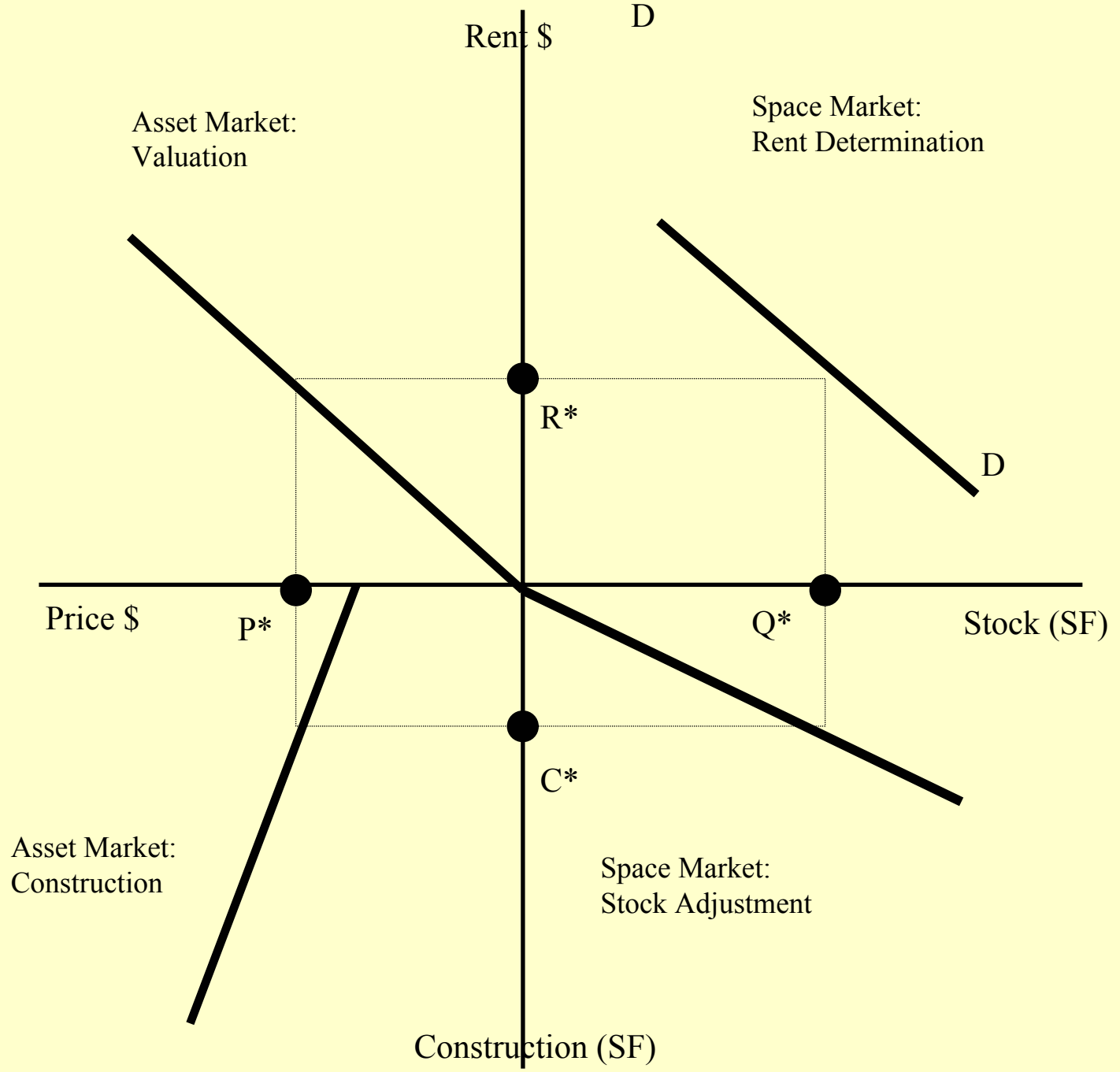
# Concept check:

*How do the **development industry** and the real estate **asset market** work together to provide a (long-run) negative feedback loop in the Real Estate System? ...*

