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Influences on Real Estate Value

■ LEARNING OBJECTIVES

Students will be able to

1. identify and understand the five attributes of land including the concept that land is unique in location and composition, is durable, is finite in supply, and is useful.
2. identify, understand, and give examples of the social, economic, physical/environmental, and governmental forces that impact real estate value.
3. recognize that categorizing the four forces (social, economic, physical/environmental and governmental) can sometimes be subjective. Being able to identify and measure the market reaction to the respective force is far more important than specifically categorizing the force.

■ KEY TERMS

durable	physical/environmental	unique in location
economic forces	forces	useful
finite in supply	social forces	
governmental forces	unique in composition	

■ INTRODUCTION

In order to perform competently, the appraiser must constantly observe and analyze influences that affect the value of land and/or improvements. This Chapter addresses some of the basic influences with which the appraiser must become familiar.

PART ONE The Attributes of Land

Land (real estate) has characteristics that are different from all other assets. Land is

1. **unique in location**—no two parcels are identical in terms of location.
2. **unique in composition**—no two parcels are identical in their geological composition.
3. **durable**—land is long-lasting.
4. **finite in supply**—land is something that is not continually created.
5. **useful**—land has use or utility to people.

Because land has these five characteristics, it has value. Land's usefulness is especially critical to its value. Obviously, land that has a most logical use as a corn field has less value than land that has a realistic use as a downtown office building site. It is our job as appraisers to identify what factors and conditions create value, to analyze them, to formulate a conclusion, and to communicate these findings in an appraisal to our client.

PART TWO The Four Forces

Academics isolate the following four forces that impact real estate value:

- a. Social
- b. Economic
- c. Physical/Environmental
- d. Governmental

Identification may be confusing and overlapping sometimes, but all influences on property value can be classified into one or more of these four forces.

■ SOCIAL FORCES

Social forces relate to trends in society or culture. Sometimes these forces are imagined while at other times they are based on actual facts and figures. Some of the social forces that affect real estate value include the following:

Population Trends (Growth, Decline, Stability)

Many people tend to think that populations are always increasing, fueling the demand for real estate. In many rural areas, however, population is actually declining as modernization of the agricultural industry has lessened the demand for farm labor. Also, an

individual neighborhood may be losing population even though the housing stock remains the same because children are growing up and leaving the households.

Family Composition

No one can argue that the traditional view of the American household and its composition is changing. This is not to say that the idea of the traditional household with working father, homemaking mother, and two well-adjusted children is obsolete. Many suburban neighborhoods are composed of 80 percent to 90 percent traditional-type households. Single-parent households, households with two working parents, empty nesters, and *DINKs* (double-income, no kids) are all on the increase. These redefined households demand a different housing type than that customarily viewed as proper for the traditional American household. Rather than the detached, single-family dwelling on a subdivision street somewhere in suburbia USA, these changing households have created demand for apartments, townhomes, cluster-type residences, and other housing alternatives.

Aging of America's Population

The aging of America's population has created the need for more retirement homes, assisted care living facilities, senior apartment communities, nursing homes, hospitals, medical offices, and so on. Empty nesters (mature couples whose children have left home) usually desire less spacious homes, but homes that are high quality on small, easy-to-maintain lots with retirement amenities such as golf courses, lakes, tennis facilities, nature trails, etc.

Evolution of Home Offices

The high-tech age in which we are living has allowed many individuals to work partially or totally at home. Fax machines, computer networks, and advanced communications have led to reduced demand for office space in many metropolitan areas as well as a trend toward less office space per worker than ever before.

Environmental Consciousness

Homes today are more environmentally friendly than ever with increased awareness of builders and homebuyers alike in the construction of homes. Examples include more efficient mechanical systems, extra insulation, and low-consumption water devices.

Security Consciousness

The perception of an ever-increasing crime rate has drastically affected consciousness of security. Homes today are often prewired for security systems and fire protection.

Many communities emphasize the security aspect through guard gates, surveillance equipment, and so on.

Leisure Time

With the focus on leisure time since the 1960s, unprecedented demand is expected for second homes such as vacation retreats, weekend rentals, and homes and/or lots on lakes, beaches, and mountains.

