Marketing of Real Estate

by

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A DISSERTATION

Presented to the

Economic Scientific Faculty at the University of Oradea

in Partial Fulfillment of Requirements for the Degree of

Doctor of Philosophy

Under the Supervision of Professor Dr. M. C. Demetrescu

Oradea, Romania

October, 2001

Abstract

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This dissertation investigates the relationship between the various taxes imposed upon the landlords of land and buildings as well as upon buyers, sellers and users of real estate, and the marketing methods of real estate via tax shelters and anonymity.

A theory asserting that this relationship is targeted to the inherited resistance in human culture to pay taxes to the rulers - kings or democratic governments, without breaching the law. While tax evasion is illegal, tax avoiding is legitimate legally and socially.

In order to understand the inherited resistance in human culture to pay taxes to the rulers, one should learn the phenomenon of the role of land for human kind. The concepts of rent and land taxation nowadays as well as in previous centuries should be discussed. The growth of population impact on the land use and the evolving of cities and mega-cities should be investigated. This dissertation tries to compete with all this tasks.

The empirical results confirm the theory's hypotheses. Because anyone would prefer to avoid paying taxes and some would prefer to become an anonymous owner of real estate assets, it creates the need for investigating and developing marketing methods of real estate via tax shelters and anonymity.

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ACKNOWLEDGMENT

A superb adviser and a scientific guide Professor Dr. M. C. Demetrescu supervised this research. Professor Demetrescu has played many rolls. During the last five years he became a supporting friend, a helpful instructor, a catalyst to fulfil the academic obligations, a wonderful teacher, and finally a mentor.

I met Professor Demetrescu in a hotel in Oradea where we accommodate while he lives in Bucharest and I live in Israel. My introduction to the marketing world started at that hotel since I practice law and specializing in land-law and taxation-law. Professor Demetrescu became my bridge to the Economic Scientific Faculty at the University of Oradea and helped me to overcome the Romanian language obstacle.

Thanks to my partner at my law office in Israel, Pinhas Gilad, who carried the burden during my visits to Romania and my absence during learning and writing this dissertation.

Last but not least to be thanked is my wife Jehudit and our three kids Etgar, Oryan and Nefertiti who supported me all the way along. This degree is the product of that entire environment.

Chapter 1 Introduction

Real estate is man's single most expensive requirement in life, and purchasing this asset requires the savings of many years of labour. Real estate can be used as both a habitat and a livelihood.

In addition to the economic value of a man's house, there is also an emotional value attached to it. The instinct to guard one's own territory is a basic instinct that applies to fish, amphibians, reptiles, birds and mammals. Similar to the instinct in animals, the territorial instinct is the strongest of man's instincts, and he is ready to sacrifice his own life in protection of his territory.[1]

As recently as 10,000 years ago, people gathered into small Neolithic settlements. There were from five to 10 million human beings then - not enough to exercise much influence on the ecosystem within which they lived and worked. That situation prevailed for the most of the next 10,000 years. Only in the last few decades have humans brought about changes comparable in magnitude to those wrought by nature during long epochs of geological time.[2]

The complex of developments in stone tool technology, food production and storage, and social organization that is often characterized as the Neolithic

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1 Ardrey, Robert. African Genesis A Personal Investigation into the Animal Origins and Nature of Man, Dell Publishing, 1961.

2 Keyfitz, Nathan. "The Growing Human Population", in Managing Planet Earth: readings from Scientific American magazine, W. H. Freeman and Company, New York, 1990, p. 61. See chapter 3.4.

revolution was in progress in China by at least the 6th millennium BC. Developments in the Chinese Neolithic were to establish some of the major cultural dimensions of the subsequent Bronze Age.[3]

The perpetual growth in the world's population[4] decreases the amount of land per person[5] and, as a result, increases the value of the existing land. Today, more man-hours are required to purchase an average apartment, or house. The process of increasing the value of land is destined to continue as long as there is an increase in the number of consumers interested in purchasing a "product" which is impossible to create - *Land*. The phenomenon of continuous growth in the value of land is especially true in cities, although there is also an influence on the value of land in outlying areas, where there is more available land to be populated.

The trend of growing population leaves less land per person and causes elevation prices of land. Since the industrial revolution people move from the country to the cities, and it causes the trend of the high prices of the land in the growing cities. I discuss these trends through the history of man and land.

