

PREPARING THE NEXT GENERATION

by Kerry Vandell, CRE

The days of the real estate industry being perceived as an army of "gunslingers," the soldiers of which shoot from the hip and live for the deal based on their gut instinct alone, are over. Even at the local level, our world has changed over the last 25 years:

We have gone through some significant industry-wide dislocations, especially in the 1970s and late 1980s—early 1990s, that weeded out many of the most unprepared.

We have been faced with new regulations and legislation (such as the Tax Reform Act of 1986, ERISA, and the Garn-St. Germain Act of 1982 that deregulated banking institutions) that gave us new opportunities in some cases, but also circumscribed our ability to do what we wanted.

New land use regulatory measures have been developed (such as transfer of development rights, TIF's, and inclusionary zoning) that force us to understand and deal with the public sector to a degree that has never been necessary before.

ABOUT THE AUTHOR

Kerry Vandell, CRE, PhD, is the director of the Center for Land Economics Research and Lorin and Marjorie Tiefenthaler Chair in Real Estate and Urban Land Economics at the University of Wisconsin, Madison. (E-mail: kvandell@bus.wisc.edu).

New ways of delivering capital to the real estate market, especially through the "public" markets via the REIT and CMBS products, have not only created entirely new sectors in the real estate market, they forced even those on Main Street to understand and reference their role in the marketplace.

Capital has also flowed into the market from foreign sources (and we have engaged in more offshore investing than ever before), creating a true international real estate market.

We have observed as technology has transformed our previous ways of doing business. From e-commerce to new CMBS derivative products, firm-wide computerized networks, vastly improved software for corporate and asset management and feasibility analysis, "green" building technology, and new construction materials and techniques, real estate has participated with the rest of the world in the "new economy."

Many of these innovations have been driven by basic and applied research tools that have enabled their introduction, including the Black-Scholes option pricing model (the intellectual basis for the CMBS industry), Marcowitz, and other portfolio design and management tools, and new designs for market-based policies to accomplish certain community development goals.

Finally (and unfortunately), we have been faced with some embarrassing moments, when some of our most esteemed professional colleagues have been singled out for scrutiny by government and law enforcement investigators for violations of legal and ethical standards that in some cases even resulted in prison terms.

The above examples give ample evidence to the fact that to prepare the next generation for assuming successful roles in guiding the real estate sector through the shoals of the next twenty-five years, we have to ramp up our educational products—the formal education of the college classroom as well as the professional and executive education classroom and the corporate environment through which so much "applied" educational experience takes place. I intend in this article to provide some musings on what the nature of this educational product should be, based upon my observations of having been a part of the business over the last 28 years and having been a part of building educational programs, both at my own institutions and as a consultant for others.

A BROAD, BUT SOLID FOUNDATION

Jim Graaskamp, the University of Wisconsin's legendary "Chief", who educated thousands of loyal alumni and perhaps had one of the most enlightened, holistic views of the place of real estate education in the world, would always announce in one of his introductory lectures that real estate professionals had to become true "Renaissance men and women." While this pronouncement perhaps seemed strange in the 1970s and '80s, given the trade school mentality of real estate educators at the time, as was typical of many of Graaskamp's pronouncements, it turned out to be right on the mark. Graaskamp understood the fact that real estate—as shelter, as an asset, as a symbol—permeated many aspects of the modern world. To be able to effectively deal within that market with such a multiplicity of goals and considerations required one not simply to be in command of the technical tools of the trade, but also to understand and operate from the broader perspective of an agent of human society. If true in Graaskamp's time, his precept is even more true today.

One needs first to be literate and articulate. If there is one consistent shortcoming I see in too many students entering the professional world today, it is that they are ill-prepared to present themselves as professionals through the written and spoken word. They get too-little opportunity to present their work to an audience, to be forced to think logically and clearly about the way in which they can most efficiently bring out the points they wish to get across and respond to questions. They are too-infrequently critiqued today in their written essays and reports on everything from grammar and spelling, to sentence construction, organization, and "flow." Whereas it may be too late in real estate higher education to deal effectively with these shortcomings, we at Wisconsin are attempting to at least provide experience in team presentations (where everyone needs to take a turn at bat) and detailed grading of written work by hired English grad students, as well as faculty.

