Developing For Demand- An Analysis of Demand Segmentation Methods and Real Estate Development

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Demand Segmentation: Adapting a Marketing Method to Real Estate Development

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ABSTRACT

Marketing is commonly mistaken in the real estate development industry for the practice of advertising and sales. In reality, marketing is a set of concepts and methods created primarily in the consumer packaged goods industry that start with a focus on the consumer. Many of these concepts and methods can be used in the real estate development process to create more thoughtful and competitive projects. This thesis focuses on the marketing concept of demand segmentation and whether the real estate development process could be better served through a more defined focus on identifying specific consumers through demand segmentation techniques.

Specifically, this thesis will answer the following questions:

What is the existing structure for real estate market analysis? What is the concept of demand segmentation and how might it apply to real estate development? How has consumer segmentation specifically been applied in real estate development ventures? What are some important considerations to be aware of when developing real estate for a specific consumer segment?

To answer these questions, this thesis reviews current thinking on demand segmentation through a review of relevant, marketing related literature for both the real estate and consumer packaged goods industries. This thesis also examines three subject developments that are examples of completed real estate development projects that serve the specific needs of a deliberately identified demand segments. The intention of this thesis is to define current marketing practices, analyze how a concept commonly used in the consumer packaged goods industry can be adapted for real estate and discover a body of questions and conclusion that can advance the practice of demand segmentation on real estate development.

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INTRODUCTION

Marketing is an often misunderstood term in real estate development. Most development professionals mistakenly believe that marketing is solely focused on advertising and sales and is best left to brokers and consultants. However, marketing is not the process of creating glossy flyers, buying magazine adds and showing model units to potential customers. Marketing is a professional discipline that emerged from the consumer packaged goods industry and is characterized by a set of concepts and methods that inform the creation, design, distribution and sale of a product. The modern practice of marketing, as used in the consumer packaged goods industry, offers concepts and methods that can be used by the real estate industry to improve due diligence, underwriting and proforma analysis, building design, selection of amenities and features, pricing and finally sales.

Underlying the practice and methods of marketing is a philosophy developed in the 1960's called the 'marketing concept' that dictates "marketing strategies must be based upon consumer needs and wants." This is a consumer centric view where the needs of the target customer dictate the product, position place and price decisions made by a firm. Real Estate professionals tend to focus solely on supply based concepts of marketing. Developers want to know how much of a broadly defined product, like office, exists in a specific market and whether the rents are going up as an indicator of market demand. At best, this way of thinking leads to broad conclusions that do not critically question who or what is driving demand for additional space. The concept of who drives sales of a product is a primary consideration in the consumer packaged goods industry. That is not to say that marketers of consumer packaged goods do not ignore supply, they simply review it after examining demand.

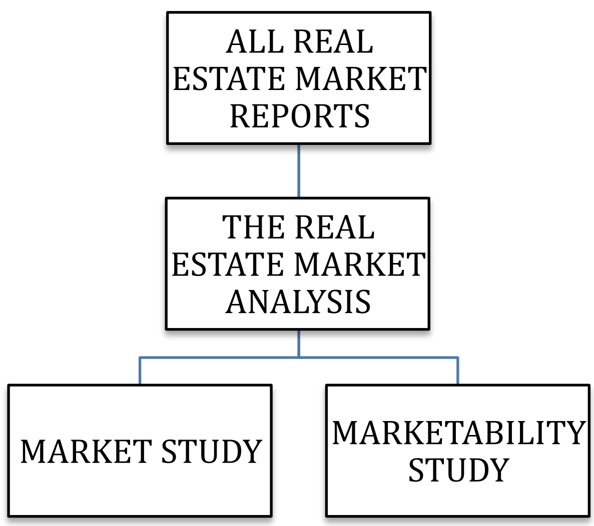
The focus on supply or demand is a primary point of distinction between the real estate industry and the consumer packaged goods industry. While the structures of these two industries are very different, the marketing concepts that drive them don't necessarily have to be. This thesis deals primarily with the concept of 'demand segmentation' and how it can be applied to the practice of real estate development. Demand segmentation is but one of many concepts commonly used by marketing professionals in the consumer packaged goods industry that can be helpful to real estate developers. Like consumer packaged goods, Real Estate can also be conceived of as a product defined by a consumer buying space and time. Demand segmentation is a process that can help a developer define who the consumer is and what they value or need.

This thesis begins by examining the current form of real estate market analysis through the commonly used market and marketability study. It goes on to introduce the Hourglass model conceived of by Emil E Malizia and Robin A Howrath to provide a contextual framework to organize the concepts of demand segmentation and how they relate to real estate development. The thesis continues by defining the concept of demand segmentation, examining methods of segmentation and discussing some of the potential benefits of segmentation as they relate to real estate. Finally, the thesis examines three cases of real estate developers who used demand segmentation to varying degrees to create a hotel for snowboarders, a co-op wine tasting room for time constrained, San Francisco tourists and a shopping mall created for generation X and Y shoppers. These examples are a limited selection of projects that have been created for defined demand segments. However, they represent a spectrum of success. One project recently closed, the other is struggling in the face of a disappearing demand segment and the last project has been fully leased for 15 years. The examples are intended to help illustrate how demand segmentation has been used to create new projects and review the experiences of customers and developers in an effort to draw conclusions and questions about how to further the practice of adapting demand segmentation to real estate development.