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3 Encyclopædia Britannica, China, history, prehistory, Neolithic period, http://www.britannica.com/eb/article?eu=127710&tocid=71613. It is now thought that the first human inhabitants of Asia migrated into the continent from Africa at least one million years ago. The earliest traces of human activity in Asia are associated with the Homo erectus fossils found at Zhoukoudian near Peking. Encyclopædia Britannica, Asian people, http://www.britannica.com/eb/article?eu=118213&tocid=65114

4 In 1998 the population was 6,000,000,000 while only 200 years ago the population was about 600,000,000. U.S.A Census Bureau - The official statistics, data of historical population in the world, http://www.census.gov/ipc/www/worldhis.html

5 "Having developed technologies that transformed the earth, humankind now wonders about whether the planet and its resources can continue to sustain life. But the author sees that several modern technological trends are leading us toward a better, not worse, environmental future. He notes that we are using energy and land with increasing efficiency, and suggests that these trends may make human existence, even with population growth, less of a burden to the planet in the next century--if rapid growth in personal consumption and waste can be contained." Jesse, Ausubel H. "Can Technology Spare the Earth?", in American Scientist, March-April 1996, Volume 84, No. 2. http://www.amsci.org/amsci/Articles/96Articles/Ausubel.html

1.1 The Burden of Taxes on Real Estate

The ownership of real estate, the various uses of property, and the profit resulting from the sale of real property was utilized in history as a "good excuse" to draw taxes by a ruler on his subjects.

In ancient Egypt, a tax of 20% was imposed on the crops.[6] In ancient Greece in the 5th century BC a tax was imposed on selling of real estate.[7] As the burden of different types of taxes grew, the efforts of the taxpayer and his consultants looking for tax shelters increased.

In 1918, Joseph Schumpeter[8] observed, "The fiscal history of a people is above all an essential part of its general history. An enormous influence on the fate of nations emanates from the economic bleeding which the needs of the states necessitates, and from the use to which its results are put... The spirit of a people, its cultural level, its social structure... all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here discerns the thunder of world history more clearly than anyone else."

Other scholars have argued that the burden and harm of taxation have been even worse than war and conquest. English classical economist Nassau Senior[9] stated in the 1840s, "Arbitrary taxation, in despotism to supply the wants of the ruler, in aristocracies and in oligarchies to supply the state, is perhaps still more destructive to providence than even war. The presence of the foreign enemy is occasional and local, that of the tax-gatherer is universal and perpetual. The one can be resisted, the other can be only eluded."

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6 Genesis, chap. 47, par. 24. "And it shall come to pass at harvest times, that you shall give the fifth part to Pharaoh, and four parts shall be your own, for seed of the field, and for your food, and for them of your households, and for food for your little ones."

The word *Fiefdom* in English is derived from this Biblical example of 20% (one - *fifth*) of a serf's land production being a compulsory payment to the landlord or king.

7 Fuks, Alexander. The Athenian Commonwealth, Politics Society Culture, Hebrew edition, Mosad Bialik, Jerusalem 1964, p. 77.

8 Joseph Alois Schumpeter, Feb. 8, 1883 - Jan. 8, 1950, a Moravian-born American economist and sociologist known for his theories of capitalist development and business cycles.

9 Nassau Senior, September 26, 1790 - June 4, 1864, was a British classical economist who influenced the political and economic policies of his days.

It has also been insisted that by taxing the wealth and property of those who are the producers of any society the state merely succeeds in creating a class of non-producers who live off what others have produced and bringing into existence a category of wasteful expenditures for the goods these non-producers consume.

"I conclude," said American economist Thomas Cooper[10] in 1830, "that taxation increases the number of unproductive consumers, and the amount of unproductive consumption; and tends, not to enrich, but to impoverish a nation. Hence, as taxes are an evil, the fewer we have of them, and the smaller the amount, the better."

The distinction between those who pay taxes out of their productive efforts and those who consume the wealth of those others was never made more clearly than by the 19th century American statesman John C. Calhoun.[11] Calhoun explained that "the unequal fiscal action of the government... divides the community into two great classes: one consisting of those who, in reality, pay the taxes and, of course, bear exclusively the burden of supporting the government; and the other, of those who are the recipients of their proceeds through disbursements, and who are, in fact, supported by the government; or, in fewer words, to divide it into taxpayers and tax-consumers."

The modern economy since the industrial revolution and the need for sophisticated systems of selling goods developed the theory of marketing. This theory deals with the analysis of -

a. The needs, wants and demands of consumers;
b. The choice of products - goods, services and ideas;
c. The understanding of the subjective value that a specific product or service has in the eyes of a specific consumer;
d. The price of the product and the satisfaction gained by the consumer;
e. The buying patterns of the product - selling and barter methods;

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10 Thomas Cooper, March 20, 1805 - July 15, 1892, an English writer whose political epic the purgatory of suicide promulgated in verse the principles of Charism, Britain's first specifically working-class national movement, for which Cooper worked and suffered imprisonment.