*How can “**forward-looking**” behavior (good forecasting of the space market) in the development industry and R.E. asset market (capital market) **improve** this negative feedback loop? ...*

## **2.3 The “4-Quadrant Model” (4QM)...**

Exhibit 2-3: The DiPasquale-Wheaton 4-



## 2.4 Using the 4QM to help understand “boom & bust” cycles...

# EXHIBIT 7-10: THE "ROLLER COASTER RIDE" IN COMMERCIAL PROPERTY PRICES OVER THE LAST QUARTER-CENTURY . . .

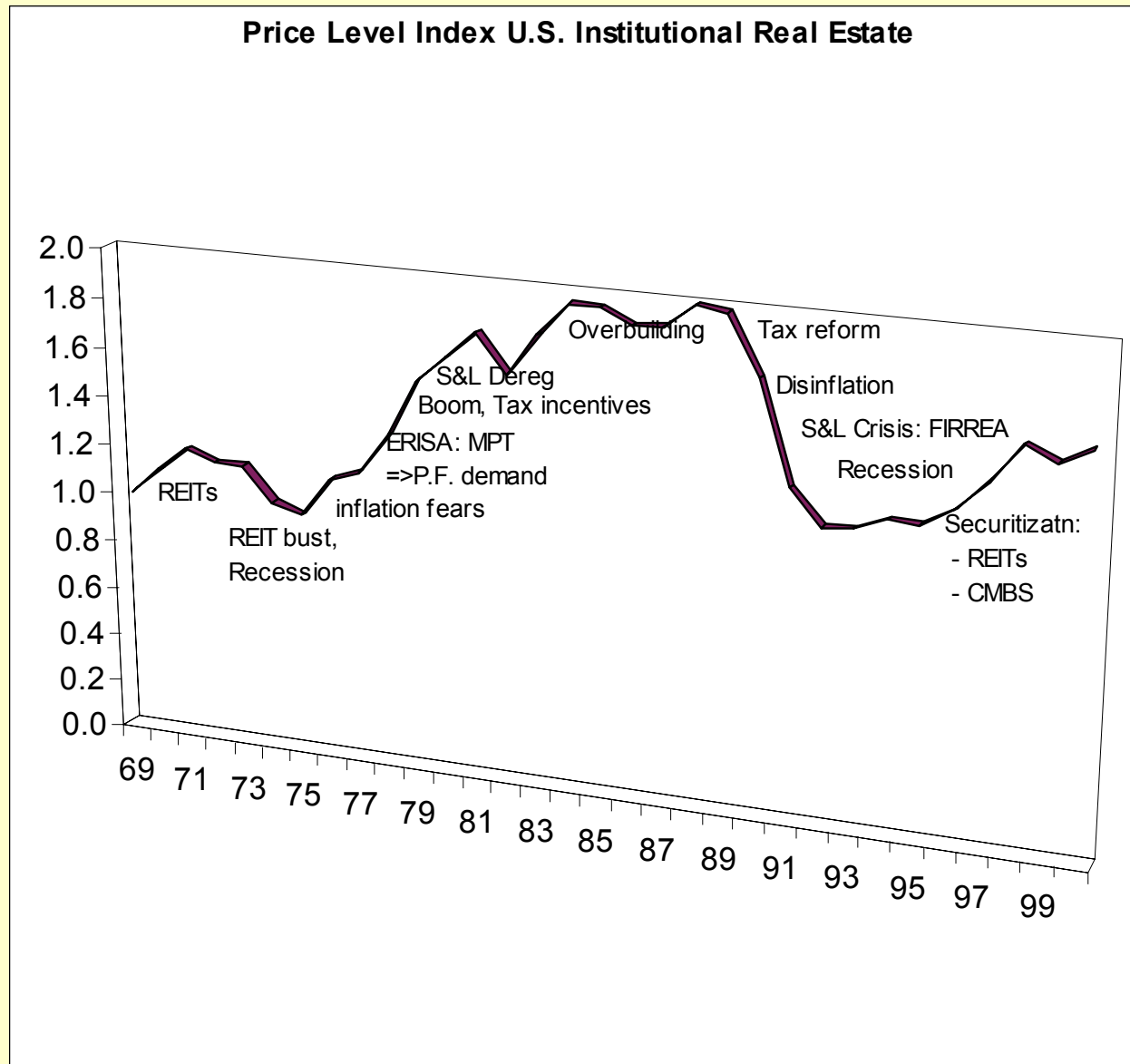


Exhibit 2-4a: Effect of Demand Growth in Space Market:

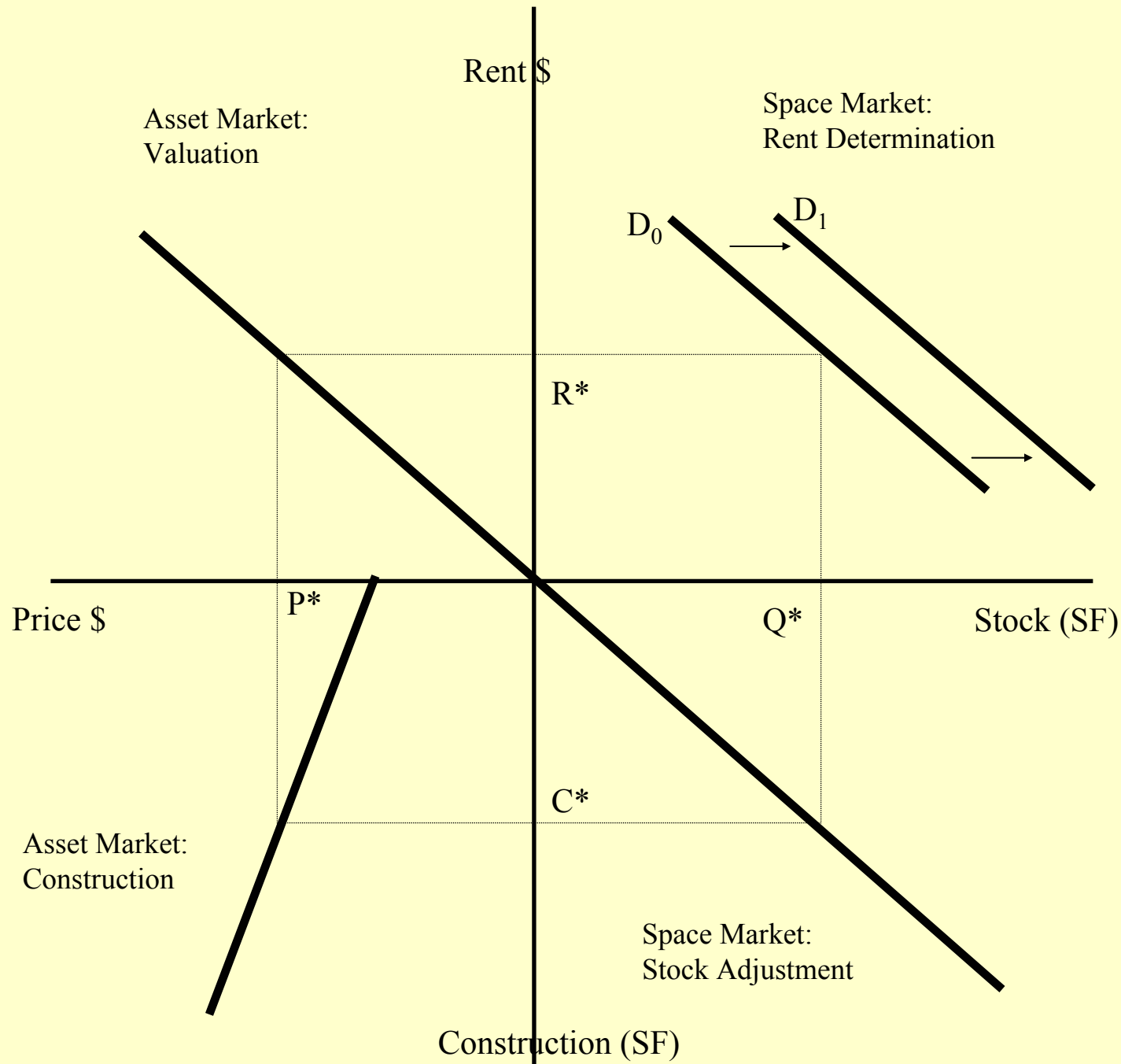




Exhibit 2-4a: Effect of Demand Growth in Space Market: **First phase...**

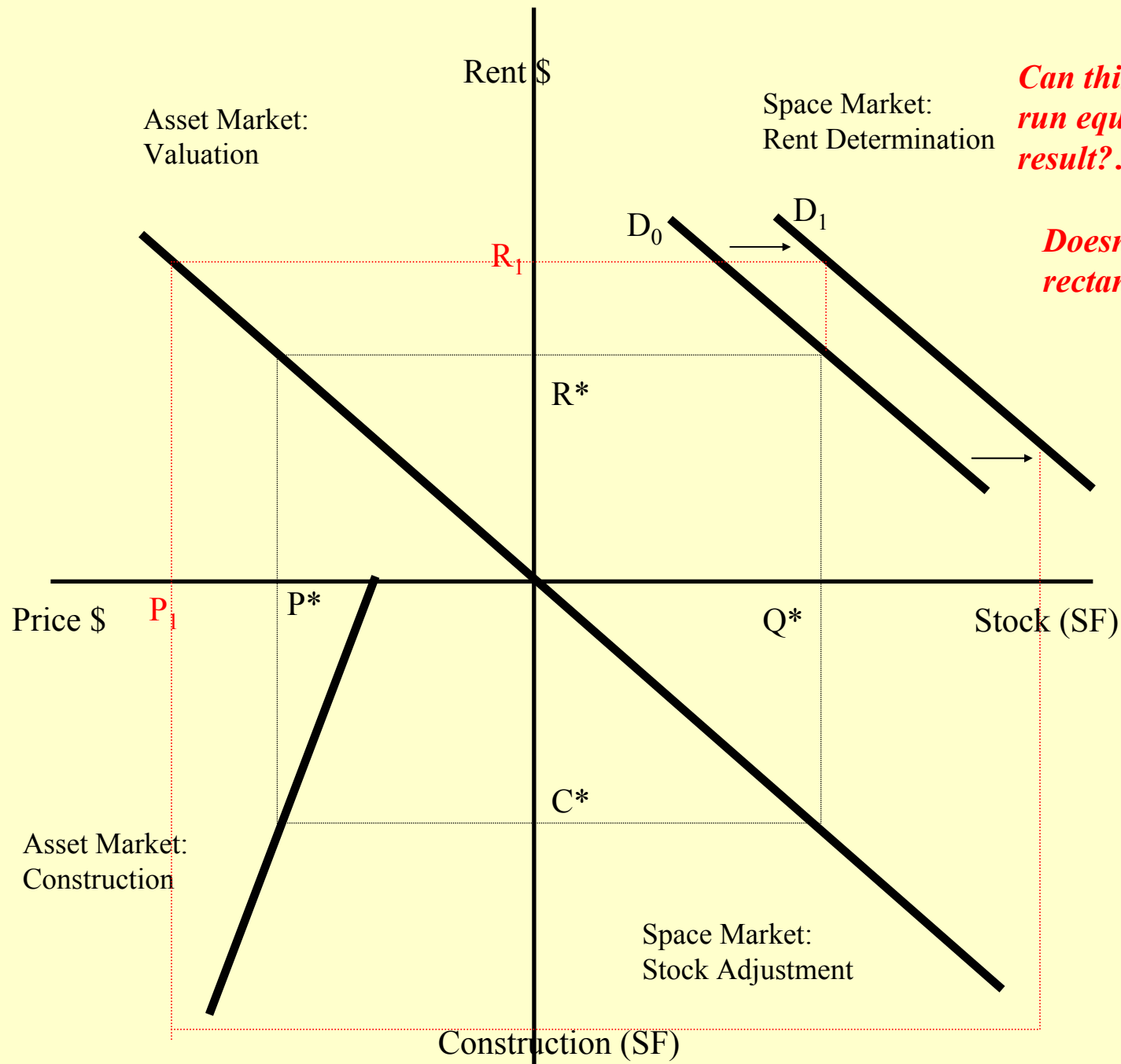


