

## the big idea RCLCO'S FOR-SALE HOUSING MARKET OUTLOOK

As the close of 2007 approaches, it's clear that there was indeed a for-sale housing bubble in many parts of the United States, and that it has burst. Conditions in many markets feel much like they did in 1990—the last time builder confidence was about as low as it is now.

This Advisory begins with RCLCO's current housing market outlook, followed by a summary of what is working in various locations and some recommendations to achieve success in these uncertain times. It then takes a closer look at current market conditions and how we got to where we are now, and provides some of the background behind our Outlook.

All of us at RCLCO of course would be pleased to discuss our outlook with you, as well as any ways that we can help you make the best of this challenging period.

### RCLCO's Outlook

RCLCO's current outlook is that the mortgage crisis and resultant restructuring, and likely slower economic growth if not a proper recession, will result in a longer downturn than had been anticipated even a few months ago. Furthermore, the high exposure of areas such as Texas to subprime mortgages will drag down even markets that did not overheat, making the problems much more national than they had been. (Many previously overheated areas, such as in California and Florida, are also suffering from subprime mortgage problems.) A just-completed RCLCO survey of real estate leaders in the Washington, D.C., area revealed that 73% expect a recession within the next 12 months if not sooner.

Nevertheless, the recovery will occur at different clips in different places—it will be very specific to location, product, and price range. In general, closer-in portions of metropolitan areas with stronger job growth, with supply constraints and relatively low oversupply of built product, will recover most quickly. Homes that are priced relatively affordably, even if they are smaller, will tend to do best in any given location, with the very high end also doing comparatively well in some areas.

Overall in the U.S., we expect that prices may still take two more years to settle down to levels that will bring buyers back into the market. The D.C. area real estate leaders who responded to RCLCO's survey are somewhat more optimistic on average—60% expect new home prices to reach bottom in 2008. The largest number of respondents (53%) expects new home prices in the D.C. area to decline by an additional 6%-10% before reaching bottom. In any given location, we anticipate that greater additional adjustments will be required in prices of resale homes than in those of new homes. We expect it will be three or more years from now on average before excess inventory is worked off and supply and demand are back in balance, which will be necessary to enable prices to start

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increasing again.

However, in some metropolitan areas and submarkets, economic and market forces may create a brighter outcome, with prices bottoming in one year and excess inventory taking no more than two years to work off. Conversely, recovery may be delayed further if a recession does occur.

### What's Working Now Will Work for the Next 2-5 Years

Currently the strongest performers in residential real estate in the U.S. include:

- Primary homes in first-tier suburbs (including closer-in master-planned communities) with employment and shopping in place, particularly in infill, supply-constrained locations in high-growth markets.
- Builders and developers who have been able to lower prices quickly because they own or control legacy land or lots priced at levels of 2001-02 or earlier.
- High-end mountain, ocean, and lake resort communities. Prices have been holding steady, with sales volumes dropping 20% to 30%. While traf-

fic in these locations is down, conversion rates remain near 2006 numbers. Sales activity is concentrated at the lower end of the price offerings.

More generally, the best performers relative to their direct competitors:

- Are focused on execution;
- Are very oriented to marketing and customer service;
- Provide a high level of amenities;
- Appeal to multiple market audiences;
- Offer a range of products and price ranges;
- Have a strong brand; and
- Are well located.

Outside the U.S., the strongest performance has been seen in supply-constrained destinations with healthy source markets where wealth is being created. Russia, the U.K., Western Canada, the Mediterranean (North Africa, Italy, and Spain), and the Middle East are all prime examples. East and Southeast Asia and India are awakening giants, with strong potential for the future.



## Strategies for Success in Uncertain Times

We have the following strategic recommendations for builders and developers for the next few years.