11 John C. Calhoun, March 18, 1782 - March 31, 1850, an American political leader who was a congressman, secretary of war, seventh vice president (1825–32), senator, and secretary of state. He championed states' rights and slavery and was a symbol of the Old South.

f. The development of long term relationships with suppliers, marketers, point-of-sale and consumers; and
g. The study of different market factors, the forecast of market trends, and the preparation of the marketing foundation according to these trends.[12]

Because this dissertation focuses on the marketing of real estate, I found it appropriate to apply the general marketing definitions to the special nature of this "product".

The rise and fall of civilizations is caused by the kinds of taxes levied and the means used to collect them. Rome fell because the egalitarian tax reforms of Emperor Julian were weakened and finally overturned by his greedy, arbitrary successors.

The Moslem hordes of the Middle Ages are seen as mild-mannered revenue agents, which explains why Islam spread so widely before the world's first excise tax unhinged its empire.

Enlightenment thinkers equated liberty with tax consent and defined tax freedom as a "natural right": The American Revolution codified that strain of thought.

"Will we end up as citizen-serf-taxpayers like the later Romans? The current direction of our tax system's penal laws and spying devices makes this a possibility. We can find ourselves shackled to a kind of neo-serfdom to the modern fiscus. If that happens, then the struggle between democracies and dictatorships will enter a new phase in which the choice will be not liberty or bondage but, rather, which kind of bureaucratic bondage." [13]

Even when governments have instituted tax regimes that did not originally completely suppress all incentives for work, saving and investment, the fact is that the systems have always degenerated into exactly that - engines for economic stagnation and decay. The only times when governments have, in general, pulled back and lightened the burden and the pervasiveness of its tax regimes were when they were under threat or actualized revolts of the taxpayers.

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12 See definition of "marketing" in paragraph 2.1

13 Adams, Charles; Rabushka, Alvin. For Good and Evil: The Impact of Taxes on the Course of Civilization. New York: Madison Books, 1993.

Even in these situations, often the lifting of the tax burdens and the moderating of the methods of enforcement have been more an illusion than reality. From the beginning of recorded history, governments have used the same methods of enforcement that dominates our own time: spying, audits of tax records, imprisonment and confiscation of property for failure of proper payment, lies, and deceptions.

Since the 18th century, when governments have become increasingly democratic and supposedly a reflection of the will of the people, those governments have continued to impose increasingly higher taxes. The key to understanding this phenomenon is the myth of democratic government. Since under democracy, the people are supposed to rule themselves through the representatives they elect, there is the belief that government can never be oppressive, because the people cannot oppress themselves. But "the people" never rule, even in a democracy. It is always a coalition of groups who elect those who hold office, and a primary purpose of forming such coalitions is to obtain financial support from the state for various purposes at the expense of others in the society who are made to pay for them. Our leaders claim that big governments and big spending ought to solve the world's problems.

1.2 Methodology

The first phase of this research was the investigation of three different fields: marketing, land, and taxation.

Marketing is a modern science, that developed mainly in the 20th century. The need for marketing attitude evolved after the world faced a new phenomenon in the human history - over productivity. Before the industrial revolution the main market was an agriculture domestic market where peasants or merchants sold mainly food and craftsman offered their skills. There existed an unsophisticated competition but merely a need for strategic marketing methods.

Land is a most powerful factor in human life. It is driven by instincts to have a territory and to guard it. During the history land and territory were the main reason for wars. The use of land has two main categories - private ownership, and feudal regime (especially in rural land) where a vast country belongs to few families and peasants who are practically slaves.

Taxation is an ancient phenomenon with modern trends. The modern democratic regimes impose taxes preaching similar excuses to their subjects as counts and dukes preached to their vassals and the chief preached to his fellow caveman, "it is necessary for the community and I have the power to collect it".

The second phase of this dissertation is to merge these three different fields into untraditional strategies of marketing of real estate.

The trend of a growing population leaves less land per person. Since the industrial revolution people move from the country to the growing cities. I discuss these trends through the history of man and land.

1.2.1 Statement of the Issue

Marketing of real estate has its traditional methods - advertising, adjusting market price, finding segment markets etc. While doing so, the competitive market uses the same traditional techniques.

1.2.2 Purpose of the Research

This research is designed to provide entrepreneurs and contractors untraditional methods to improve their prospects of marketing in the competitive market.

1.2.3 Basic Premises of the Research

The Competitive Bidding Pack - Imagine a pack of wolves hunting for prey. The pack may run very close together or spread out over a significant distance. As they hunt, the leader of the pack changes frequently. Sometimes, being the leader has its advantages. If the pack encounters a small rabbit, the leader will be able to catch the rabbit for itself, regardless of the distribution of the pack. However, if they encounter a bear while spread out, the leader is probably going to die before help arrives. Obviously, the optimum position for any one wolf is to be the first in line for lunch without running so far ahead of the rest of the pack. The leaders of the pack will be the aggressive wolves, who are hungry and willing to take the risk of leading. Other wolves may tend to be apathetic about hunting and disinterested in leading the pack.