Exhibit 2-4a: Effect of Demand Growth in Space Market: **LR Equilibrium...**

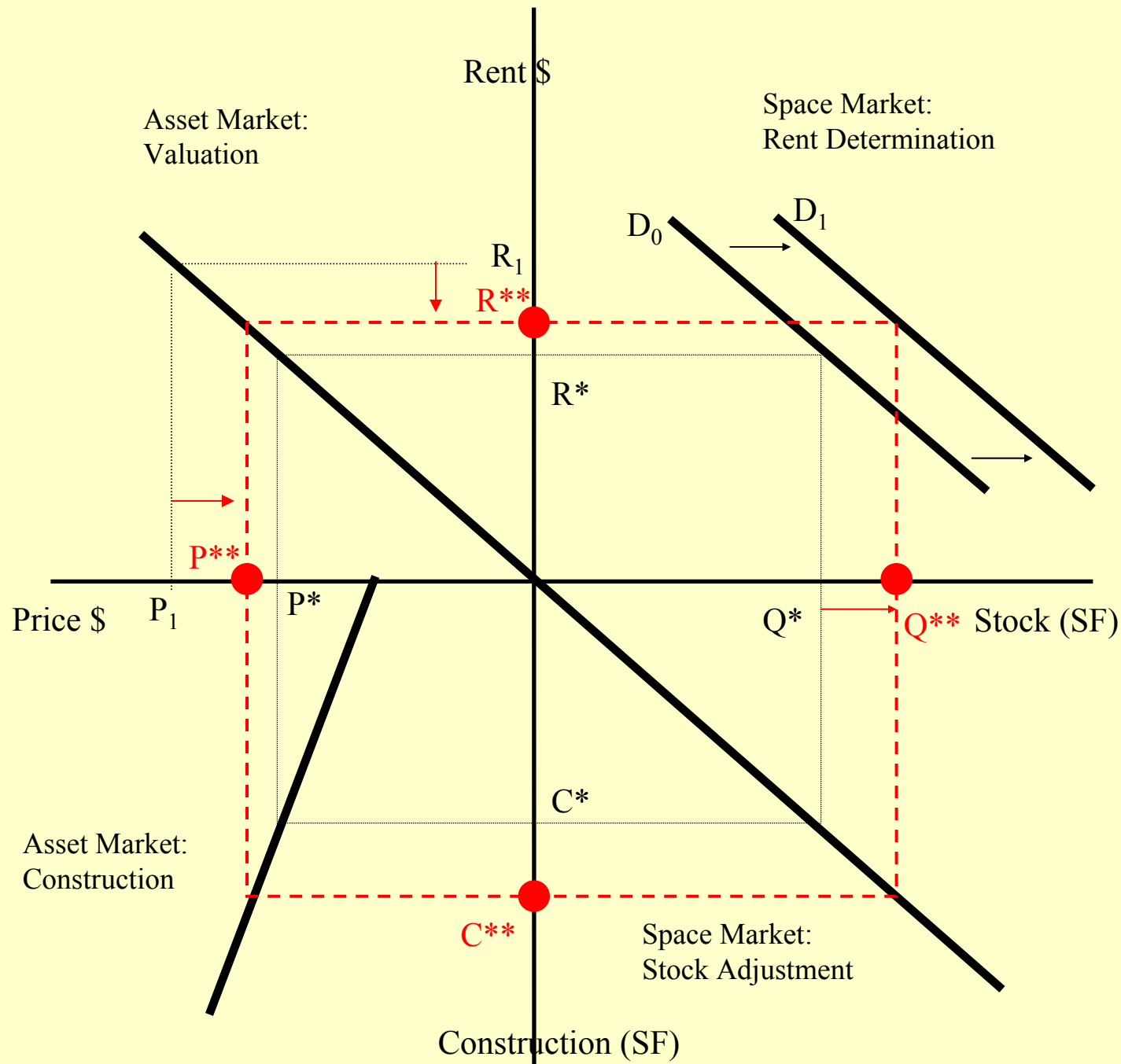


Exhibit 2-4a: Effect of Demand Growth in Space Market: *LR Equilibrium...*