CHAPTER 1: An Examination of Real Estate Market Analysis

Market research and marketing reports serve a myriad of functions within the real estate industry from appraisals of a single property to an economic base study that "analyzes the entire economy of a given nation[i]." Each reports serves a specific need and is analyzed with different goals and viewpoints. This section of the thesis presents what is commonly known as the real estate market analysis, generally composed of two smaller reports called the marketing study and the marketability study. The relationship is shown below in Figure 1. The structure and composition of the market analysis is based upon a review of relevant academic and industry literature on real estate marketing.

FIGURE 1: Composition of The Real Estate Market Analysis



The real estate market analysis is used primarily by developer's considering speculative developments or the repositioning of an existing asset. Composed of the market study and marketability study, the market analysis "is an important risk management technique in that it provides the backup for the set of assumptions used in the cash flow analysis and therefore reduces or at least delineates the riskiness of projected cash flows.[ii]" Its fundamental purpose is to inform a developer considering a new speculative venture about the applicable market conditions and how they relate to the proposed project. The real estate market analysis should present a comprehensive overview of both the existing supply of potentially competitive properties to the subject project as well as the nature of the demand for the proposed space.

The first and most logical contextual element that a market analyst must consider is geography. The geography can be defined by a region, city, sub area or neighborhood depending on the type of project being considered. For example a regional mall's relevant geography would be different than the relevant geography for an apartment building. The historic emphasis that developers and investors have placed on location, location, location is born of the reality that "unlike all other products, people cannot take real estate home. Instead, the customer must move to the product, which offers a distinctive location[iii]." This seemingly simple insight helps explain why the real estate market analysis starts with some geographic definition. While the point of the real estate market analysis is to help a developer make a decision about a particular speculative development project it "considers only properties within a certain geographic boundary. Thus even a general market study must have some geographic referent.[iv]" The geography is best defined by the market analyst in conjunction with the developer based on local market knowledge and a thoughtful review of the project.

With the geography defined, the real estate "market study" can be prepared with the goal of providing aggregate supply and demand data to assist the developer in "understanding the effective supply of and demand for space of a broadly defined user group[v]." For example, the study for a multifamily development should quantify the number of rental units within the defined geographic area as well as the number of potential renters. In terms of defining the existing supply, a market study should also examine the quality of existing space, space under construction, vacancy rates of the subject supply, recent absorption of space, market rents and lease terms and other applicable criteria that can help define the existing product in a market. In terms of demand, the market study should provide a basic overview of a market's population, employment, income and macroeconomic factors to put market wide demand in context. Both the supply and demand conclusions should be based on some combination of primary and secondary data, "as reliance solely on secondary data produces an 'arm chair' analysis which is likely to be inadequate[vi]."

In their paper *Clarifying the Structure and Advancing the Practice of Real Estate Market Analysis*, Emil E. Malizia PhD and Robin A. Howarth advocate additional rigor in the practice of market studies through the incorporation of quantitative forecasts to establish demand for additional space over some period of time. According to Malizia and Howarth, a sound market study should also analyze historic rates of absorption and create a "causal model" that is capable of forecasting space absorption based on correlated economic trends. Additionally, current and forecasted supply of comparable properties should be incorporated into a thorough market study because it is just as critical to make informed assumptions about future supply as future demand. The rigorous additional steps advocated by Malizia and Howarth are rarely undertaken in practice but would certainly offer greater clarity as to whether or not a development was worth pursuing.

The point of the market analysis is to determine whether a development concept is feasible when considered in the context of broad market realities. If market researchers and developers determine that their concept has potential, then they outline a series of important questions that are not answered in the market study and undertake the second part of the real estate market analysis, called the marketability study. The marketability study answers the specific questions posed by the market study and brings an additional level of rigor to the market analysis process.