A group of entrepreneurs and contractors, who bid competitively for marketing their real estate, can be similar to the pack of wolves. They are hunting for the customer in a hostile environment. Like the lead wolf, the lead entrepreneur or contractor needs to optimize his position, offering lower prices to sell his building but not offering much lower than his closest competitor. To find the optimum position, the contractor must take into account how hungry/aggressive, or how satiated/disinterested, the other entrepreneurs or contractors are.

The Pack Price - The usual approach for marketing in a competitive market is the concept of the "pack price". The pack price is defined as the lower of the two bids that are closest together. The pack price is the price upon which two, independent, equally informed, competitive entrepreneurs or contractors came closest to selling their building.

The pack price marks the division point between the aggressive contractors, who will bid lower than the pack price, and the disinterested contractors, who will tend to bid more than the pack price. The pack price can be defined as the break point between the aggressive bidders and the disinterested bidders. Thus, the pack price should reveal what the price of the building would be if there were no aggressive bidders desperately trying to beat everyone else and if there were not disinterested bidders purposely bidding high.

The Emotional Approach - The backbone of this research is the concept of the emotional approach of the customer of real estate. The emotional approach to buying and owning real estate assets will be presented in this research.

One may expect that his competitors will not use the untraditional methods he uses. The hypothesis of this research is that using those methods will submit a unique advantage in the competitive market.

This research does not intend to underestimate the traditional methods of real estate marketing, it merely presents untraditional methods to handle this issue.

Taxation and Real Estate - In order to understand the significance of taxes in real estate buying, selling and owning process, I describe the essence of taxes and the various compulsory payments imposed on land and buildings in the history and nowadays. The target customers (market) are those who prefer to buy real estate and enjoy the benefit of tax shelters and anonymity. The target product should be adjusted to this target market.

The purchase of real estate, when the profit from the sale is tax-free is known to only a small stratum of sophisticated investors, assisted by lawyers and consultants specializing in this area. This know-how is not accessible to the majority of the population who is used to investing in real estate and paying taxes on their profit at the time of sale.

The marketing of real estate through the incentive of tax shelters is aimed at this large stratum of the population. There is an inherited resistance to pay taxes to the rulers - kings or democratic governments, without breaching the law.

The **first premise** is that the consumer, who wants to buy real estate assets, will prefer to do so in a way that allows him to enjoy capital gains without sharing it with the Treasury and to enjoy various economic benefits.

The ownership of real estate is registered in the land registry bureau. The registry is open to the public and the procedure of the registration process is rigid. The **second premise** is that this common method does not have the benefits of selling shares in a "real estate association".[14]

1.2.4 Benefits of the Research

The main benefit of the successful completion of this research is to enable entrepreneurs and contractors to better understand the mental state of mind of the customer of real estate. As a result, the entrepreneur may be able to require a unique advantage in marketing real estate based on a new understanding of the impact of emotional reasons involved in the process of buying a residence for dwelling, offices, shops or any other asset. This would give him one more piece of information to use to improve his marketing strategies.

He may find that his probability of marketing similar real estate assets at the same

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[14] See definition of "real estate association" in paragraph 6.1

price as his competitors is much higher by offering his customers tax shelters and/or anonymity.

1.2.5 Summary

This dissertation discusses two marketing methods for real property via two tax shelters anonymity and economic benefits: the sale of shares in a real estate association, and barter-transaction in real property. The goal is to enable unconventional methods of marketing.

The possibility of enjoying a tax-free profit and economic benefits on one hand, and the anonymity of ownership over real estate as well as simplicity of the registration process of ownership on the other hand, are presented as the main incentives for the potential buyer.

1.3 Epistemology

The real estate market is a traditional one, and most of the transactions are performed in the same legal way as hundreds of years ago. Upon this traditional transactions the legislators imposed traditional taxes that are almost impossible to reduce or avoid.

The traditional method of land registration reveals the identity of the owner. When somebody prefers to stay anonymous, he might register an association, i.e. offshore company, and buy property via this association.

The issue of untraditional methods of real estate marketing fascinated me for many years. Since I could not find books or references dealing with these methods, I found it important to try to clarify its advantages as I see it.

The starting point is to dismantle between buying, selling and owning real property and the legal and personal outcomes lays in abandoning the traditional methods of dealing and owning.

The method to dismantle the traditional linkage between selling and buying real property and taxes imposed on it lies in the untraditional methods of performing sales as it was described above. Marketing of real property via pre-registered real estate association (REA) may create various tax shelters as well as anonymity.

Using these methods creates an edge in marketing real property by offering tax shelter and anonymity as well as other economic and personal advantages to both parties - sellers and buyers. This unconventional marketing does not need to compete with others performing the traditional deals in the various real estate markets.

