BUILDING YOUR BUSINESS: MARKET STRATEGIES

Rethinking the Way We Analyze Information

Methods for computing company profitability are in need of an overhaul in favor of accuracy.

By Patrick S. Duffy

Recently, I was talking with a reporter and well-known blogger in Orange County, California who told me a story of an in-house market research analyst for a major home builder whom he met at a local soccer game during the tail end of the housing bubble. "I really envy what you do for a living," he told the reporter. "You get to tell the truth."

Having worked not just for various real estate consulting companies but also for a public home builder and a large land developer in my building industry career, I knew exactly what this guy meant. With internal pressures to hit certain targets for prices and absorption, failing to help make a division president's pet projects see the light of day could otherwise mean the end of an interesting and well-paying job.

When I first started writing market studies in the late 1980s, figuring out the demand for new homes in specific price ranges based on growth in employment and households was a requirement for a full-fledged analysis. But by the late 1990s, as the market began to rebound and public home builders snapped up local companies, the only data many clients wanted to see were the prices and sales velocity of their top competitors.

Indeed, some companies offering consulting services to developers owe their entire growth strategies to their reputations for providing supposedly objective reports – at least from the unknowing point of view of compliant construction lenders – that would magically hit pre-set targets for prices and sales velocity. But dig a little deeper and you would often find a highly suspect analysis obscured by expertly formatted exhibits, sunny narratives

> **As the market began to rebound and public home builders snapped up local companies, the only data many clients wanted to see were the prices and sales velocity of their top competitors.**

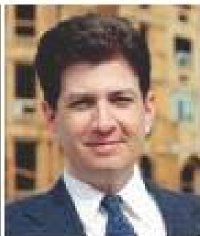
and professionally bound copies on expensive paper. Today, one only needs to follow the trail of bankrupt land development deals and mothballed projects to see the true consequence of such financial sleight of hand, in which an entire industry must pay the price.

One company which soared during the boom did so due to its reliance on 'econometric modeling' (a fancy word for statistics) and some admittedly impressive but off-the-shelf software that allows clients to alter recommended prices based on changes in interest rates, existing home prices and other factors. By charging several times the typical rate for market studies and declaring all staff members to be in the "Top 5% IQ in the country" (with no apparent proof to back up the claim), the firm would provide clients with Bible-sized reams of data comparing proposed projects against not just direct competitors, but also home sales by zip codes, submarkets and county regions. Recommended prices were ultimately determined not by an experienced consultant who knew why Builder A could command a premium over Builder B, but by simply averaging averages: if this is the average price from this zip code and among these competitors and from this county, then here's your price. Next!

So how do you know if you can trust a consultant? I'd say the willingness to state the truth in public, even if it risks alienating potential clients who would prefer listening to sycophants. For MetroIntelligence, this search for the truth led to a partnership with Beacon Economics, which has emerged as a trusted source to the media as well as clients in the private and public sectors. Rather than warning about the bust to come, we're now talking about how and when to prepare for the rebound. And finally being able to tell the unvarnished truth to clients willing to listen – apparently with the entire economy at stake – has never been so important.

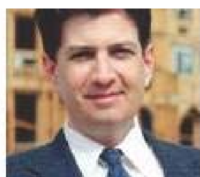
Patrick Duffy *is a Principal with MetroIntelligence Real Estate Advisors (www.metrointel.com), a division of Beacon Economics (www.beaconecon.com), authors The Housing Chronicles Blog (www.housingchronicles.com) and contributes to the Wall Street Journal's Developments blog. He can be reached at pduffy@metrointel.com or at 888-82-DEVELOP.*

Fast Facts



- Truly objective market studies should accompany all development projects.
- Determining housing demand should be required for all market studies.
- Lenders should perform better due diligence on third-party consultants.
- Wishful thinking should never override the realities of careful analysis.

Fast Facts



- Truly objective market studies should accompany all development projects.
- Determining housing demand should be required for all market studies.
- Lenders should perform better due diligence on third-party consultants.
- Wishful thinking should never override the realities of careful analysis.