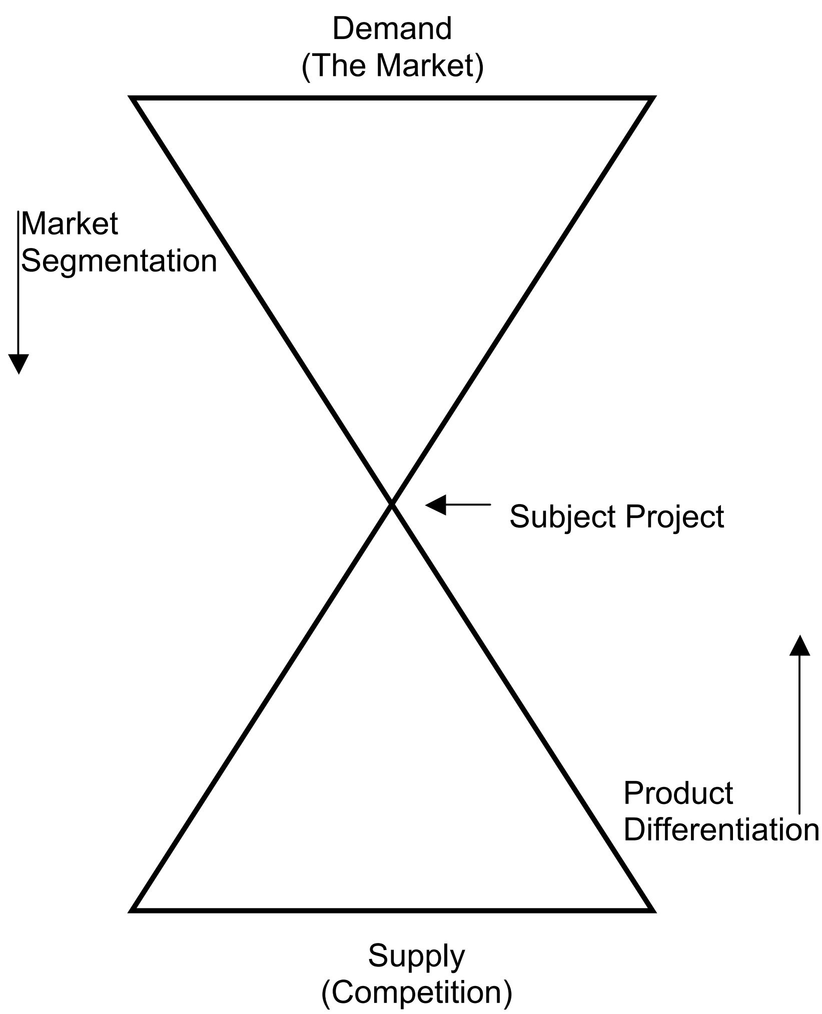
The marketability study "focuses on a specific property in the attempt to maximize the property's competitive position in the market[vii]." The first step in a marketability study is to analyze the demand within a market and segment it in a manner that divides different potential customers into groups that are likely to have similar needs and exhibit similar preferences. The marketability study should include a "segmentation of analysis [that] generates knowledge of the characteristics of targeted consumers." Once the characteristics of the potential customer are identified, the marketability study should define the features and benefits of the proposed project[viii]. Malizia and Howarth emphasize a "careful exercise of market segmentation and product differentiation when moving from the level analyzed in a market study to the narrower definitions of demand and supply considered in a marketability study."

The basic framework used by developers and marketing professionals to analyze a speculative development begins with a defined geography and consists of a market study that examines the macro economic forces that impact a potential development and a marketability study that makes micro level recommendations for a specific property about space users, appropriate features and amenities and pricing. While not always used or consistently applied, this framework represents the effort undertaken by marketing professionals and developers to determine whether a speculative project is feasible and if so how it should be specifically positioned within a market. This structure for real estate market analysis, if properly applied and conducted, provides a comprehensive market overview and important specifics necessary to build a profitable and competitive project. The proceeding chapters of this thesis will present a graphical model to further explain market analysis as well as focus on a series of recommendations to improve the relevance of the marketability report.

CHAPTER 2: Expanding on the Market Analysis- The Hourglass Model

The basic composition of the real estate market analysis is simple enough to understand, but a graphical model presented by Malizai and Howarth in their paper, *Clarifying the Structure and Advancing the Practice of Real Estate Market Analysis,* helps present the market research process and its intended effects in a more thorough manner. Further, it aids in the discussion of specific recommendations made by industry practitioners and academicians on how to improve the real estate market research process. Figure 2 below shows the Malizai and Howarth Hourglass model with a detailed explanation of its meaning

FIGURE 2: The Malizia and Howarth Hourglass Model



According to Malizia and Howarth, the "lengths at the top and bottom of the hour glass represent forecasted demand and supply in a specific market. An analyst begins the demand side analysis with market segmentation. Each relevant segment is identified by describing the characteristics of potential consumers more completely and by directly considering their tastes and preferences. As specificity increases, the segment represents an increasingly smaller portion of the overall market. (I.e. moving from the top of the hourglass downward). At the same time, however, the directly competitive supply also decreases. With the process of product differentiation, a market analyst moves form a more generic subject project considered in the market study (e.g. garden apartments, specialty retail) to a more differentiated subject project in a marketability study (e.g. two story apartments with specific unit features and external amenities, specialty retail with a specific tenant mix). As differentiation helps to better define a subject project (located at the center of the hour glass), it also eliminates supply to leave only competitive projects (movement from the bottom of the hourglass upwards[ix]."

The purpose is not necessarily to reach the intersection of the hourglass but is instead to intentionally position the subject property within the Hourglass based on market segmentation and a clear definition of the target customer. The intersection of the Hourglass labeled "Subject Property", can be likened to a 'build to suit' project. The demand is perfectly matched to the supply. The development project is defined exactly by what the build to suit client wants so no market or marketability study is necessary. However, when considering a new development, the market and marketability study are necessary to determine if a projects is worth pursuing and if so how best to position the project within the market. The marketing process is designed to mitigate or at least quantify that risk by positioning the subject development within the spectrum of supply and demand.