Chapter 2 Marketing

2.1 Definition and Terms

"Marketing" is a social and managerial process by which individuals and groups obtain what they need and want through creating, offering, and exchanging products of value with others.[15]

This definition is one of many, and it is a difficult term to define in a business sense because the word is used in so many ways.[16]

The philosophy that marketing strategies must be based on known consumer needs has come to be known as the marketing concept.[17]

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[15] Kotler, Philip. Marketing Management, Analysis, Planing, Implementation, and Control, 9th edition, p. 9.

[16] "Marketing" is a series of planning and management activities leading to transaction between a seller and a buyer - a process that makes it possible to sell goods or services to people who want to buy them. Keegan, W. & Moriarty, S. & Duncan, T. Marketing, 1992, p. 6.

[17] This view, which began to win wide acceptance in the mid-1950s, seems so logical today that one wonders why marketers did not turn to it sooner. There are two reasons. First, marketing institutions were not sufficiently developed before 1950 to accept the marketing concept. Products were distributed and advertised on a mass-market basis; few were targeted to defined consumer segments according to their needs. The marketing concept requires a diversity of facilities for promoting and distributing products to smaller and more fragmented market segments. This diversity in marketing institutions did not exist before 1950, when the emphasis was on economics of scale in production and marketing.

2.1.1 Definition of Marketing of Real Estate

For the purpose of this dissertation, the classic definition of marketing should be altered in order to adjust it to the nature of real estate, and it would be defined as follows.

"Marketing of Real Estate" is a social and managerial process by which individuals and groups obtain what they need and want through offering and exchanging land and creating, offering and exchanging buildings directly and indirectly to others.

In order to understand and analyze this definition, as well as the concept of this dissertation the various terms will be defined in this chapter. Those terms are: *real estate market; market; needs, wants and demands; price; cost; satisfaction; value of real estate; market value of real estate; real estate appraisal;* and *sale and exchange.* One term will be defined in chapter 3: *real estate and real property.* Four terms will be defined in chapter 4: *profit; wages; interest;* and *rent.* Two terms will be defined in chapter 5: *tax,* and *tax shelters*. One term will be defined in chapter 6: *real estate association.* One term will be defined in chapter 7: *direct and indirect exchange.* In light of the specific focus of this dissertation - "marketing of real estate", other terms of the marketing theory will not be considered relevant.

2.2 The Real Estate Market

"Market" - A market is a place where man takes part in the barter and exchange of merchandise. At the beginning of human history, the market was always situated in the middle of a community, on a central street or square, where the producers of food, clothes, and other consumer goods would gather to sell their

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The second reason the marketing concept was not widely accepted until the 1950s is that before that time there was no economic necessity to do so. There was little purchasing power during the Depression to spar an interest in identifying customer needs. During World War II and immediately thereafter, scarcities where prevalent. There was no competitive pressure to adjust product offerings to customer needs. Manufacturers sold what they made. They did not have to worry about making only what they could sell. Assael, Henry. Marketing management, Strategy and Action, 1985, p. 9.

wares.[18] The term "market" originally meant a physical place where an exchange occurs - a fair, farmer's market, or bazaar, where people came together to sell and buy things.[19]

The desire to widen the borders of the local market was the main factor responsible for the development of the shipping industry and the search for new markets. Those markets enabled the purchase of goods that did not exist in the native country and the sale of goods that were in abundance. The development of railroad tracks and airports made a worldwide marketplace, existing in conjunction with the local markets. Modern communication such as the press, radio and television allow anybody and everybody to offer easily his goods and services to consumers the world over.

The Internet[20] is the largest marketing tool and it expends rapidly. This tool will be definitely the most important one in the next century.[21]

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18 "Market": A public place in a city or town, where provisions or cattle are exposed to sale; an appointed place for selling and buying at private sale, a distinguished from an auction. Webster's 1828 Dictionary, http://65.66.134.201/cgi-bin/webster/webster.exe?search_for_d:/inetpub/wwwroot/cgi-bin/webster/web1828=market

"Market": an open area, building, or event at which people gather to buy and sell goods or food. A marketplace is a place, usually in an open area, where goods or food is sold. Cambridge Dictionary Online, http://dictionary.cambridge.org/

A Market consists of all the potential customers sharing a particular need or wants who might be willing and able to engage in exchange to satisfy that need or want. Kotler, Philip. Marketing Management, Analysis, Planing, Implementation, and Control, 9th edition, p. 13.

A set of arrangement in which buyers and sellers are brought together through the price mechanism. The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 19.

19 Keegan, W, Moriarty, S, Duncan, T, Marketing, 1992, p. 7.

20 The World Wide Web is the latest stage in the hyper-accelerated evolution of the Internet and is responsible for its current popularity. The rapid rise to prominence of the Internet over the last few years, especially the World Wide Web, has left many with the idea that this is an invention of the 1990s. The Internet, however, celebrated its 26th anniversary in 1995. The Internet is ideal for real estate marketing in that it allows consumers to search worldwide for property listings. Power, Glan P., "The Internet: an essential tool", in Canadian Appraiser, Vol.: 40 Iss: 2 Summer 1996, pp: 43-46.