<p><b>1. Stop Pretending the Market Hasn't Changed—It Has!</b></p>	<ul style="list-style-type: none"> <li>• Time to revisit your segmentation model</li> <li>• Invest in research to relearn who your customers are and what they want</li> <li>• Reinvent your sales and marketing approach</li> <li>• Adjust your unit sizing and pricing—smaller units and lots may be the only way to hit necessary price points and still make money, while oversized homes in fringe locations will likely perform poorly for years to come</li> <li>• If possible, consider projects that can stay within conforming loan limits in closer-in locations</li> </ul>
<p><b>2. Get on the Offensive—Test Your Corporate Strategies and Efficiencies</b></p>	<ul style="list-style-type: none"> <li>• Dust off your corporate strategy and make sure it is still relevant</li> <li>• Consider a strategy audit to test and refocus core competencies and strategies</li> <li>• Quit doing what's NOT working</li> <li>• Assess your pipeline to understand what you have and where you are most exposed</li> <li>• Go for market share, don't focus on margins</li> </ul>
<p><b>3. Take a Serious Look at Your Portfolio—Is It the Market or Is It You?</b></p>	<ul style="list-style-type: none"> <li>• Benchmark your performance against the market</li> <li>• Develop criteria to evaluate location and product type for your portfolio strategy</li> <li>• Prioritize markets and products</li> <li>• Determine and define the timing appropriate to maximize your investment</li> </ul>
<p><b>4. Recognize Market Nuances</b></p>	<ul style="list-style-type: none"> <li>• Not all markets are behaving the same; evaluate locations and product types in accordance with submarket realities—don't get too caught up in the national or regional averages</li> <li>• Understand which markets are being underserved</li> <li>• Understand land values</li> </ul>
<p><b>5. Got the Right People on Board?</b></p>	<ul style="list-style-type: none"> <li>• Critically evaluate your human capital as you would your financial capital</li> <li>• Take advantage of opportunities to hire talent as others shed staff</li> </ul>
<p><b>6. Return to Basics</b></p>	<ul style="list-style-type: none"> <li>• Refocus on location and product</li> <li>• Step up your market analysis and due diligence</li> <li>• Focus on execution – take hard and soft dollars out of your cost structure</li> </ul>
<p><b>7. Revisit Project Amenities to Compete—What Do People Really Value?</b></p>	<ul style="list-style-type: none"> <li>• Think about reprogramming existing amenities and reformulating your marketing plans</li> <li>• Golf is generally out; health and well-being are in</li> <li>• Cultural and extended learning opportunities are on the rise</li> </ul>
<p><b>8. Understand Demographic Trends and Consumer Demands</b></p>	<ul style="list-style-type: none"> <li>• The Gen Y wave—are you ready for it?</li> <li>• Boomers and Gen X</li> <li>• The melding of lifecycles and lifestyles</li> </ul>
<p><b>9. Accumulate “Dry Powder” and Use It to Take Advantage of Opportunities</b></p>	<ul style="list-style-type: none"> <li>• Someone else's pain can be your gain</li> <li>• The worse the downturn, the greater the buying opportunities are; some fantastic deals will probably become available; one-third of the respondents to RCLCO's survey expect a significant number of suburban land transactions to finally occur within the next 6-12 months, with another third expecting to wait until 12-18 months from now</li> <li>• Figure out what you would invest in where, and at what price, and start looking even though good deals are still rare—then have the patience and wisdom to act at the right time</li> <li>• Cash will be king – hold on to yours</li> </ul>

## Current Market Conditions

U.S. home sales and starts have declined precipitously since early 2006. Total seasonally adjusted starts in October 2007 were slightly higher than in September due to an increase in multifamily construction, but 46% lower than in peak month, January 2006. Single-family detached starts were lower than in any other month since October 1991.

Prices, on the other hand, have remained comparatively steady, although they have declined at least somewhat in most areas. The S&P/Case-Shiller Home Price Index of resale single-family homes for 20 large metropolitan areas showed a 5.3% decline from peak pricing as of September 2007. Other than economically depressed Detroit (down 12.8% from its peak), the sharpest declines from peaks (between 8.9% and 11.7%) have been in markets that experienced rapid price increases earlier in this decade, such as Miami, Tampa, Washington, D.C., San Diego, Phoenix, and Las Vegas. A few particularly land-constrained markets that also experienced rapid price increases—New York, San Francisco, and Los Angeles (including Orange County but not the Inland Empire)—have seen less severe price drops from their peaks (4.4% to 7.0%). Markets with healthy economies that did not fly as high early in the decade (Atlanta, Dallas, Portland, Seattle, and Charlotte) had just begun to show price declines from their peaks as of September 2007. However, many of the non-boom areas have heavy exposure to subprime and Alt-A mortgages, so they are likely to be increasingly drawn into the slowdown in coming months.

In most of the previously boom markets, resale price increases racked up since mid-2005 have been given back—but probably still not enough to achieve the affordability required to generate healthy sales. Only Boston and San Diego have already seen prices return to 2004 levels. Resale prices in most other high-flying markets would still have to decline by 15%-35% to return to 2004 levels.