The Family and Functional Utility

New homes are now built with more functional living areas such as the *great room* versus the former separate living room and den. More expensive homes also offer *keeping rooms*, rooms just off the kitchen where families can read, watch TV, study, or work while other members prepare meals. Another evolution has been the media room with its home entertainment system with TV, VCR, DVD, and stereo equipment. Home designs of the 1980s and 1990s have focused on the master bedroom and bath along with more bathrooms serving other living areas. Another trend of the 1980s was the movement toward larger and more functional kitchens.

Conversely, the theme of the 1970s was on living rooms, dens, and car storage (evolution of the garage and the garage door with automatic opener).

■ **ECONOMIC FORCES**

Economic forces relate to the fact that land has value because of its productivity. Land may be used to grow crops, support single-family residential subdivisions, or support highrise office buildings. Virtually all land has some use and therefore some desirability. Because of this desirability, land has value. Because different sites have different desirability, values differ from site to site and from period to period. For this reason, an appraisal must be site specific as of a specific date.

Economic influences also relate to consumers' ability to purchase and use real estate. Economic forces are always present on national, regional, and local market levels. Presented in the following paragraphs are some examples of economic forces.

Income Levels

Regardless of how much someone wants to purchase or rent an item, service, or parcel of real estate, the desire does not translate into market activity until there is adequate purchasing power. Personal income levels are vital in the valuation of real estate. A proposed single-family subdivision with homes priced from \$300,000 to \$350,000 will not be viable if the prevalent purchaser in the area has a gross income level in the \$30,000 to \$50,000 per year range.

Employment

The nature of employment is a critical economic factor which should always be considered in an appraisal. Unemployment rates should of course be noted, but the stability of employment should also be addressed. Most communities strive for employment diversity with no major dependence on a single industry. The economic base of an area can be a stabilizing one such as a governmental center. Conversely, the economic base of a community can be an unstable one such as tourism.

For years, communities with a dependence upon military installations were deemed as very stable; however, the early 1990s witnessed the downsizing of the military and the closing of numerous military installations. Major economic recessions occurred in most of those communities that experienced such closings. Southern California is an example of such an area. On the other hand, military conflicts, potential military conflicts, and new military technology could have beneficial effects on a community.

Another example of dependence upon a single industry is the southwestern United States where, to a large degree, the economy was dependent upon oil. Many communities suffered catastrophic downturns in their economies when oil prices plummeted in the 1980s, thus affecting employment. Stabilized oil prices or rapidly escalating oil prices can have the opposite affect.

Housing Construction Costs

The construction cost of housing directly and indirectly influences real estate prices. The costs for items such as wood, concrete, and steel are obvious influences. Less obvious ones are financing costs, land costs, and indirect costs (building permit fees, sewer tap fees, or re-zoning costs). Sometimes, stringent governmental regulations and impact fees increase the cost associated with residential as well as commercial and industrial construction, perhaps restricting the growth and development of a particular location.

Credit Availability

The availability of debt money also influences real estate. When credit is plentiful, as in the 1980s, loans are easy to obtain, and the availability of money results in an active market. When credit is scarce, as in the early 1990s, illiquidity occurs, and prices often decline because only a few people can pay cash or qualify to borrow or find a bank to loan them money. In the early 2000s, interest rates declined drastically, and this trend expanded the borrowing power of many people. The unstable economy also prevalent during this time period served to dampen purchasing, a mitigating factor.

Interest Rates

Trends in interest rates affect housing affordability and thus demand for new and resale homes. A person making \$25,000 per year may qualify to buy a \$70,000 home if the interest rate on the borrowed funds is available at 7 percent. If the interest rate increas-

es to 10 percent, however, the same home may not be affordable. This lack of affordability drastically impacts new housing construction and resale activity. A less obvious influence is the interest rate a builder must pay on borrowed funds during the construction period (indirect costs).

Utility Costs

The cost for utilities can also influence the supply and demand and pricing of real estate, particularly for industrial and commercial customers whose utility bills may be in the hundreds of thousands of dollars per year.