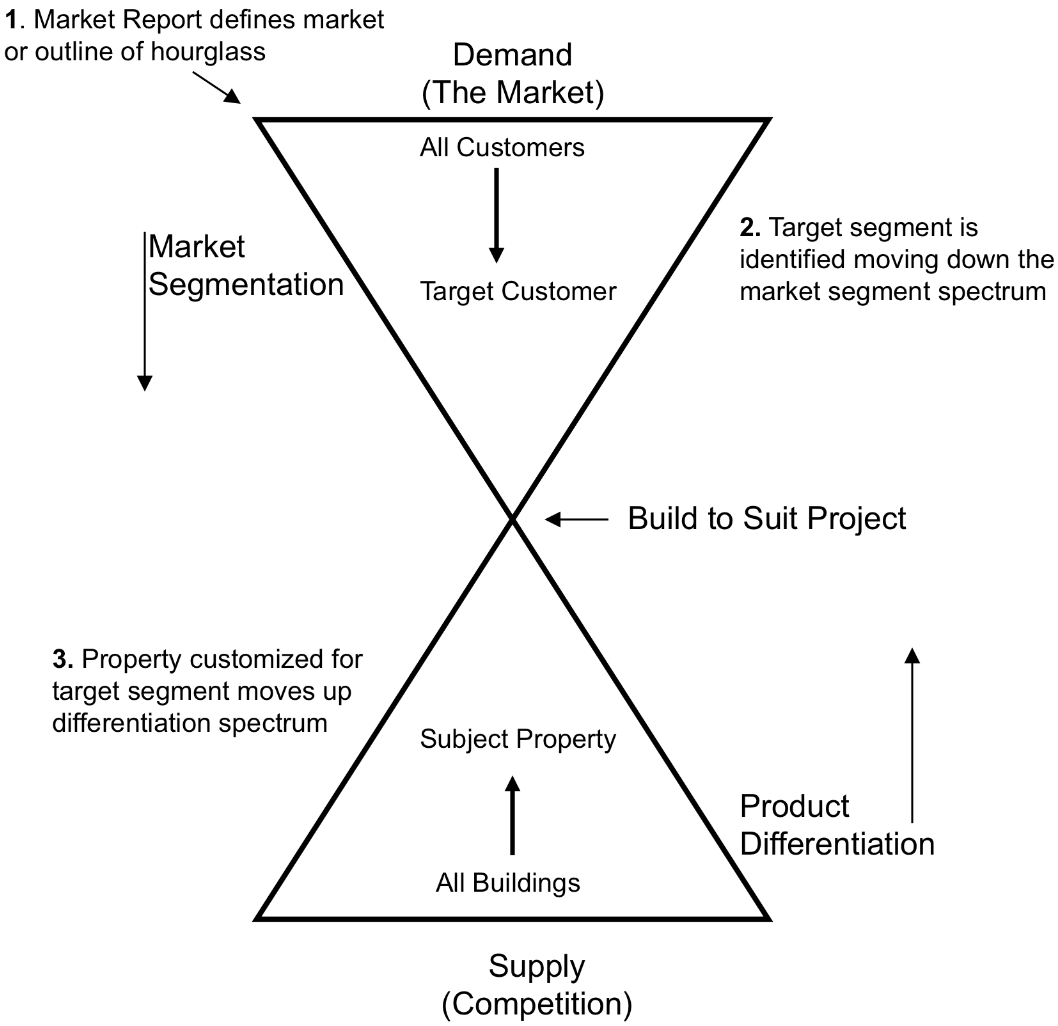
The Hourglass model offers an intuitive, graphical representation of the purpose of real estate marketing and the end result of the market and marketability studies. The top and bottom line of the hourglass represent a market's supply and demand, which are quantified and described through the market study. The marketability study analyzes demand within a market and identifies appropriate customers segments for the subject property. The process of market segmentation occurs in the upper part of the Hourglass and defines a specific customer for the project. Once a specific customer is identified, their needs are assessed in the marketability study and recommendations are made to inform a developer of how to create a project that appeals to the target segment. The marketability study should define the customer segments based on "a distinctive combination of people, lifestyles, purchasing power and place."[x] The marketability study can then recommend specific rents, design features, amenities or any characteristic that appeal to the target segment. The resulting product is thus defined in the bottom portion or differentiated supply section of the hourglass. The process of customizing the subject property for the subject demand segment moves the project up the bottom of the hourglass towards the hourglasses intersection making the project more differentiated within the market.

The following commonly accepted sequence emerges to analyze a real estate market and position a project accordingly. The specific sequence includes:

1. Perform a market study that specifies supply and demand as represented by the tops and bottom of the hourglass. The outline of the hourglass now represents the market
2. Perform a marketability study and identify a target consumer segment who's needs are unmet or underserved in the market. The process of segmenting the market and identifying a specific customer segment moves the demand target away from everyone at the top of the market to a more specific group towards the intersection of the hourglass.
3. This process of creating a property based on addressing the segments needs and preferences results in the projects position moving from the bottom of the hourglass away from the general supply and towards a more differentiated position in the market and the intersection of the hourglass
4. The overall process results in making the subject project (supply) more specifically suited to the target customer segment (demand)

The following modified hourglass, Figure 3, shows how the commonly used market analysis process defined in the first section of this thesis specifically applies to the Malizia and Howarth model and demonstrates the mechanics of demand segmentation. Again, the result is the creation of a project (supply) that is meaningful to a specific consumer segment (demand)

FIGURE 3: Relating the Hourglass to the Real Estate Market Analysis



CHAPTER 3: The Real Estate Industry's Focus on Supply

Few real estate marketing professionals and developers take full advantage of the process of demand segmentation. The lack of demand segmentation analysis is a lost opportunity and adversely impacts how the real estate industry uses market and marketability reports to define projects within a marketplace. According to Malizia, "in real estate, we study supply to understand demand which makes no sense. No one in real estate studies demand to understand demand.[xi]" Understanding demand requires direct, consumer level research which is expensive and time consuming. Many developers claim they "just know" what the market wants and will rely upon input from brokers and consultants to design a project. Further, they use brokerage reports to define market rents and trends but very rarely speak with a potential tenant.

