

# New Tools to Prevent Another Boom-Bust Scenario

Going forward, how can we develop a more objective and comprehensive framework of market-based due diligence?

By PATRICK S. DUFFY



**T**he building industry largely missed the signs of the housing bubble, ignored its profound consequences, and adjusted too late. What went wrong? How can it be fixed?

The first question is easy to answer: Blinded by one of the greatest housing booms in history, homebuilders and developers enlisted compliant market research consultants to massage and parse data in support of assumptions that had little basis in reality. I distinctly remember reading a market study a few years ago that proclaimed new construction was able to command a 50 percent premium over the existing resale stock in a popular, high-income suburb of Los Angeles. And just what was this premium based on? Because they said so.

Not surprisingly, the urban division of that homebuilder was among the first to fail. In its wake, it left the partially finished shell of a large project in the middle of a dense — and formerly gentrifying — neighborhood, thus also punishing thousands of neighbors for its internal myopia. It's hard to imagine worse publicity for the building industry than that.

So how can this be fixed? Hopefully, the industry's own role in helping to destabilize the global economy by over-building for false demand will never be repeated, but these boom-and-bust cycles do have a tendency to repeat themselves, in large part because solid, objective data is often difficult to obtain.

For example, state-mandated affordable housing study guidelines require consultants to use demographic estimates from private companies, such as ESRI or Claritas, that — at

least for now — can be based on Census data that's more than 10 years old. Therefore, if the mathematical models used by Wall Street firms to gauge risk on mortgage-backed securities failed so spectacularly, why should we assume the forecast models used by demographers are any different?

Although these companies will soon be updating their databases as more findings

... population growth of 2 million per year is exciting, but the winners will excel only by ensuring that they're building for the right buyer (or renter) in the right locations.

from the 2010 Census are released, for each year that passes, the data only becomes more stale. Moreover, the changing demographics of the country's population — which is now projected by the United Nations to grow from 310 million to 400 million in 2050 and nearly 480 million by 2100 — will require the building industry

to better match supply with demand. To be sure, population growth of 2 million per year is exciting, but the winners will excel only by ensuring that they're building for the right buyer (or renter) in the right locations.

Fortunately, soft markets can be the best time to try out new strategies, and formulating a new framework for due diligence is becoming a crucial topic of discussion for builders, developers and investors. At this month's 2011 PCBC in San Francisco, two different panels moderated by G.U. Krueger of HousingEcon.com on which I will be participating will focus on reforming how housing market research is conducted, analyzed and distributed.

Split between two different days, the Consumer Insights panel will focus on today's homebuyer, including those investors buying foreclosures or REOs and the impact of shadow

supply. It will also ask how to best quantify the behavior of groups, such as baby boomers or Millennials, and how they're reacting — often in different ways — to being surrounded by an increasingly diverse population. The next day, the Innovation Strategy forum will review market research techniques which haven't worked, such as faulty pent-up demand assumptions, the difference between cyclical and non-cyclical factors and new tools that we are now using to better gauge housing demand based on job growth. To be sure, history may repeat itself, but we can at least seek to moderate the damage.



**Patrick S. Duffy** is a principal with MetroIntelligence Real Estate Advisors ([www.metrointel.com](http://www.metrointel.com)), a division of Beacon Economics ([www.beaconecon.com](http://www.beaconecon.com)), and authors *The Housing Chronicles Blog* ([www.housingchronicles.com](http://www.housingchronicles.com)). He may be contacted at [pduffy@metrointel.com](mailto:pduffy@metrointel.com) or at 888-82-DEVELOP.

## Fast Facts

- Market research techniques need to evolve and reform.
- Objectivity should never be clouded by short-term gain.
- Builders need to plan for an increasingly diverse population.
- New tools make matching supply and demand easier than ever.