Homebuilders in the most overheated markets have generally been dropping effective prices more than resale home sellers. So builders have already absorbed some of the price correction that's likely to be necessary for sales to revive. However, the Census New Residential Sales Index has only picked up this trend recently, reporting the first drops in nominal median home prices since 1991 beginning in the second quarter of 2007. The median new single-family home

price according to this index was 9.3% lower in September 2007 than at the peak in March 2007.

## We've Been Here Before

The present environment feels very much like the late 1980s to early 1990s. By 1990, resale prices had reached what turned out to be their cyclical peaks in such markets as Los Angeles, San Francisco, San Diego, Washington, D.C., and Boston. New home construction dropped precipitously in 1990, and a financial crisis was brewing, driven by poorly underwritten lending and investment.

## How We Got Here

The cyclical nature of the housing market is largely dictated by supply and demand fundamentals. Demand for housing outpaced supply for 12 of the last 15 years, which pushed up prices rapidly in many areas. Equilibrium was reached in 2005, and supply now exceeds demand. Although the extreme boom and bust nature of this cycle led to a significant decline in consumer confidence, the essential problem is not that consumers are irrationally skittish. Consumers are generally smart, and they recognize that it's unwise to buy when there is a supply/demand imbalance and prices are higher than many other buyers can afford. As the homebuilding industry cuts back production and owners shift for-sale properties into the rental market, and in all likelihood prices adjust somewhat further downward, supply and demand will move back into balance as the first step in the process of recovery.

The housing bubble was caused by this confluence of supercharged demand and, initially, constraints on new development, as well as relatively few existing homes coming to market. By the time prices had been bid up to unsustainable levels (in 2005 in many hot markets), builders and developers had figured out how to dramatically add to the supply of lots and homes (often by paying too much for land in far-out locations), and a flood of homeowners decided it was finally time to try to cash in on the boom before it was too late. The situation has been exacerbated by homes coming back on the market because of the subprime and Alt-A mortgage crisis, combined with a tightening of credit for households who would consider buying.

## Increased demand

In response to the 2001 recession and the 9/11 attacks, the Federal Reserve cut interest rates in an attempt to keep the economy on track and prevent a more severe recession. The lower interest rates encouraged many new households to consider homeownership. In turn, lending institutions financed homes for buyers who would have previously been considered unqualified, often using adjustable rate mortgages and/or interest-only loans. These newly qualified buyers were also added to the growing ranks of those interested in purchasing homes.

As demand intensified, too much money was chasing too few deals. Buyers were flush with cash and cheap financing, buying everything available, and pushing up prices in an effort to secure property at almost any cost. Psychological factors also began to spur households to buy in time to stay ahead of the curve. The media reported rapidly rising home prices, and buyers increasingly felt that if they did not buy right away, they would be priced out of the market forever. Land-constrained markets became engulfed in a speculative fever, as real estate investment was encouraged through the publication of such books as "Are You Missing the Real Estate Boom?" by the National Association of Realtors' chief economist, published in February 2005.

## Oversupply

Developers and builders, also flush with plentiful and cheap money, and confident that home prices would continue to increase, aggressively acquired land and ramped up production in an effort to meet the growing demand. Finding land to purchase became challenging, particularly with anti-growth sentiments rampant in many areas, so new projects were being conceived in pioneering locations, but with cost structures that necessitated high prices. Even though these locations were often second and third tier, developers began to believe their own story and the "value of their brand." To a large extent, the success developers were experiencing wasn't their own creation. They were simply in the right place at the right time with a product that, even if wrong, was "better than nothing" for the customer. These transactions drove up land prices,

which drove up home prices, which further bid up land prices and reduced land inventories. Demand appeared much deeper than it really was because supply lagged behind demand, and rapid price increases combined with cheap money attracted a flood of speculative investors.

Finally, beginning in late 2005, the market began to attempt to correct itself. Home sales slowed as too much inventory clogged the market. Speculators got caught between buy and sell cycles, as buyers were confused and concerned by the continued addition of new offerings to the market, and price increases rose beyond fundamentally supportable levels—far outstripping increases in incomes. The result was the bursting of the housing bubble, as production outpaced sales and buyers became justifiably cautious.

Mortgage problems further intensified the troubles in the housing market. Homeowners with questionable qualifications who were approved for financing began defaulting on their mortgages. These foreclosures added to the already swollen inventory of homes on the market, and the problem will likely get much worse before it gets better. According to Bear Stearns, foreclosures will reach an annual pace of \$1.8 billion in the fourth quarter of 2008, compared with \$660 million between 2002 and 2006. Problems within the credit industry led to tightening of lending standards and fewer lenders. Though these corrections have helped move the mortgage industry back towards sustainable practices, fewer potential buyers can purchase homes, which will slow inventory work-off.