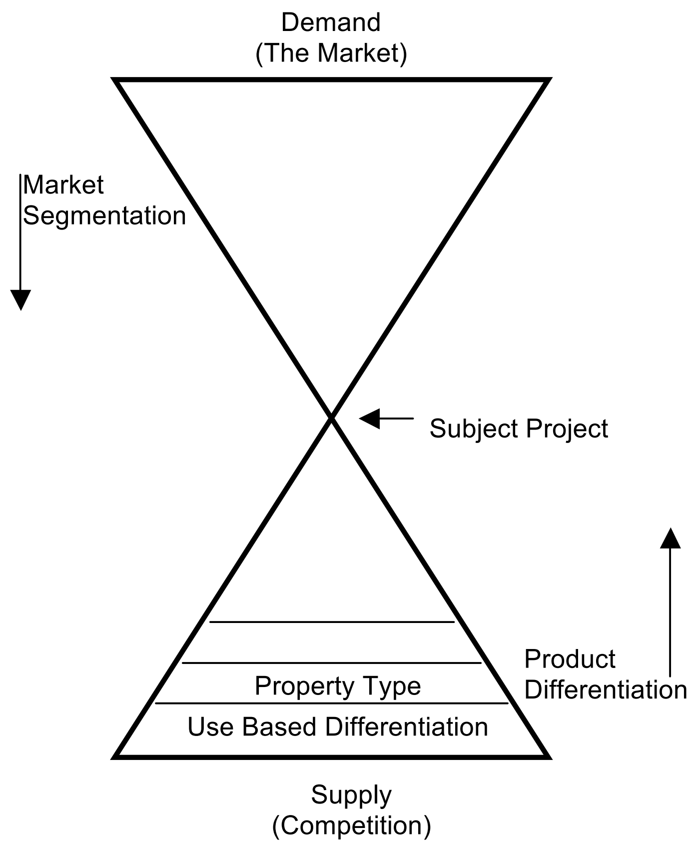
Traditionally, Real estate development has "been a spatially segmented industry: most developers only worked in a few locations and constructed one or two product types.[xii]" Accordingly, a structure for supply has emerged for all of the core property types supported by widely accepted industry trade group definitions. Within any market, property supply segments are differentiated among easily identifiable, use based classifications including office, retail, residential, industrial, hotel and institutional. These easily defined use based classifications are then divided by property type classifications. For example, residential includes single family, multifamily rental and condos. After a property is defined by its sub category some product types are segmented within a spectrum of quality like office class A to class C. Accordingly, a basic framework for classifying the natural differentiated supply can be defined by primary use, property type and spectrum of quality.

Industry trade groups including the Urban Land Institute (ULI), International Council of Shopping Centers (ICSC) and the Building Owners and Managers Association (BOMA) have described various property types but don't generally have a system that can define the spectrum of quality. In some cases, the sub classifications of property are still subject to a great deal of debate. Senior Resident Fellow at ULI, Michael Beyard, believes that "the characteristics that are often used to describe lifestyle centers are so vague that they could be used to describe any number of other type of shopping centers.[xiii]" Ultimately the term has become so ambiguous that it is meaningless as a classification and instead has become lost as marketing and sales jargon.

Even if a property type is well defined, like a regional mall, the spectrum of quality is subjective. Brokers and building managers frequently use terms like class A or luxury to describe their newest listing. BOMA defines Class A offices as the "Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence.[xiv]" This a broad definition subject to a great deal of interpretation however it is frequently used in the market.

These commonly used supply segments offers an organizational framework that helps expand on the Hourglass model and further the discussion of real estate market research practices. Figure 4 below shows the Hourglass figure, integrating the commonly understood differentiation of supply to present the natural or common state of real estate market analysis where supply is partially defined or differentiated but little effort has been put into examining and segmenting the demand.

FIGURE 4: The Hourglass Model With Common Real Estate Supply Differentiation



Often times, market researchers and developers analyze and segment the demand section of the hourglass solely through census tracks, area median income or other broad based market demand information from secondary sources. The marketability study rarely involves consumer level research or even asks important questions to identify demand beyond simple demographics. Marketability should include questions like, who is the customer? Who uses this space and what features and amenities can the developer provide to distinguish the project so it directly appeals to the target consumer? Are there enough target tenants available in the subject market? If developers undertake thorough, consumer level market research and target a specific consumer segment, they can make more informed decisions that distinguish their development within a market.

A developer's segmentation decisions are usually only supply oriented, generally stop at the quality spectrum and rarely involve much demand level analysis Decisions about amenities, design, layout and finishes that ultimately position the project, are informed by brokers and design professionals as opposed to direct consumer research. Some property types, like hotels, are better than others in researching the needs of their target consumer but most developers tend to create a generic product with certain features and amenities that design professionals identify as important. How a consumer values these decisions is rarely known in any detail and a potential opportunity to create a superior product for a defined consumer segment is lost.

While real estate supply focused approach has certainly worked in the past, it often results in the creation of a commodity product subject to competition from anyone else willing to build a similar project in the same trade geography. One of the purposes of marketing, specifically demand segmentation and building a project for a target customer, is to "protect the developer from the uncertainty of competitive pricing…so that as a developer, one is not forced to use price cutting as a primary device to acquire business.[xv]" By not effectively using marketing and demand segmentation, developer's run the risk of creating an undifferentiated project at the bottom of the market hour glass without a specific customer. This failure to effectively use marketing and demand segmentation is at best, a lost opportunity.