21 The World Wide Web is an on-line information service on the Internet. Since early 1995, the number of people with access to the web has grown from about 2 million to somewhere around

Market includes all potential consumers who need and want a certain product and are willing and able to give something of equal value in return. The term "market" relates also to a group of consumers who are interested in a specific product; i.e. the food market, the confection market, the sport car market, the youth market, the North American market, the employment market, etc.

The real estate market[22] also answers this general definition and it can be found in the real estate sections in the newspaper, radio and television. Today, it is also possible to find tens of thousands of web sites on the Internet that offer the entire scope of real estate assets all around the world.[23] There is land for building, offices and shops for purchase or rental, luxury apartments and less expensive ones. There are even sites where tenants seek partners to share the rent.

2.3 Needs, Wants, and Demands

At the forefront of marketing theory is the principle that man needs wants and demands certain products. Concerning the marketing of real estate, man *needs* a place to live and, sometimes, to work from. He *wants* a place, where he can entertain and rest, and *demands* real estate in a specific place, in the building style and size that he likes.

People have a "need" for a dwelling, and a real estate asset from which they can make a living. That need is an essential need, and is not a need created by a

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20 million. Martin, J Roger, "Marketing on the World Wide Web", in Commercial Investment Real Estate Journal [CIJ], Vol: 14, Iss: 5, Nov/Dec 1995, pp: 30-34.

22 "Real Estate Market": The potential buyers and sellers of real estate at the current time, and the current transaction activity for real estate. It includes markets for various property types, such as housing market, office market, condominium market, and land market.

23 Today's commercial real estate professionals have ample marketing options to get their names out. In addition to such methods as advertising and promotional efforts, direct mail, and destinations, brokers, can take steps that include networking at organization meetings, picking up leads from residential brokers, and taking their marketing endeavors international. With the advent of Internet marketing, conventional forms of advertising may diminish in importance. Today, visibility need not be limited to local or even national markets. Increasingly, newsletters have become an important direct mail tool for both large and small firms. McCloud, John, "Taking Marketing to the Next Level", in Commercial Investment Real Estate Journal [CIJ], Vol: 17, Iss:2, Mar/Apr 1998, pp: 42-44.

specific society or by marketing. The *desire* to be the owner of a vacation home is designed according to the culture and tradition of the society.

A "demand" is the relationship between price and quantity demanded for particular goods and services in particular circumstances. For each price the demand relationship tells the quantity the buyers want to buy at that corresponding price. The quantity the buyers want to buy at a particular price is called the "quantity demanded". The demand for a specific architectural design of a building, and the place and size of the asset, are the direct results of the person's financial capabilities and his desire to purchase.

Buyers are the people who want or need the product or service. The term "demand" refers to the willingness and ability of people to purchase the good or service in the market. The demand relationship expresses that willingness and ability for the whole range of prices. To say that a person has a demand for a particular product is to say that the person has money with which to buy and is willing to exchange the money for the goods. People will not demand what they do not want or need, but a want or a need unbacked by purchasing power is not a demand.

Similarly, it is not enough that the suppliers possess the good or the service. Supply also means willingness to sell. Most of us have experience living in the market economic system, and that makes economics seem like a common-sense field -- but sometimes that common-sense feel can be deceptive. People sometimes use the term "demand" ambiguously -- as if "demand" were the same thing as need. But it is not.

Need without purchasing power will not create effective demand in the marketplace. Economists sometimes stress this point by using the term "effective demand" in place of simple "demand."

Demand can be ambiguous in another way. We should not think of "demand" as a particular quantity -- because the quantity that people are willing and able to purchase will change when the price changes. Economics assumes that there is a systematic relationship between the price in the marketplace and the quantity that people are willing and able to buy. This relationship is called "the demand relationship" or, simply "demand." The quantity that people buy at each price is called the "quantity demanded" at that price. We think of the "demand relationship" as a relationship between the price and the quantity demanded.

It is important to distinguish between the demand relationship and the quantity demanded. This may seem like "splitting hairs," but not making the distinction between them causes a lot of confusion. The convention in economics is to use the word "demand" to mean the demand relationship and "quantity demanded" for the specific quantity that people are willing to purchase, when there could be confusion.

The law of demand is that at a higher price, the quantity demanded will be less, and it creates the "ceteris paribus".[24]

2.3.1 Price and Cost

There is a difference among the price of a specific real estate asset, its cost, its market value, and its worth or value, as far as the purchaser and seller are concerned.