## Underpinning of RCLCO's Outlook for the Next Few Years

With such dramatic changes underway, what builders, developers, and investors do in the next three years could well determine how successful they are over the next 10.

Though economists are divided on the probability of a recession, the economy is in a precarious position. There is some good news. The Commerce Department reported that the economy grew at a robust 4.9% pace in the third quarter, after a 3.8% pace in the second quarter. The Federal Reserve Bank cut interest rates 25 basis points to 4.5% on October 31, following a 50 basis point cut in September. Hopes are also pinned on the strength of exports due to the weak dollar. And, of course, the underlying demand

for housing in the U.S. is strong.

Despite these notes of optimism, at least a shallow recession is increasingly likely. Wall Street Journal economics editor David Wessel contends that housing market problems are too pervasive to avert a recession. He predicts that the slow stabilization of the housing market, coupled with rising oil prices and increasing credit problems, will result in a short and shallow recession. However, he anticipates that further interest rate cuts will prevent a more significant downturn.

History does not bode well for rapid recoveries from bursting housing bubbles, although so far the economy is stronger than it was during previous housing downturns. In most of the markets that experienced

rapid run-ups prior to 1990, housing construction and prices did not begin to increase on a sustained basis for six to eight more years, although when prices did finally go up they regained their nominal historical peaks in only one more year. As is true today, less overheated markets were not down as much from their peaks in 1990, and they recovered much more rapidly. For example, nominal prices in such markets as Phoenix, Las Vegas, Miami, Tampa, and Charlotte had climbed back to their peaks by 1993-94.

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## in sites

### GETTING TO KNOW YOUR CONSUMER AGAIN FOR THE FIRST TIME

In the last few years, buyer frenzy in many markets was so rampant (and unhealthy) that many builders and developers could have sold sand in the desert. Today's market, of course, is drastically different. To be sure, the current for-sale housing malaise is definitely hitting the industry hard.

Savvy developers are leveraging the downturn to take a strategic pause and using the time to gain a much deeper understanding of what drives so much of the housing segment: the buyer. Where did the buyers go? Since some projects are faring better than others, did they really just disappear, or are some developers and builders simply missing the mark in their market? What does today's buyer actually want? More importantly, what will tomorrow's buyer want when the market returns? Much of this strategic discipline may have been overlooked during the boom years, and as a result many project managers don't know exactly who their target market is, what they want, how to reach them, and how best to bring them to the table. The answers to these questions are hardly intuitive and just may surprise you.

For example, RCLCO research confirms that shifts in consumer preferences have created pent-up demand for housing in walkable, vibrant, mixed-use neighborhoods. RCLCO analysis suggests that this pent-up demand may exceed the supply of currently occupied stock by 140% over the next 10 years. And demand is coming from unusual places, such

as existing owners of single-family large-lot detached housing; RCLCO research suggests that approximately 25% of these occupants would prefer small-lot, townhome, or multifamily living in their next home purchase. And while only 6% of current homeowners classify their current neighborhoods as traditional neighborhood development (TND), over 12% of homeowners would prefer to live in a TND community in their next home purchase.

Is your business model prepared for these shifts in consumer preferences when the market returns?

Detailed consumer research can help align your project with its potential buyers. Getting underneath buyer sentiments—including why some projects are successful in luring them from the sidelines while other projects continue to languish—is often the difference-maker in times of market downturn. Moreover, this type of strategic thinking can help prepare your organization to hit the ground running when the market returns. Organizations that rediscover the buyer and engage in a radical recommitment to the customer will be best equipped to survive the downturn and ride the crest on the way back up.

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## in sites CONTINUED...

### CHALLENGING MARKETS REQUIRE INNOVATIVE MARKETING

Advertising and marketing residential real estate can be challenging even under favorable market conditions. At the height of the recent housing market boom, developers found themselves engaged in fierce marketing wars. In some cases, splashy parties and signature cocktails became de rigueur for new condominium project launches, and new master-planned community launches took on almost a festival atmosphere. Such activities are less frequent in today's cooler environment, to be sure, as marketing budgets are tight and buyers are hard to come by.