When considering new developments, the "competitive edge depends on finding a true unmet need of a consumer group. It is not an edge obtained through gimmicks and cleverness on the part of the designer or the developer[xvi]." Analyzing and segmenting demand presents an opportunity to position a project thoughtfully within a market. Real estate developers do not always capitalize on this opportunity partially because the industry has historically been divided, studied and understood in the context of supply. The concept of demand analysis and consumer segmentation, while common in the manufactured goods industry, is not well understood by the real estate community. An analysis of how marketing and demand segmentation is applied in other industries will further develop the hourglass model and explain the importance and methods of demand segmentation.

CHAPTER 4: The Marketing concept and how it applies to real estate?

As the process of real estate development and investment has matured into a professional industry, business concepts commonly found in other industries have been integrated with traditional real estate practices. ULI's text, Real Estate Development Principles and Process, states that "attention to classic notions of marketing helps bring greater structure and discipline to real estate development." While there are important differences in the economic structures of real estate and consumer packaged goods, there is not necessarily a need for a distinction in marketing methods. Similar to manufactured goods firms "people-employees- create and manage marketing campaigns to achieve a companies objectives – no less in real estate development companies than at Microsoft or General Foods[xvii]."

While numerous academics and marketing professionals have advocated the integration of marketing concepts and techniques commonly used in other industries, many real estate professionals operate under the mistaken impression that marketing is a discipline used solely in advertising and sales. ULI's textbook, Real Estate Development Principles and Process, elaborates on the misconception and states that "marketing objectives ought to be part of most [real estate] management functions. In practice, however, the task of finding and keeping customers is at times solely left to the marketing staff- which, in real estate development means leasing agents or sales people." It is important to highlight that marketing is not the very limited practice of advertising and sales. Marketing specialist Philip Kolter emphasizes the point by explaining that marketing "should not be narrowly construed as the process of selling products but more broadly understood as satisfying human wants and needs[xviii]." Kolter's description of marketing as a study and response to fundamental human needs, stems from an idea introduced the 1960's by Pillsbury Company marketing executive Robert Keith[xix], called the "marketing concept."

The marketing concept is "the philosophy that marketing strategies must be based upon consumer needs and wants[xx]." It is a demand-centered concept that dictates that an "organization should endeavor to satisfy the needs and wants of customers through a coordinated set of activities that allows the organization to achieve its goals at a profit.[xxi]" ULI's Real Estate Development Principles and Process, attributes the popularization of the marketing concept to US companies efforts in the 1980's to regain market share lost to emerging manufacturing powers like Japan[xxii].

This customer centric way of thinking helps inform every aspect of the real estate process including due diligence, proforma underwriting, design, entitlement, construction and finally advertising and sales. More importantly, it forces the marketing practitioner and real estate developer to ask the critical question, who is our customer? This question should be answered in the marketability study along with a set of recommendations to tailor a real estate project to that customer. Once demand is segmented and the definition of the customer moves further down the Hourglass model, then the resulting project becomes differentiated within a market and moves up the Hourglass model with the target customer and real estate project moving toward the intersection of the hourglass.

The marketing concept is completely customer centric and emphasizes the examination of potential consumer needs and preferences to determine if there are unmet or underserved needs that a firm can capitalize on. In real estate, developers focus heavily on supply related information and only have a very general sense of who their customer is. Real Estate development does not embrace the focus on the end user to the same degree as the consumer goods industry. Even if the marketing concept were embraced by the real estate community, where projects were created based on a thorough analysis of demand, does not answer the fundamental question of who is the target customer? As advocated by Malizia, Howarth Graaskamp, Carn and Miles in previous chapters, the key to identifying the consumer is the practice of segmentation. While advocated by some academics and practitioners, segmentation is not widely practiced.

CHAPTER 5: Defining The Process of Demand Segmentation

Market segmentation "is the process of partitioning markets into segments of potential customers with similar characteristics who are likely to exhibit similar purchase behavior[xxiii]." Segmentation allows a firm to identifying and target specific consumer groups that are underserved by existing products or have unmet needs or preferences. If the target segment has sufficient numbers to form a compelling market a firm undertakes research to determine how to create a product that better serves the needs and preferences of the market. This leads to the creation of a new product that is thoughtfully positioned within a market and specifically customized based on thorough research. Market segmentation is a well established marketing method used frequently in the manufactured goods industry. This chapter will present and explain the concept, methods and benefits of segmentation as they apply to both consumer products and real estate.

Similar to the philosophy behind the marketing concept, the process of segmentation "is customer oriented and dependant upon market demand while product differentiation (not a segmentation strategy) is supply side oriented.[xxiv]" For example, a car company does not design a car based solely on what models are available from their competitors. Instead, they start by asking who are buying cars and whether their specific needs are served by the types of cars that are currently available? If they identify a group of people who's needs are underserved and if the group of people have sufficient numbers to form a viable market, the car company undertakes extensive research and designs the appropriate product.