"Price" - The price is the amount paid by the buyer to the seller for a specific asset. When Solomon pays Abraham the agreed price of $100,000 for his apartment, this price is a fact regardless of the market value or the value, which each party might put on it.

A price, once finalized, represents the amount a particular purchaser agrees to pay and a particular seller agrees to accept under the circumstances surrounding their transaction.[25]

"Cost" - The term cost is used in relation to production, i.e. the cost of a building is the price paid to purchase the plot, to the architects who prepare the plans, to the contractor who built the building etc. The act of predicting the total costs of labour, materials, capital, and professional fees required to construct a proposed project is known as "cost estimating in construction".

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[24] "Ceteris paribus" is a Latin phrase often used by economists, literally meaning "other things equal." Used in the context of an economic model, it means all the variables that might affect the equilibrium in the model are held constant unless we explicitly say otherwise.

[25] The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 19.

2.3.2 Cost and Satisfaction

Variable costs are costs that can be varied flexibly as conditions change. Labour costs are the variable costs. Fixed costs are the costs of the investment goods used by the firm, on the idea that these reflect a long-term commitment that can be recovered only by wearing them out in the production of goods and services for sale.

The idea here is that labour is a much more flexible resource than capital investment. People can change from one task to another flexibly, whether within the same firm or in a new job at another firm, while machinery tends to be designed for a very specific use. If it isn't used for that purpose, it can't produce anything at all. Thus, capital investment is much more of a commitment than hiring is.

In the 18^{th} century this was clearly true. Over the past century, education and experience have become more important for labour, and have made labour more specialized, and increasing automatic control has made some machinery more flexible. So the differences between capital and labour are less than they once were, but all the same, it seems labour is still relatively more flexible than capital. It is this relative difference in flexibility that is expressed by the simplified distinction of long and short run. Of course, productivity and costs are inversely related, so the variable costs will change as the productivity of labour changes.

How does the consumer choose a real-estate product that answers his needs? When Joji has a job in a specific town, he probably purchases a dwelling place in the same vicinity, in the same city or in a nearby community, on the condition that he is assured accessible and inexpensive transportation to his place of work. These alternatives describe the factors considered by a person who is choosing the location of his home.

Suppose that Joji buys an apartment in a building that was built in the 19th century, in a skyscraper, in a building with a modern design, or in a neighborhood with young where there are community services for his children. These factors illustrate his decision based on satisfaction of his wants.

The guiding principle at the beginning of Joji's choice is the level of *value* and *satisfaction* achieved. *Value* is a subjective term that describes how Joji estimates that a specific apartment will answer all of his needs, wants and demands. If Joji wants to live near his place of work, then he must purchase a home in the center of town, and pay a large sum of money for this. In this case, Joji must give up on the purchase of other products and services that he needs and is interested in. By purchasing a less expensive apartment in a place farther from town, Joji can make available his resources to purchase other products and services. During the decision process Joji can best use the money available to him. *Satisfaction* is the supply of Joji's need to buy an apartment at the lowest possible cost.

Usually we measure the cost and the value at present time, especially if we intend to buy a product or an asset. In some occasions we purchase assets because we believe that it's price will increase in the future i.e. stamps or gold. This belief gives us the incentive to obtain it and it creates a value.

In other occasions we buy property because the profit is tax free, and that is considered as a value. Sometimes the desire to stay anonymous creates for us value, and drives us to purchase an asset that does not reveal the owner's identity. A convenient cash flow can make the whole difference for many buyers especially when we deal with purchasing plots that are considerable expensive.

2.3.3 The Theory of Supply and Demand

The theory of supply and demand is a theory of price and output in competitive markets.[26]

Adam Smith argued that each good or service has a "natural price." If the price (of beer, for example), were above the natural price, then more resources would be attracted into the trade (brewing, for example), and the price would return to its "natural" level. Conversely, if the price began below its "natural" level, then fewer resources would be attracted into the trade, and the price would return to its "natural" level.

The modern theory of supply and demand differs from Smith's theory. Economists have made some progress in the last 200 years, and great economists such as John

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[26] Essential Principles of Economics: A Hypermedia Text from The journal of Economic Education, http://william-king.www.drexel.edu/top/prin/txt/Ecotoc.html

Stuart Mill, Alfred Marshall and many others have played their part in the growth of the modern theory of supply and demand. Nevertheless, the theory of supply and demand is the modern expression of Smith's great insight about "the natural price."

Before about the 1850's most economists accepted the Labour Theory of Value as the theory of the "natural price." But there were some cases it did not apply to: international trade, for example. John Stuart Mill suggested, "supply and demand" solutions for prices in international trade. Other economists extended it to apply to prices in general.

Unlike the "natural price," a long-run theory only, the theory of supply and demand applies in the short run as well as the long.