During a market trough, marketing becomes more, not less, important, especially when we have gotten away from the discipline of selling, we have trained buyers to shop based on price per square foot instead of intangibles, and large quantities of homogenized "product" sits on the market chasing a finite and shrinking supply of buyers. Without thoughtful marketing, projects run the risk of becoming bland and vanilla to the buyer. Differentiating your project from the competition requires real knowledge of who your customer is (and what they eat and what they watch and where they shop and...), creative and innovative marketing strategies, and the courage to ditch the herd in pursuit of greener pastures. If you're not already doing so, now is the perfect time to revisit your branding and marketing strategy and get more, not less, creative with your advertising and marketing campaign to bring your buyers back to the market without blowing the bank.

#### Know When to Stray from the Pack

Small- and medium-sized players may want to consider scaling back on newspaper ads or even dropping them altogether. Newspaper readership overall has been in decline for decades, and even Sunday readership—which had remained stronger than weekday readership for years—is down more than 6% from its peak in 1990. With this as a backdrop, remember that when readers not already in the market see bad housing market news on pages one through five (and 24 hours a day on television), they are less likely to even open up to the real estate section on the inside unless they are bargain hunting. Finally, even if they do open to the real estate section, they are more than likely to be bombarded by a series of multi-page

ads for major national builders touting the "sale of the century" or "super close-out savings."

While such "deep discount" ads may stir up traffic to sales offices, they often do not result in actual transactions, as these methods signal to buyers that the market has not yet hit bottom. In Southern California, John Laing Homes has attempted an end-run around these discount ads, targeting buyers who need a home—not a discount investment. The John Laing "Wish List" campaign does not offer cash or discounts, but instead asks buyers to create a "wish list" that can be used to obtain an almost unlimited range of options or services—ranging from helping to pay off existing mortgages, to upgrades, to moving services—instead of a discount or concession. In its marketplace, the program has avoided the whiff of desperation and engages real buyers in a conversation that has actually led to multiple sales for the builder even in the face of stiff competition.

#### Leveraging the Blogosphere

Instead of hoping against hope that buyers are just waiting to see your ad, consider finding your consumers where they might be trolling around for informal sources of information: the blogosphere. At last estimate, four in 10 adult Americans, some of whom are potential buyers, visited a blog regularly. These potential buyers, some of whom have left the market, are blogging right now on mommy blogs, church

The screenshot shows the 'blogdowntown' website interface. The main content area features a post titled "A Peek Inside the Park Fifth Sales Center" by Dave Blacklock and Eric Richardson, dated Thursday, November 29, 2007. The post text describes a sneak peek at a new sales center for the Park Fifth project, mentioning a 14-foot tall scale model and a pedestrian walkway. The sidebar on the right includes a "blogdowntown photo pool" with several small images, a section for "add your shots", "recent comments" with a list of user comments, and "hot topics" featuring a "Ralphs Big Opening" article.

blogs, soccer blogs, HDTV blogs—you name it. Amidst all of this typing, countless real estate blogs have cropped up in recent years—a simple Google query returns almost 1.5 million of them in the United States alone that are unaffiliated with a REALTOR—and they have become the underground pipeline for hot tips and inside secrets for the real estate savvy. More often than not, postings on these blogs are fairly sophisticated and may often involve dialogues about new projects, existing communities for sale, locations, and why some new communities might be preferable to others.

Regardless of the type of blog, they typically need some sort of revenue to survive, and—here's the good news—they can offer high-profile, low-cost advertising space. While blogs typically provide ample opportunities for inexpensive advertising, the real opportunity here is to get content integrated into the discussion. A few well-placed comments by some of your satisfied buyers, or a carefully worded and non-preachy contribution from the development team itself, could find themselves landing on fairly receptive ears. This word-of-mouth advertising, which many believe is far more effective than traditional advertising in bringing buyers to new products and into new markets, has been instrumental in keeping sales afloat at several urban condominium projects along the east coast.

### Referral Dinners

There are a variety of less tech-savvy ways to get word of mouth advertising. Some developers are successfully implementing referral dinners, whereby they pay for one of their new residents to have six of their friends over to a catered dinner. Friends want nothing more than to live near each other, and it doesn't take long for dinner conversation to turn to: "So why do you like living here? Is it easy to find a home in this community? How far is your commute? Are they still selling homes?" The existing homeowner clearly wants to be proud of their home and community and can do a better sales pitch to their close friends than even the most polished agent, and the only reward they need is the pride and satisfaction in knowing that their friends trusted their advice and recommendations and will soon be their neighbors, too. RCLCO is aware of several referral dinner programs that have proven successful in catalyzing sales when selling wasn't working.