The differences between the consumer of the Toyota Prius and the Hummer H2 offer an intuitive example of consumer segmentation based on psychographics and lifestyle. Again demand segmentation is not supply based and this example is not a comparison of the two cars. It is an example that highlights the differences in the needs and preferences of the customers to establish defined customer segments. The cars are a byproduct of this segmentation and analysis of demand. Car consumers have very different needs and preferences and the Prius and H2 were designed to appeal directly to the consumer segments identifies by Toyota and Hummer. Prius drivers value fuel efficiency and the perception of environmental sensitivity while H2 drivers value size and the perception of safety. The important point is Hummer and Toyota recognized differences in consumers and took advantage of these unique consumer needs and preferences to design more directly meaningful product for their customer segment. The segmentation process involves identifying a unique group of customer, researching their needs and preferences and then designing the product to accommodate those needs and preferences.

Ultimately, businesses engage in market segmentation in order to "analyze markets, find a niche, and develop and capitalize on a superior competitive position[xxv]." Segmentation was born of the realization that no product, except commodities, serves all consumers equally. Products are often composed of a variety of features and options and consumers value these features and options differently. If a developer's segments a market and identifies a large group of customers who are physically active and engaged in athletics, the developer can install meaningful amenities that fit their lifestyle like an expanded workout room or indoor pool. These amenities do not appeal to every apartment renter equally but in this example they appeal to the athletic consumer segment identified by the developer through market segmentation. The apartment is more relevant and meaningful for this target segment consumers than the average consumer. The more specific the segmentation of the consumer the more specific the nature of the amenities and characteristics of the apartment building,

According to Art Weinstein, a leading researcher in the field of consumer segmentation, a firms has "two basic choices: to segment the market or treat the entire market as potential customers… This latter option, known as aggregation, means that the firm uses an undifferentiated marketing strategy. There are few firms that can minimize their cost and maximize their returns with an aggregation strategy." The idea of marketing a product with mass appeal to every person is best suited for commodity products. Accordingly, these products are subject to risk from similar competition and price fluctuations based on market cyclicality.

A developer may build a more generic building including amenities and unit fit and finish that may not appeal directly to any particular consumer segment but are sufficient for many consumers. While this will lead to a broad appeal, it does not distinguish the project in any meaningful way and the building becomes a commodity product that may be more sensitive to market pricing based on market supply, which is beyond a developer's control. However, an apartment targeted at a specific consumer segment may not be as subject to pricing volatility from the introduction of additional generic supply (more apartment buildings) because it is designed for a specific segment. According to James A. Graaskamp, consumer segmentation based marketing "is intended to protect the developer from the uncertainty of market based pricing……so that as a developer, one is not forced to use price cutting as a primary device to acquire business [xxvi]."

Art Weinstein's book *Market Segmentation: Using demographics, psychographic and other segmentation techniques to uncover and exploit new markets,* defines two general segmentation categories including physical attributes and behavioral attributes. Within each attribute category are description of the most commonly used methods of consumer segmentation. This section will review the basic definitions of these segmentation methods and introduce an emerging concept called tribal marketing that is both enhancing and challenging commonly held notions about demand segmentation.

Physical Segment Attributes: The following are brief descriptions' of the most commonly used physical segment attributes and their associated characteristics.

1. Geographics: This is the simplest form of physical attribute segmentation and involves the division and selection of a market based on geography. As discussed in chapter I, all real estate market analysis begins with a market referent so this geographic segmentation is usually well defined in real estate.

2. Demographics: The term demographic is based on the field of demography, defined as the statistical study of human populations[xxvii]. Demographic segmentation focuses on easily identifiable characteristics including number and size of households, age, marital status, sex, race, nationality and religion. Demographic segmentation is one of the easiest ways to analyze a market partially because of the extensive data that is easily accessible. The US census provides very specific data that can be sorted and analyzed in any number of combinations.

3. Socioeconomics: Socioeconomic characteristics are closely related to demographics and are used to analyze a market based on economic and related social classes. Commonly used socioeconomic characteristics include education, occupation, income, homeownership factors and social class. Similar to demographics, there is an abundant supply of accurate, secondary data.

4. Geodemographics: Geodemographics are a composite of the three physical attributes, geography, demographics and socioeconomics. Some demographers don't draw a significant distinction between the three physical segment attributes and use geodemographics to offer a complete picture of a target segment that accounts for the obvious interrelationships of the three physical segment attributes.

Behavioral Segment Attributes: The following are brief descriptions' of the most commonly used behavioral segment attributes and their associated characteristics.

1. Psychographics: The concept of psychographics was first introduced by Emanuel Demby in the 1960s to present a segment attribute that would go beyond the realm of physical description and examine the psychological traits of a customer including self-concept, attitudes, interests and opinions. According to Demby, sought to "describe the human characteristics of consumers that may have bearing on their response to products.[xxviii]"

2. Lifestyle: Lifestyle attributes "describe how individuals spend their time, what they consider important about their immediate surroundings, their opinions on various issues and their interests[xxix]." Though broadly defined and closely related to psychographics, lifestyle attributes help complete the spectrum of behavioral segmentation. While psychographics may be innate psychological characteristics of the person, lifestyle attributes are based on conscious choices.

Emerging Concepts: Marketing theory continues to evolve to adapt to changing social trends and patterns of consumption. The following is a description of one of the most compelling new marketing concepts, called tribal marketing.