One needs also to have a firm foundation in the liberal arts and especially the social sciences. "Those who cannot remember the past are condemned to repeat it" was uttered by philosopher George Santayana, relating to political leaders, but it could have been just as easily applied to real estate professionals. They make their decisions in the context of a historical tradition of past behaviors premised on laws, customs, cultural traditions, and market

forces. Without having a basic understanding of what has gone before, what has worked and what has either not worked or been rejected and why, one will face inevitable failure, either from a lack of success at getting public approval or from a failure of the project once built. This is similarly true for an understanding of our political system and civic institutions, the way that the market economy works and why we find it necessary (regardless of our political ideologies) to intervene in it so frequently, and the way that society is structured and the role that class and race and cultural traditions can play in support or rejection of proposed changes in the built environment. My general notion is that our students vary widely in their degree of preparation in this area. Unfortunately, those coming out of undergraduate business or technical degree programs tend to be the least well prepared. Again, while it may be too late for graduate programs in real estate to fill this void adequately without some prior foundation, we can at least include ample discussion of public policy issues within our curriculum and outside guest lectures.

Finally, one needs a solid foundation in analytical methodologies and an analytical approach to problem solving. This is probably the area in which I find our students best prepared on average, though even here the degree of preparation varies widely. I find frequently that students have been trained in the use of such tools as probability and statistics, evaluation of cross tabular data, and financial analysis; however they often tend excessively to seek a "recipe" for solution of problems, that is simply plugging numbers into a hand-held calculator or a spreadsheet without really setting up the problem in a logical way and knowing exactly what they are trying to get out of the analysis. Our educational program needs to provide ample opportunity to evaluate "real" problems. Whether they be mini-problem sets or full blown case studies, students should be required to separate the wheat from the chaff in terms of the information they are provided, and decide what to do with the information they have. These are not only "number-crunching" exercises; in fact in many cases the quantitative would be minimized in favor of the qualitative judgmental factors that are typically so important in real estate decision making.

THEORETICAL PERSPECTIVES

Theory has never been a favorite subject among real estate professionals. "You don't study real

estate, son; you do real estate" was one of my favorite quotes from my days in Texas. "The real world is not theory." And in many ways, this guy was right. Sterile lectures on supply and demand or multiple regression devoid of context and application have often been forced rites of passage for real estate students, reinforcing their negative attitudes about theory. However, I would contend the real problem is not so much with theory in and of itself, but rather how it is presented and the extent to which students are convinced that it can be directly relevant to their practice. It has frequently been my experience that those most contemptuous of theoretical perspectives are not those (primarily grad) students who have had ample experience in the marketplace, for they have a "need to know" premised on their desire to put in perspective some of the phenomena they observed in practice. Rather, the skeptics are the undergrads and others without prior experience, to whom everything they are studying is an abstraction.

This suggests that theory is best presented in the context of applications, especially via case studies or problems that illustrate how an understanding of theory can provide insights and creative solutions that would be otherwise counterintuitive or impossible to discern. It is a difficult undertaking to come up with exactly the right illustration, but such efforts must be made by educators to provide a rational basis for its inclusion in the curriculum, for if such an illustration cannot be provided, we must ask ourselves honestly whether we are including theory because it is truly important or because it is what we "do" and what we find interesting.