### Using Your Location, Location, Location

If word-of-mouth advertising doesn't seem like your angle, consider using the environment—be it urban, suburban, or rural—to give people an excuse to be on-site for seemingly unrelated purposes. With the winter holidays coming up, put that model home kitchen to use and host cooking classes geared for the season. The active adult buyer might prefer a wine tasting, which of course would be hosted in a meticulously furnished model home. Families are always looking for holiday events such as tree lightings or gingerbread house contests. Urban buyers might be attracted to the idea of a tour of nearby art galleries, with the building lobby or sales center as the embarkation point. In essence, this strategy embraces the notion that the sales center approach is decades old and beyond stale—it is time to blow that strategy up and develop an experiential home discovery process for your potential buyers. Whatever the strategy employed, be careful not to sabotage the effect by conflating a tactful marketing message with a frothy advertising pitch. Instead, let the medium be the message—what you are selling is the experience, and that should speak for itself.

More unconventional approaches can often achieve dramatic results, but may require the help of outside experts. For example, a Los Angeles-based public relations firm recently staged a series of improvised theatrical performances in model homes to the delight of home shoppers and the media. Titled "HomePlay" for Centex Homes and "Loft Life" for The Kor Group, these events attracted attention far and wide, from local buyers to the New York Times.

Regardless of your eventual strategy, remember that marketing your community in today's market is going to require ingenuity, creativity, persistence, and vision—facets that, until recently, were less important than a loan officer and ink pen. There are buyers out there, and communities and projects that are creative in getting their message to the buyer are showing that they are capable of bringing buyers to their products. It is up to you to truly understand who your buyer is (or might be), where best to reach them, and how to convey to them that what you are offering is not just "product," but a way of life.

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## on the ground

### CREATIVE MARKETING SELLS



Project: Barker Block Lofts  
 Location: Downtown Los Angeles, in L.A. Artists District  
 Developer: The Kor Group  
 Architect: Nakada Associates  
 Marketing Team: Roddan Paolucci Roddan

The Kor Group ([www.koratlas.com](http://www.koratlas.com)) launched sales at the 395-unit Barker Block Lofts ([www.barkerblock.com](http://www.barkerblock.com)) in the beginning of summer, 2007. To their dismay, initial sales at the project were far too slow to keep the project afloat. The developer called in Roddan Paolucci Roddan, a PR firm, to re-brand the marketing effort. The team immediately gathered to take an in-depth look at their potential buyer profiles, needs, desires, and purchasing patterns to re-launch the project.

After this due diligence, the team decided that the project needed a dose of ultra-creative marketing, and began a series of unconventional PR events. This marketing campaign was orchestrated and executed over a two-month period. Simultaneously, the team ceased nearly all newspaper ads for the project.

On one evening, they hired a well-respected theater group from the neighborhood to put on theater presentations in the loft models, aptly called "Loft Life". On another night they held a very hip concert co-sponsored by local public radio station KCRW along with



a wine-tasting session hosted by LearnAboutWine.com. This "hipster" concert (a Swedish "swingatronic" band named Koop and groovy world-beat group named Motian Worker) created a lot of internet buzz, before and after the event. Critically, they took care to solicit participation from the retailers who are joining the surrounding neighborhood of the Barker Blocks.

As of November, 2007, Kor reports that sales have rebounded from flat to between one and two per week. They have registered 20 move-ins since October and have 8 additional sales pending as of the writing of this piece. The project is far outpacing competitive projects in the market area today.

## minding your strategy

### CHARLIE HEWLETT OFFERS ADVICE FROM HIS BOOK, *STRATEGY FOR REAL ESTATE COMPANIES*



In January 2008, ULI and RCLCO will release the new edition of the highly acclaimed book *Strategy for Real Estate Companies*. In future Advisories, RCLCO will provide passages and insights from the book. Below is an interview with author and RCLCO Managing Director Charles Hewlett.

**Q1: The first book RCLCO wrote on this topic was released in 1991, during the last major real estate downturn. How is this downcycle similar or different from the last?**

First, it is important to recognize that every downturn is different. There are differences in causes, effects, duration, severity; different sectors of the economy and real estate market are affected more or less adversely; etc. The classic sine wave cycle graph is actually a poor analogy for economic and real estate market fluctuations—a more apt analogy is an ocean's wave. There are fundamental common characteristics of each cycle—there is a building of momentum and a rising level of activity that cannot be sustained; demand moderates while the supply/capacity continues to grow, creating an unsustainable balance; and pricing power and momentum are lost, much as gravity forces the wave to crash down and tumble into the sand. The basic forces are similar, but no two waves look the same—some are steep and crash hard, others are smooth and produce little foam—so too in real estate cycles or waves.