■ **PHYSICAL/ENVIRONMENTAL FORCES**

Physical/environmental forces on real estate values are the easiest to identify. Variances in location, topographical features, climate, and other similar factors are easily observable by even the casual buyer or seller.

Certain physical factors may be desirable or undesirable, depending upon the property use type.

For example, a site with excellent visibility and substantial frontage along a major commercial highway may be advantageous for a retail outlet but very disadvantageous for a residential use. Level, street grade topography may be very desirable for a fast-food restaurant, whereas rolling topography may bring a premium in a residential community.

Some examples of environmental forces on real estate include:

Location

Every particular parcel of real estate is uniquely different in that it occupies a geographically defined location on the earth's surface. In practicality, however, many properties share the same major locational influences.

An old-time cliché in the real estate industry is that there are three important value determinants. These are “location, location, and location.” Obviously, this is a redundant statement, but it does illustrate the importance of location in the real estate industry. Essentially duplicate houses can have vastly different prices if located in different neighborhoods.

Transportation

In our mobile society, the primary linkages are highways. In selecting a house, most purchasers look initially for a good neighborhood but also for one with easy access to

shopping, employment, recreation, and other points that are visited on a regular basis. The development of the interstate highway system has had a major impact on national, regional, and local economies in that long distances can be traveled in a relatively short period of time.

Public transportation is also important to some cities. In recent years, many cities have developed rapid rail systems which are frequently augmented by bus networks.

Other transportation alternatives relate directly to other land uses. Industrial facilities often locate along rail lines or interstate highways. The relocation of a corporate headquarters to a certain city may well be dependent upon that city's air transportation facilities.

Topography

The topography is important not only to the development of the land, but also to the desirability of the land. Rolling, wooded topography may be highly desirable for residential usage, but the grading costs required to produce a level site may preclude utilization of the land for commercial or industrial development. A property's drainage is important, as well as its soil and subsoil conditions. Extreme topographical problems may in fact preclude any development, rendering the property useful only for aesthetic purposes.

Topography also relates directly to farmland. Gently rolling to level land may be well suited for cropland, whereas more severely rolling contours may limit the agricultural use to pasture.

Climate/Weather

The climate/weather of an area can have a direct influence on the nature of the development pattern. Florida has become a vacation and retirement center because of its tropic-like weather, coupled with its abundance of coastline. Central Florida has become a major tourist attraction as theme parks have located there because there are few days during the year when the climate is intolerable.

■ **GOVERNMENTAL FORCES**

Whether on a national, state, or local level, **governmental forces** on real estate values can be significant. The very essence of our private real property ownership system relates to historical governmental evolution. Even subtle changes in monetary policy can have far-reaching implications on values. Governmental forces on real estate may include:

Taxes

Higher city and/or state income taxes result in less disposable income for real estate purchases. Although high income taxes are not good for homebuilders, apartment landlords may fare quite well because their tenants cannot afford to buy homes.

Freeport (no taxes on inventory) status, allowable depreciation schedules for capital write-offs, and capital gains tax treatment are other tax-related government factors.

Federal Monetary Policy

Although interest on borrowed funds and savings is usually considered to be an economic influence, the federal government can definitely affect the level of interest rates. The federal government generally seeks to maintain a proper balance between economic growth and inflation and tends to manipulate monetary policy to this end. By changing the discount rate for funds furnished to member banks, the Federal Reserve can have a direct influence on the level of interest charged for these funds to be loaned to individual consumers for construction loans or mortgages. More discussion about the Fed is found in Chapter 5.

In recent years, the federal monetary policy has been impacted by worldwide monetary phenomenon in that funds are now competing in a world market.

Real Estate Taxes and Assessments

Local real estate taxes affect the supply and demand of homes and land in a certain area as well as commercial properties and industrial projects.

Labor Issues

Labor issues can have a major influence on a business's choice when building or relocating a facility. A company may decide for (or against) a certain location because of certain labor laws and regulations, including whether or not labor unions are prevalent.

Quality of Schools

The quality of schools in a certain area may place a neighborhood, area, or even an entire county or state in a competitive advantage or disadvantage relative to another neighborhood, area, county, or state. Test scores at different grade levels, percent of students who finish high school and go to college, expenditures per student, and ratio of students to teachers are important factors in determining the quality of schools within a system or comparing system to system.

