Characteristics of Real Estate Markets

Market Segmentation and Delineation

A real estate market consists of a group of individuals or firms that are in contact with one another for the purpose of conducting real estate transactions. Possible market participants include the following:

- buyers
- sellers
- landlords (lessors)
- tenants (lessees)
- lenders (mortgagees)
- borrowers (mortgagors)
- developers
- builders
- property managers
- owners
- investors
- brokers
- attorneys

Each market participant does not have to be in contact with every other participant. A person or firm is part of the market if that person or firm is in contact with another subset of market participants.

The actions of market participants are prompted by their expectations about the uses of a property and the benefits that property will offer its users. Market segmentation, therefore, differentiates the most probable users of a property from the general population by their consumer characteristics. The activity of individual market participants in a real estate market focuses on a real estate product and the service it provides. Product disaggregation, therefore, differentiates the subject property and competitive properties from other types of properties on the basis of their attributes or characteristics.

A market segment is delineated by identifying the market participants likely to be interested in the subject real estate and the type of real estate product or service it provides. Product disaggregation includes both the subject property and competitive and complementary properties. Thus, market analysis combines market segmentation and product disaggregation. The characteristics of a subject property and its market area that are investigated by an appraiser in the process of delineating the market are illustrated in Figure 11.1.

An appraiser should include only relevant data in analyzing the market and preparing the appraisal report. For example, an appraisal report for an apartment property should not include a detailed market

submarket
A division of a total market that reflects the preferences of a particular set of buyers and sellers.

market segmentation
The process by which submarkets within a larger market are identified and analyzed.

disaggregation
Grouping properties together based on similar attributes or characteristics.

Figure 11.1 Market Delineation Process

To identify a specific real estate market, an appraiser investigates the following factors:

1. Property type (e.g., single-unit residence, retail shopping center, office building).
2. Property features such as occupancy, customer base, quality of construction, and design and amenities.
   a. Occupancy—single-tenant or multitenant (residential, apartment, office, retail).
   b. Customer base—the most probable users. Data on population, employment, income, and activity patterns is analyzed. For residential markets, data is broken down according to the profile of the likely property owner or tenant. For commercial markets, data is segmented according to the likely users of the space. For retail markets, the clientele that the prospective tenants will draw represents the customer base. For office markets, the customer base reflects the space needs of prospective companies leasing office units.
   c. Quality of construction (class of building).
   d. Design and amenity features.
3. Market area—defined geographically or locationally. A market area may be local, regional, national, or international in scope. It may be urban, suburban, or rural. It may correspond to a district or neighborhood of a city. Retail and residential market areas are often delineated by specific time-distance relationships.
4. Available substitute properties—i.e., equally desirable properties competing with the subject in its market area, which may be local, regional, national, or international.
5. Complementary properties—i.e., other properties or property types that are complementary to the subject. The users of the subject property need to have access to complementary properties, which are also referred to as *support facilities*.

analysis of the retail and office property markets and fail to provide a thorough analysis of the apartment market. Another common error is failing to identify correctly whether the market for the property is local, regional, or national.

Specific real estate markets can be identified by property type, property features, market area, substitute properties, and complementary properties.

Defining Geographical Boundaries

The boundaries of market areas, neighborhoods, and districts identify the areas that influence a subject property's value. These boundaries may coincide with observable changes in land use or demographic characteristics. Physical features such as structure types, street patterns, terrain, vegetation, and lot sizes help to identify land use districts. Transportation arteries (highways, major streets, and railroads), bodies of water (rivers, lakes, and streams), and changing elevation (hills, mountains, cliffs, and valleys) can also be significant boundaries.[1]

To identify the boundaries of a market area, an appraiser

1. Examines the subject property. The process of defining a market area's boundaries must start with an analysis of the subject property.
2. Examines the area's physical characteristics. The appraiser should drive or walk around the area to develop a sense of place, noting the degree of similarity in land uses, structure types, architectural

1. In defining a district, variations in the relevant characteristics of properties may indicate that more limited boundaries should be established. For example, consider an urban area where many high-rise apartment buildings are constructed along a natural lakeshore and separated from other land uses by major transportation arteries. In this type of district, there may be great variations in apartment prices, sizes, views, parking availability, proximity to public transportation, and building ages. These variations suggest limited district boundaries that must be identified to reveal market and submarket characteristics.

styles, and maintenance and upkeep. Using a map, the appraiser can identify points where these characteristics change and note any physical barriers–e.g., major streets, hills, rivers, railroad tracks–that coincide with these points.

3. Determines preliminary boundaries on a map. The appraiser indicates lines on a map of the area to connect the points where physical characteristics change.
4. Determines how well the preliminary boundaries correspond to the demographic data. The market area boundaries are often overlaid on a map of geographical areas (e.g., zip codes, census tracts, block groups). The appraiser's observed market area and the areas for which data is available seldom match up perfectly. The information available for census tracts, zip code regions, and counties must be segmented to delineate pertinent submarkets.[2] Reliable data may also be available from local chambers of commerce, universities, and research organizations, often through online sources.

> Market areas are defined by a combination of factors–e.g., physical features, the demographic and socioeconomic characteristics of the residents or tenants, the condition of the improvements (age, upkeep, ownership, and vacancy rates), and land use trends.

In unusual cases an appraiser might consider surveying area residents to identify relevant characteristics. Appraisers may also interview business people, brokers, and community representatives to establish how far they think the market area extends. Through experience, an appraiser learns to observe changes and recognize how market areas are perceived by their inhabitants.

Legal, political, and economic organizations collect data for standardized or statistically defined areas such as cities, counties, tax districts, census tracts, and special enumeration districts. Although this data may be relevant, it rarely conforms to the market area boundaries identified for property valuation. If such secondary data is used to help identify market area boundaries, the appraiser should verify and supplement the data with primary research.

Value Influences in Real Estate Markets

As mentioned in the previous chapter, the four forces that influence value (i.e., social, economic, governmental, and environmental forces) interact in the marketplace, creating unique combinations of factors. Careful study of general data related to a real estate market's character is a prerequisite to the more formal application of market analysis, highest and best use analysis, and the approaches to value.

Social Influences

An appraiser identifies relevant social characteristics and influences, focusing on the demographic characteristics that tend to influence prop-

2. Every 10 years the Bureau of the Census of the US Department of Commerce collects data on population and housing characteristics, employment, and earnings. For information on applying US census and other data to the analysis of market areas, see Stephen F. Fanning, *Market Analysis for Real Estate: Concepts and Applications in Valuation and Highest and Best Use* (Chicago: Appraisal Institute, 2005), Chapters 7 and 8, and the forthcoming new edition of that book.