What is different about this downturn when compared with 1991 is that it is, for the moment, largely contained to the for-sale housing sector, and that this bursting of the residential bubble has not coincided with, or been caused by, a general economic downturn. Speculative fever, fueled by easy credit, created an enormous wave of demand for housing (both new and used) that could not be sustained, particularly when the momentum pushing the wave along started running into various rocks on the beach, including the exit of investors and speculators, rising prices, and then a tightening of credit. What's similar is the fact that the wave did in fact crest and fall, just as we all knew it inevitably would. And companies in the real estate space should be doing exactly what they

did back in 1991: revisit their corporate strategy and shift to activities and roles that are appropriate for the downturn phase of the cycle, or rather, wave.

**Q2: RCLCO's position is that the housing recovery is not likely to begin until 2009. What are you advising your clients to do at this point of the cycle?**

Residential real estate companies, as well as those in other sectors of the industry that could be affected by a possible recession, should be actively considering and deploying appropriate cycle (rationalization) strategies at this stage. Cycle strategies involve challenging every geographic market, product, and/or service that the company offers and making sure that they are still viable, relevant, and profitable as the market shifts into a new phase. Companies should also begin (if they have not done so already) to look for new/different activities, such as service businesses, property/asset management, and/or work out opportunities, if they believe that capital risk development and building activities will be challenged over the next several years. Every company, residential and commercial, should now be focused on honing their game to make sure they are operating efficiently, consider eliminating projects or businesses that are not profitable, and ensure that they have the right players in the right seats on the bus. The smart players will make sure that they have capital ("dry powder") to take advantage of opportunities that will present themselves after the wave crashes and the water is flowing back out to sea.

**Q3: When is the best time to undertake a full review/overhaul of a strategy? How often should companies revisit their strategy?**

Ideally, a real estate company should develop a strategy just before each phase in the real estate cycle comes to an end: as the downturn seems to be yielding to the upturn, as the upturn ripens into the mature phase, and before the mature phase falls into the downturn. Strategic planning should not be an annual exercise, but it should be undertaken at least every

five years. “Checkups” should be held annually or every other year to confirm the validity of the strategy and to reaffirm management’s and the brand’s commitment to the strategy. In fact, a company that finds itself revisiting its strategy every year or two probably has not done a very effective job of defining a true strategic direction; that company likely is mistaking business planning for strategic planning. Rather, the phases of the industry cycle and fundamental changes in the internal or external environment will dictate when it is time to revisit and possibly amend a company’s strategy.

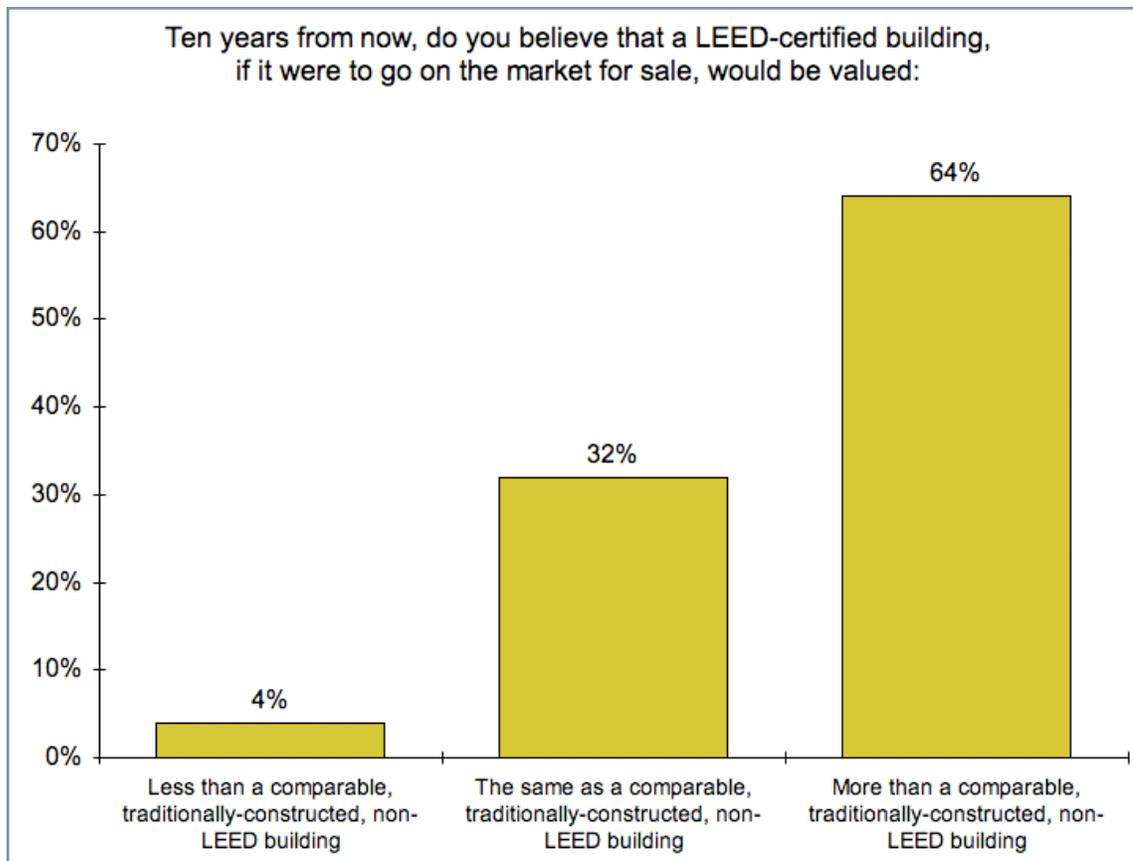
**Q4: What are the essential elements of any strategy?**