The above suggests a number of revisions in the traditional curriculum. Urban economics, consistently one of the most difficult courses to convince real estate students of its relevance, should be transformed to "real estate" economics, which provides numerous applications of location theory, externalities, amenity theory, and the dynamics of supply and demand drawn from relevant professional experience in the marketplace. These should be related directly to the tools generated from market, feasibility, and highest and best use analysis. The tools of appraisal should not be presented in isolation as the "three approaches," but rather as the derivative products of the underlying theoretical principles of the land market and the above analyses. Financial theory, too, should be presented as the solution to a defined problem, thus pro-

viding a "need to know," rather than as theory floating in space. Finally, statistical theory -- most often in the form of the application of multiple regression to the estimation of drivers of rents or values, estimation of price indices over time, or simple comparisons of sample means -- is much more acceptable to students who are first presented a real-world problem, accept its relevance, and then recognize the capability of these tools to address it.

THE FOUR-QUADRANT MODEL

Those who have been in the real estate market for any time begin quickly to recognize that its essence can be distilled down into flows of capital into and out of the market. In recent years, the capital markets for real estate have matured dramatically. Many professionals have come to think of the real estate market as embodying today four-sector investment activity: 1) private equity (individual proprietorships, partnerships and LLC's, joint ventures, opportunity and other commingled funds, etc.); 2) public equity (REIT's and REOC's); 3) private debt (mortgages, lines of credit, mezzanine financing, etc.); and 4) public debt (mortgage-backed securities, bonds, etc.). Each of these sectors has become a not-insignificant component of the overall market.

Understanding the investment process in real estate requires the full understanding of each of these four sectors—their size, their legal and institutional structure (the "players"), their growth and dynamics, the economic fundamentals of their market, and the details of the process leading to changes in these capital flows, whether they be new investments, restructurings, or unwindings of positions. For this reason, it seems to me that the "core" of graduate education in real estate (beyond the theoretical underpinnings cited above) ought to revolve around courses dealing with each of these market sectors. That is not to say that all real estate students are going to become REIT analysts, but they need to understand the role REITs play in the market in influencing overall prices and availability of capital. Understanding the public equity markets also play the dual role of guiding students toward an understanding of the underlying principals of corporate finance—the notions of accretion and dilution, preferred shares, and other specialized interests that are so much a part of valuation of real estate firms, whether public or private.

DEVELOPMENT AND DESIGN

As with all assets, real estate is characterized by a production process that creates, repositions, and ultimately destroys it. The developer, of course, serves as the market agent to facilitate this process. Thus, it is important that those becoming versed in the real estate market have a command of the developer's role in shaping it. Many programs have included within their curriculum a "development" course with greater or lesser degrees of success. Having been involved in the creation, oversight, and teaching of various permutations of development courses over the years permits me to offer several observations on what seems to work and what does not.

First, this is a course that should be taught (or at least team-taught) by one who has had significant experience in development practice. Development by its nature is an applied course requiring synthesis of many of the component elements of the deal, and a full understanding of these relationships, especially at the detailed institutional level, is more difficult to impart unless one has "done" it. That is not to say regular faculty do not have an appropriate role in the development curriculum, for one aspect that I have sometimes found missing in such courses taught by practitioners is the provision of a synthesis that places the development process in a broader conceptual framework.

The development course should also be heavily case-oriented; its heart should be a "real" project with a "real" site and a "real" problem. The students, working in teams with the owner or developer, through the course of the semester can undertake the market, feasibility, and highest and best use analysis for the site, but that exercise is not unique to the development process. The next step is unfortunately omitted in most development courses but in my opinion is the essential core of the experience: The construction process should be planned in detail, with scheduling and pricing of various systems, practice in evaluating construction contracts, and studying the process of applying for and administering construction financing. The "deal" should be shaped as the product of an evaluation of the merits of several capital structuring alternatives. Unfortunately, the time frame for the development process is typically too long to directly involve a "real time" development effort. However, by bringing together the right professionals as a review panel to advise and judge teams on their products, one can simulate the forces that move the development process forward.