Competitive markets work through an interaction of "supply and demand." Alfred Marshall compared the supply and demand sides to the two blades of scissors -- one won't cut by itself. You have to have both.

Equilibrium of Supply and Demand - The interaction of supply and demand is understood as *equilibrium*. We may think of demand as a force tending to increase the price of a good, and of supply as a force tending to reduce the price. When the two forces balance one another, the price would neither rise nor fall but would be stable. This analogy leads us to think of the stable or natural price in a particular market as the "equilibrium" price.

This sort of equilibrium exists when the price is just high enough so that the quantity supplied just equals the quantity demanded. If we superimpose the demand curve and the supply curve in the same diagram, we can easily visualize this equilibrium price. It is the price at which the two curves cross. The corresponding quantity is the quantity that would be traded in market equilibrium.

Competition and Equilibrium - The price is in constant motion, up or down, except when quantity demanded is equal to quantity supplied. Put another way, it is the price toward which competition pushes the price. At equilibrium, there is no competition either to buy or to sell, because everyone can buy or sell however much they may wish, "at the going price". But whenever the market is away from equilibrium, competition will arise and tend to force it back. Competition eliminates itself, by forcing the market into equilibrium, in which there is no need to compete.

2.4 Value of Real Estate

Value is extrinsic to the commodity, goods, or services to witch it is ascribed. It is created in the minds of the individuals who constitute the market. Four interdependent economic factors create value: utility, scarcity, desire, and effective purchasing power.[27] A value of real estate is the result of the use that it has for people, nations and governments. Nevertheless, the value of a real estate asset is a subjective concept. There is a difference between the market value of a certain asset and the value of said asset in the eyes of the seller or the buyer.[28]

Sometimes, the seller is interested in the quick disposal of the real estate in question as a result of financial or legal difficulties, in which case he is willing to settle for a lower price than the market value. Abraham knows that the market value of the asset that he would like to sell is $100,000, but he requires cash in order to have surgery that could save his life.[29]

Paul hopes that he will recover from his illness, continue to live or get better and earn money in the future influences the value of the real estate he wishes to sell therefore, he will sell it for less than it is worth. Also, when someone is facing

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27 Utility is the ability of a product to satisfy a human want, need, or desire. Scarcity is the present or anticipated supply of an item relative to the demand for it. Desire is a purchaser wish for an item to satisfy human needs or individual wants beyond the essentials required to support life. Effective purchasing power is the ability of an individual or group to participate in a market. The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 28.

28 In par. 2.4 I defined *Value,* as a subjective term that describes how Joji estimates that a specific apartment will answer all of his needs, wants and preferences.

29 The sellers of a real estate property and his broker have two primary goals: to sell the property for as high a price as possible and as quickly as possible. While these are separate objects they are closely related through the listing price of the seller. The listing price affects how long it takes to find a buyer (i.e., Time on the Market = TOM) and TOM influences the price that results from the bargaining between the seller and the buyer. This leaves the seller and his agent with an important question: What is the optimal price to be asked for the property? Yavas, Abdullah. & Yang, Shiawee. "The Strategic Role of Listing Price in Marketing Real Estate: Theoty and Evidence", in Real Estate Economics, 23(3), Fall 1995, pp. 347-368.

bankruptcy or the loss of a business due to a cash flow deficit, he will sell his real estate for less than its value because at the same time, the real estate has a lower value than his business or his reputation.

When Joji has a building site upon which he cannot build because of planning restrictions or squatters and other nuisances, he may sell the asset at a lower price than its real value. Usually, one doesn't have the legal means to deal with the problem, the finances to pay the professionals or the emotional strength to invest his time and money in solving the problem.

In all of the above situations it is obvious that the value of the real estate is determined by the personal circumstances and priorities of the seller and not by its market value. In the same way, when a man is emotionally tied to his house, the value of the house increases above the real value, and sometimes he will not agree to sell the house even if the price received is 50% more than the market value.

Just as the seller might render the asset to be of a different value than that which the market determines, so might the buyer. Sometimes the buyer is willing to pay more than the market value for a certain asset since this specific asset meets his needs and he feels that he must have it.

When Nelu is interested in living in the same building his parents live in, he will pay more for the apartment than it is really worth on the market. When Reuven has a successful store which he wants to expand, he will be ready to spend more for the adjoining store than for a similar store which is not close by. When the buyer has knowledge that is not available to the general public, which means that in the future, the value of a certain asset will increase, he will be willing to pay more for the asset than its actual market value.

In these cases, the value of the asset is determined by the buyer's desire to live close to his parents, his desire to increase the size of his business, or by his hope that the value of the asset will shortly increase significantly.

The conclusion is that the value of an asset is a subjective concept for the buyer and seller alike. It is influenced by the market value, but also by personal factors and private, special needs which are not in the public domain and therefore, have no bearing on the market value of the asset.