Quality of Services

Similar to schools, a government's quality of services can be an influence. These include such items as police and fire protection, the availability of health care, and municipal recreational facilities.

■ IDENTIFICATION OF FORCES

In most cases, a particular force is easily identifiable and categorized as social, economic, physical/environmental, or governmental. In other cases, however, identification of the force is not as easily recognized. Consider the following:

1. Is the lack of utilities in an area a governmental or environmental force?
2. Zoning requires a minimum 20,000 square foot site to develop whereas the subject property contains only 15,000 square feet. Is this an environmental or governmental force coming into play?
3. The Federal Reserve has reduced the discount rate charged to member banks, and interest rates begin to fall. Is this a governmental or economic implication?
4. An increase in the income tax rate has reduced demand for starter housing in a certain community. Is it an economic or governmental factor?

In these examples, there is no clear classification, and identification of the force may vary according to the person doing the interpretation. The most important thing is to recognize that the four forces often interact and overlap. It is more important for the appraiser to measure the market reaction to these forces than to spend time identifying the classification of the force.

CHAPTER ONE Review Questions

- Which of the following would be an example of an economic force?
 - A trend toward smaller household sizes
 - A city ordinance banning outdoor advertising
 - A city's favorable climate
 - A manufacturing plant reopening after closing
- Which of the following would be an example of a social force?
 - Higher utility rates for a certain area
 - Lower interest rates
 - An increasing divorce rate
 - Recurring flooding of a certain few homes in a subdivision
- Which of the following would be an example of a governmental force?
 - An area's abundant natural resources that results in lower lumber costs
 - Strict building codes requiring poured concrete foundations for homes within the city
 - The development of a new private country club golf course
 - The opening of a new grocery store
- Which of the following is NOT a governmental influence?
 - Development of a new subdivision by a local builder
 - Sales tax increase for a certain area
 - A hotel occupancy tax
 - Development of a new sports arena financed by city bonds
- An area has a reputation for being a neighborhood with a low crime rate and an excellent quality of life. What force is this an example of?
 - Social
 - Economic
 - Governmental
 - Environmental
- A neighborhood has excellent views of the ocean. What force does this exhibit?
 - Social
 - Economic
 - Governmental
 - Environmental
- A city has a zoning code that does not allow satellite dishes in the front yard. This is an example of which kind of force?
 - Social
 - Economic
 - Governmental
 - Environmental
- San Francisco is a city influenced by its strategic location along the Pacific Coast and its favorable climate. Which of the four forces are these part of?
 - Social
 - Economic
 - Governmental
 - Environmental
- Los Angeles had some major obstacles in its economic expansion in the 1980s including civil rights issues, crime, and illegal immigration. Which of the four forces were these part of?
 - Social
 - Economic
 - Governmental
 - Environmental
- A severe hurricane damaged the Miami region in August 1991. Which of the four forces does this represent?
 - Social
 - Economic
 - Governmental
 - Environmental
- The Disney theme park outside Orlando has had a significant impact on uses of land in southwest Orlando for many years and an influence on the value of that land. Which of the four forces does this represent?
 - Social
 - Economic
 - Governmental
 - Environmental

12. The King's Bay Submarine Base in southeastern Georgia is one of the largest developments in America. It was created by the Department of Defense to build nuclear submarines for the Navy. What force does this represent?
 - a. Social
 - b. Economic
 - c. Governmental
 - d. Environmental
13. The Tax Reform Act of 1986 had a dramatic impact on real estate by eliminating many of the tax advantages for passive real estate investors. This is an example of which kind of force?
 - a. Social
 - b. Economic
 - c. Governmental
 - d. Environmental
14. A real estate mall developer purchases a site with the intent of building a regional mall because the immediate area has a significant number of households and the income level of those households is affluent. What type of force is the neighborhood going through?
 - a. Social
 - b. Economic
 - c. Governmental
 - d. Environmental
15. Families are more aware of recycling their consumer wastes than ever before. This is an example of which kind of force:
 - a. Social
 - b. Economic
 - c. Governmental
 - d. Environmental