And finally, the improvements should actually be designed. The one characteristic that makes real estate so interesting as an asset class is the richness of its physical characteristics. Yet ironically there is often little in formal educational programs in real estate that explicitly consider design issues, including architecture and, at the broader scale, urban design. Thus, it is little wonder that developers and real estate professionals in general are considered philistines when it comes to caring about and judging design quality. In fact, research has found strong linkages between design characteristics and economic performance in the marketplace, not only from those characteristics relating directly to efficiency and functionalism but also from those relating purely to aesthetics. Again, this does not mean that one can create a silk purse out of a sow's ear in terms of turning real estate students into architects, but they can at least by this process become sensitized to both the micro-level functional and aesthetic considerations that go into the design process. A course I was involved with a number of years ago at the Graduate School of Design at Harvard perhaps best illustrates this integration of design and development. The students, composed of both Business School students and designers, were forced to both price out alternative design schemes, do a detailed market analysis projecting rents and absorptions, and back out the optimal design program. (By the way, the Inn at Harvard Square is the tangible product of this exercise, reflecting closely the development program proposed by the winning student team).

PUBLIC POLICY AND GOVERNMENT

If real estate professionals are often thought of as philistines when it comes to their design sensitivity, they are positively held in disdain when it comes to an understanding and appreciation of the role of government and public policy. Again, that is not to say that they have to be forced into the largely advocacy courses that unfortunately characterize many of our planning and public policy programs, or to accept the positions taken at the too-often parochial ideological battles characterizing local land use debates. But they do need to come to understand the rational arguments for the existence of land use regulatory policy, environmental policy, taxation of real estate income and wealth, and affordable housing policy and to be able to frame their own efforts in reference to these. Such a perspective in my view not only renders them more effective challengers of parochial policy advocates, it results in better projects more respectful of broader community values.

How is this sensitivity to be imparted in the classroom? There can be a significant dose of policy discussion certainly in the development course, in real estate law, housing policy, and finance. But perhaps one of the most effective exercises I have experienced has been embodied in a simulation game—the old Community Land Use Game (CLUG) developed originally at Cornell University and since elaborated into several derivative products. Players accept the role of planners, public officials, and private sector participants, making sequential decisions about investment and taxation that result in alternative community futures. If this sounds very much like a version of the computer game SimCity, it is. Integration of such game simulations into the curriculum, at least as one module in a broader seminar, could reap substantial rewards in terms of student insights into the planning process and the role of public policy.

THE INTERNATIONAL MARKETPLACE

If there is one aspect to real estate education that has perhaps been most profoundly changed over the last 25 years, it is the fact that the market has clearly become an international one. Institutional portfolios have become diversified internationally as well as domestically as new market opportunities have emerged and investors have come to appreciate the advantages presented by cross-border activity, supported by tax laws and legislation to make it happen. This is equally true of overseas investors in the U.S. and U.S. investors overseas and holds true for individual investors as well as institutions.

The most concrete evidence of the international revolution in educational programs is the growth in the representation of foreign nationals in our real estate programs. Our Masters program in Real Estate at Wisconsin has been about 33% international for a number of years, with representation primarily from Asia (especially China and Korea and, for a time, Indonesia), but also with a solid presence of Germans, Finns, South Americans, Mexicans, and many others (our PhD program is 100% international at present and even our undergraduate program has significant international representation). Many of these students hope to work in the U.S. for a time to gain experience and a certain degree of "status" within their home country, but a large proportion of them intend to return to their home country at some point in the future to build their careers there.

We at the University of Wisconsin have attempted to embrace these students, recognizing that the function of a truly "world class" institution is preparing the "world" for the future. Every year, we undertake at least two international field trips—one to the MIPIM Conference in Cannes France and one to another location (which in the past has included everything from Eastern Europe to Western Europe, South America, Asia, and Africa). We also offer an International Real Estate course, which has provided case studies on cross-border investment issues. We attempt in many of our other courses to provide an international comparative perspective on differences in tax regimes, legal and regulatory rules of the marketplace, and institutional structure. Often, this information is provided by international students who are asked to report on their home country's situation. The international perspective within our educational program is by no means perfect or adequate, but at least we do provide an international reference point from which students (both domestic and foreign) can gauge their position.