RCLCO has developed a strategic planning process

specifically for real estate companies. This time-tested process applies as much to large, multi-business unit/market companies as it does to small real estate companies whose senior managers wear more than one hat. Whatever the size and scope of the operation, the strategic planning process rests on several underlying assumptions:

- The strategic planning team is armed with sufficient background information and enjoys freedom of expression;
- Consensus decision making is feasible and achievable in the team; and
- The corporate strategy is well defined and spells out goals and objectives that can guide planning at the business unit/division level.

## RCLCO MarketBeat



According to surveyed members of the National Association of Office and Industrial Properties (NAIOP)

## announcements



RCLCO is pleased to announce the addition of Tim McGarrity to its team. Tim is Managing Director of RCLCO's Federal Advisory Services practice. His work draws upon 20 years of corporate and institutional real estate experience, most recently

as Managing Director at Jones Lang LaSalle's Public Institutions Practice.

## knowledge link

Visit our knowledge link to download recent presentations from RCLCO experts.

### Recent additions

- "Strategy Planning in an Era of Change"
- "Treasure Coast Trends"
- "Present and Future of Amenity Communities"
- "Opportunities in a Down Market: 2008-2010"
- "Green Building is Coming to a Market Near You"

## upcoming events

### December 2007

#### Shyam Kannan

December 10 - 14, 2007

"Measuring the Market for Shared Equity Housing"  
Plenary Speaker and Panelist  
NeighborWorks® Multifamily Initiative Meeting & Symposium  
Portland, Oregon

### January 2008

#### RCLCO Breakfast Meeting

Jan 8, 2008

Opportunities in a Down Market  
Los Angeles, CA

#### Gadi Kaufmann

January 16, 2008

Chair, ULI Arizona District Council Trends Conference  
Phoenix, Arizona

### February 2008

#### Gadi Kaufmann

February 25-26, 2008

Developing Resort, Second Home, and Golf Course  
Communities Conference  
Phoenix, Arizona

## about RCLCO

Since our founding in 1967, RCLCO has been at the leading edge of real estate trends and issues. Our impressive record of accomplishments has made us the "first call" for clients seeking strategic advice. We can help you with everything from market research to product programming; financial sourcing to deal structuring; conceptual design to development strategies. We set the highest industry standards by partnering with our clients to answer key questions and solve complex issues--offering strategic guidance that is always market driven, analytically based, and financially sound. Our real estate advisors help clients make the best decisions about property development, planning, and investment, so they can seize the right opportunities for tomorrow ... today. We are real estate consultants, analysts, financiers, developers, and designers--and we are dedicated to offering end-to-end solutions.

In 1985, RCLCO published its first Advisory Newsletter. Since then, subsequent issues have come to represent significant milestones in our intellectual history. Today, our e-newsletter provides over 5,000 real estate professionals with free research, tips, and original articles on various industry trends and issues.