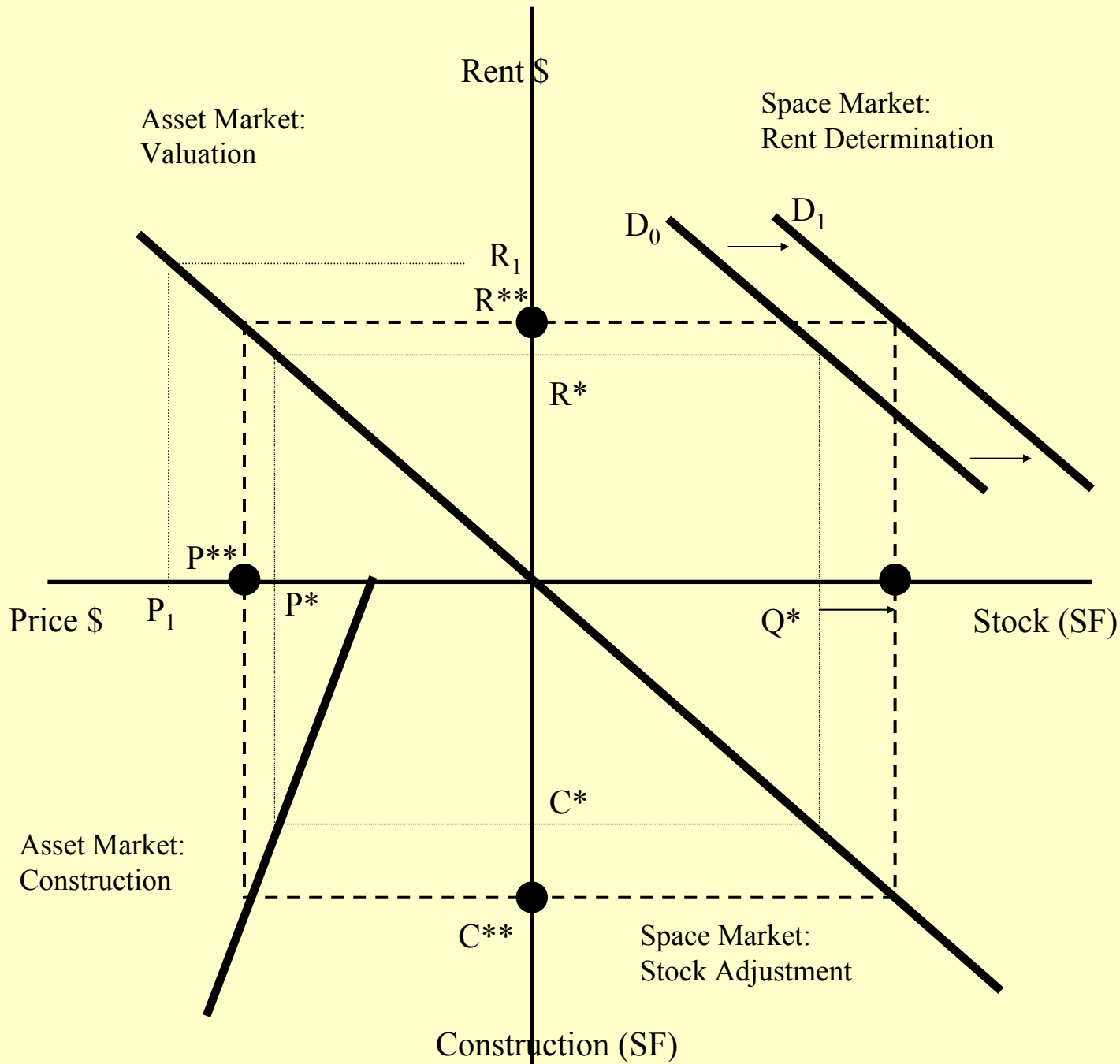
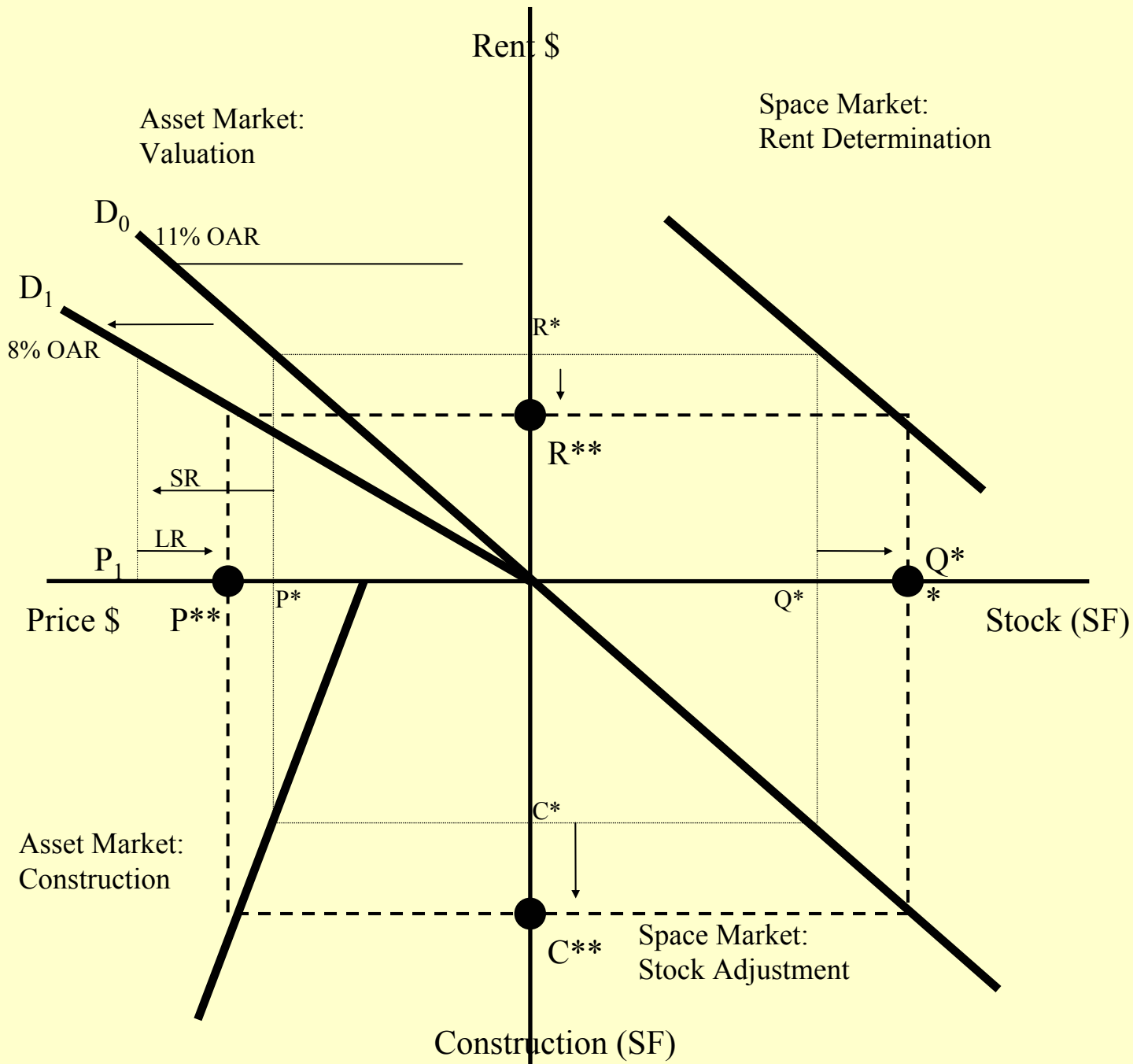
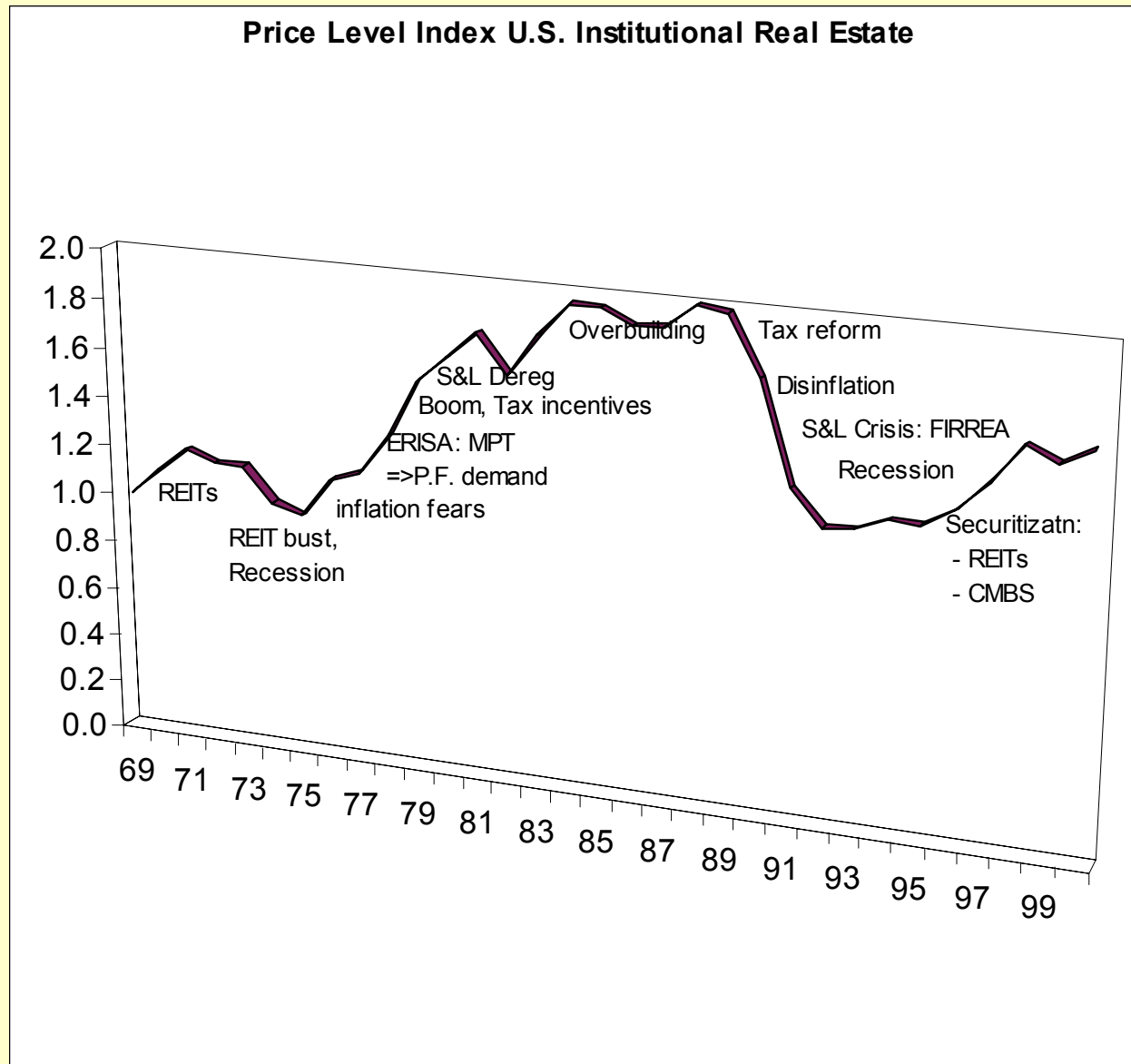


Exhibit 2-4a: Effect of Demand Growth in **Asset** Market...



# EXHIBIT 7-10: THE "ROLLER COASTER RIDE" IN COMMERCIAL PROPERTY PRICES OVER THE LAST QUARTER-CENTURY . . .



# Concept check...

- 1. What does the 4Q Model reveal about the interaction of the space market, the asset market, and the development industry in causing “boom & bust” cycles?**
- 2. How can the an understanding of the 4Q Model help participants in the asset market and development industry to avoid “boom & bust” cycles? *[Hint: Can the 4Q Model help with “forward-looking” decision-making?...]***