HANDS-ON-LEARNING

It should be apparent from the above discussion that, although traditional lectures are fine for providing a foundation, and to some extent theory, for real estate education, they are wholly inadequate in and of themselves for providing students with a sufficient grounding in the market to "hit the ground running" in terms of their abilities to produce for their employers. "Applied" education clearly must be the preferred mode of instruction for graduate education (and even at the undergraduate level for upper-level courses).

Applied education may take many forms, all of which have potential applications in a real estate program. First is "mini-cases" that reflect bits and pieces of "real world" situations. These are quite appropriate for undergraduate students and graduate introductory courses. Full blown cases, which require formal analysis and presentation/discussion should be the heart of graduate education. (That is not to say that traditional lectures imparting technical analysis skills are not useful; class discussion can take a "time out" from time to time to review relevant principles in a more formal way). Another applied educational experience includes the "real" case using a "real" site being undertaken in "real" time. This would have the potential of being perhaps the most relevant of applied educational experiences, were it not for the fact that the

timeline for the vast majority of real estate deals is excessively long to fit into a semester course. Thus, one is typically relegated to a piece of the deal or simulation of proposed solutions under the review of a panel of professionals (see above). A final means of imparting "real world" experience is through an internship or co-op experience. A word of warning on such programs as a universal component of a real estate program, however: To be done right, they require high levels of overhead support and control. Otherwise the students' experiences vary widely in quality and the necessary links between the conceptual process and practice fail to be made.

IT'S THE FIRM, STUPID!

An almost universal shortcoming of real estate educational programs (including our own) is the failure to recognize that the decision-making tools that we spend so much time on are really used in the context of managing and growing a real estate enterprise. Few students are provided understanding as to how to manage growth and change in the firm. They too often see their world as a succession of separate deals and do not realize that a successful real estate firm is more than simply the sum of its constituent deals. Some necessary skills in this regard include understanding how one assembles and organizes (and reassembles and reorganizes) a workforce; how one structures the enterprise legally; how capital is acquired and structured to facilitate operations, investments, and growth; how one markets their products and services and differentiates their products from those of competitors; how one plans strategically to achieve growth targets; how operational and tax efficiencies can be achieved; and how succession of leadership can best be planned.

Now we could require students to go through selected courses in Management and Entrepreneurship, and to be sure, and a current MBA program can insure that all students will have some exposure to such management tools in a number of courses. But there are other more specific and focused ways in which students can be exposed to decision making at the firm level. First is selection of cases such that there is ample consideration of firm-level management decisions. Guest lecturers in seminars and real estate club meetings should also be invited to spin their stories about how they grew their firm and the mistakes they made along the way, as well as providing details of deals. Teams involved in putting togeth-

er projects for "real" deals should be constituted as an enterprise with a real structure and set of experience.

To be able to move seamlessly into leadership positions within the firm, one must have an underlying "big picture" perspective on the entirety of the firm's operations and how its pieces fit together. Rather than gaining such knowledge through on-the-job "osmosis," one could benefit immensely from the head-start provided by such leadership exposure.

DEALS! DEALS! DEALS!

In spite of what I have said above about the importance of the firm, the world of real estate is clearly a world of "deals." Unfortunately, though, typical textbook treatments of real estate are focused on number-crunching of "dummied down" problems, not real deals in all their complexity and with all of their qualitative (as well as quantitative) aspects. Even cases oftentimes are simplified, or at least presented in a distilled format that eliminates the ambiguity with which one must often contend when putting together a real deal.

What is the solution here? Programs have been effective in getting into the inside of deals via a capstone Seminar in Real Estate Investments. Each week, the principal player in a real deal spends three hours with a class of advanced graduate students who have completed the rest of the curriculum. Background material is provided to them prior to the session—not a formally written case, but a prospectus, a feasibility study, material from a road show, or even transcripts of court testimony in the case of litigation. These are not organized in any particular way (just as in the real world), and the student must read them and separate out the relevant information. The students are graded based upon the quality of their contributions in the session, such as questioning the presenter about various detailed aspects of the case, being able to respond to questions about possible alternative strategies and their pros and cons, and providing unique insights into the various dimensions of the deal. We have found that ample exposure to the transaction/negotiation process and its characteristics is at least as important as the substance of the deal itself. Further, these deals are not confined to typical transactions; a wealth of insights can be obtained by getting into the insides of litigation or workout sessions in which "role playing" by the various parties to the transaction requires the students to think actively and creatively about a situation.

PROFESSIONAL AND EXECUTIVE EDUCATION

Normally, one would not think that an executive and professional education program—including both short courses, seminars, and conferences—would be an important adjunct to a traditional real estate program at the collegiate level. However, we have found it quite valuable. Tenure-track and adjunct faculty and the select group of professionals that develop and lead these programs are provided a rich array of exercises and cases that can be applied in the classroom. Students are given free access to these courses and frequently avail themselves of the opportunity to attend. The constant flow of professional talent in and out of our executive programs, and their attendant interaction with our students, have proven their worth in our program. One component of our real estate center's program that has supported this effort to facilitate interaction between professionals and the students has been our biannual Board Meeting, at which 30 or so of our Board members spend a day and a half on campus in panel discussions about current industry issues and again interact with the students, who are provided free admission. Many employment offers, many leads, and many insights have come out of this forum.

ETHICS AND DIVERSITY

Finally, let us address an issue that we all would prefer would go away as an issue—ethics and diversity within the profession. Generally, our record and history in diversity is not very good, although it is comparable to many other professions. For example, only 5.9% of real estate managers were black in 1990 and only 5.7% Hispanic, while only 3.1% of real estate sales people were black and 3.6% Hispanic (this compares to accountants and auditors at 6.8% black and 4.2% Hispanic and lawyers at 3.4% black and 2.5% Hispanic). It is encouraging to see the ethnic makeup of our students to have changed fairly significantly over the last 25 years. As I indicated above, about 33% of our program today is international, and another 15% or so is minority. We are working with our minority alumni and students to develop a more efficient "pipeline" from employers and schools to attract the strongest minority applicants to our program. It will be equally important to create a similar pipeline to the job market to smooth the entry of these increased numbers of new international and minority graduates.

Our reputation for ethical behavior in the profession is roughly on par with our reputation for diversity, although we generally do better on objective measures of ethical behavior than our reputation would suggest. It may well be that the very economic function that developers serve, as necessary and valuable to society that it is, will always dictate that developers must bear the cross of ambivalent feelings by the lay public toward them. However that is not to say that we cannot in our formal educational program provide opportunity to the students to at least think about the ethical issues that regularly confront us in the workplace.

What are we doing about diversity and ethics education? Wisconsin's new MBA program will insure that every student will take a one credit ethics module in their last semester in the program. However, within the real estate MBA curriculum, we need yet to do more than we are doing. Ethical dilemmas and cases could be interspersed throughout the curriculum, especially in our capstone Investments Seminar. Role playing could be especially effective here in engaging the students in thinking about the conflicts that exist in a real-life context. In this, we could do much better.

CONCLUSION

Please accept the musings above as my goals for an "idealized" educational program in real estate at the collegiate level. It does not represent certainly what the Wisconsin program is today; nor does it even necessarily represent what it wants to become (my colleagues have a lot to say about that). Such a program clearly could require a lot of resources to administer and teach—and may in reality require four years to complete! Nonetheless, in spite of these failings, I hope it serves to point up some areas that we definitely can improve upon relative to where we are. In the end it requires us to recognize that in education, as in everything else, the only constant is change, and that is becoming increasingly true with time. If we can at least prepare our students over the next 25 years to deal effectively, efficiently, and ethically with that change, we will have succeeded.