Within the last few years, the concept of Consumer Tribes has been introduced as a new way to think about consumption and marketing. Tribal theory defines a group of people in a target market by their tribal identity as opposed to their segment identity. Tribal theory suggests that the focus of segmentation should not be on identifying customers based on individual physical or behavioral attributes but instead should be examined in the context of a community. Bernard Cova, a leading theorist and researcher in the field of tribal marketing defines a tribe as "a network of heterogeneous persons- in terms of age, sex, income, etc. – who are linked by a shared passion or emotion.[xxx]" This is an important distinction from Cova's characterization of consumer segments defined through the more traditional attributes defined in this chapter as a "group of homogenous persons- they share the same characteristics- who are not connected to each other." Tribal theory is based on a dynamic community engaged in a common passion making a member of a tribe an advocate as opposed to a member of a segment who is merely a consumer. A passion can be an activity, sport, hobby or brand that unifies a group of people who share that interest and form a community.

Helpful examples that illustrates tribalism as it exists today are Harley Davidson motorcycle riders and Fans of Manchester United. Owners of Harley Davidson have extremely diverse physical and behavioral attributes but are all drawn to and participate in the Harley Davison brand. Tribal theory is very appealing as a way to understand and organize a market because it captures a wide breadth of potential consumers or "advocates", organized around the singularity of a community. Manchester United is a famous football club with extremely passionate fans who travel all over the world to support their team. The fans identity is inextricable linked to the identity of the football club. Manchester United fans have greater demographic specificity than Harley riders but they are still defined by their passion and community affiliation.

The community as a focal point allows marketers to easily identify and quantify a target market and assess potential unmet needs and wants. However, it is a new concept that is still emerging and lacks any comprehensive or definitive data sources. Similar to the elusive elements of behavioral segmentation, the only way to learn about tribes is through direct, human level research. Still, it offers a compelling way to organize and understand demand. In term of real estate, it may be a question of where do tribes live and what sort of space do they need?

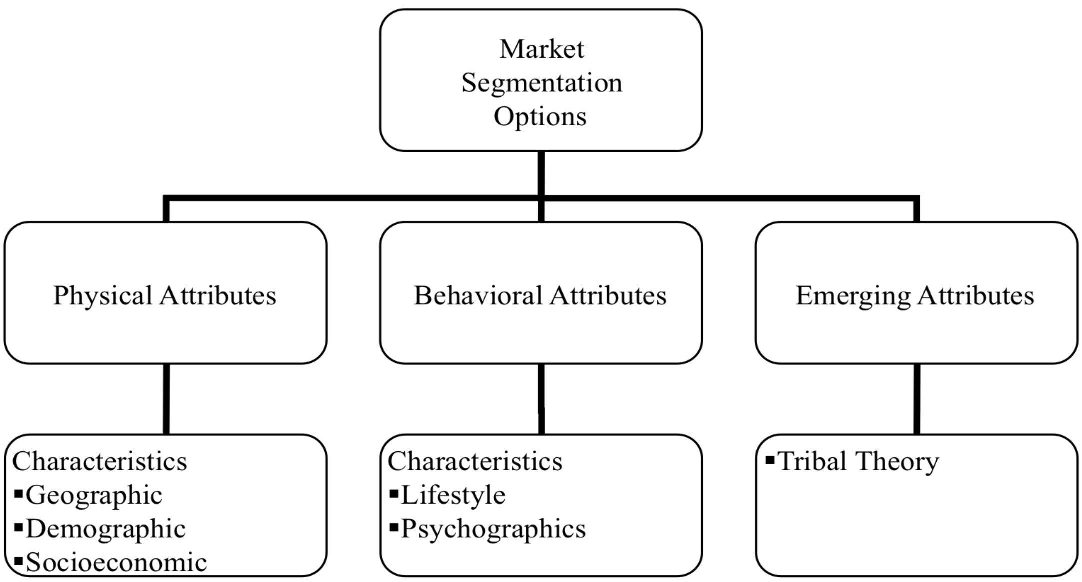
Choosing the specific attributes to segment a market depends upon the market and industry being considered. It is common for marketing professionals to mix attributes to develop their customer segment or profile. In addition to identifying a target consumer segment, firms have to choose from a spectrum of segmentation intensity. Weinstein defines three levels of segmentation including differentiation, concentration and atomization.

1. Differentiation Strategy- If a firm employs a differentiation strategy it "actively markets its products or services to different segments of the market based on different needs. For example, a computer retailer that separately targets the home user, business professional and small business." In this case a firm offers multiple products but tailors their marketing, promotional and sales efforts to a few select segments.

2. Concentration Strategy- A concentration strategy occurs when a "firm decides to serve one of several potential segments of the market." This requires the firm to choose a narrowly defined segment at the cost of attracting other potential customers. According to Weinstein, "concentrated marketing is less expensive than differentiated marketing and may be the appropriate choice for new business with limited resources."
3. Atomization Strategy- Atomization occurs when a firm "breaks down the market to the finest detail – often to the individual customer level. This strategy may be appropriate for highly costly and specialized equipment."

Demand segmentation is a multi step process that requires a marketing professional or developer to make deliberate decisions throughout the market analysis. First, a market is segmented based upon one or some combination of segment attributes. Once the market is segmented, the individual segments must be analyzed to determine if their needs are unmet or underserved by existing products. If there is unmet needs within a segment, then that specific segment is targeted for further study on preferences and needs. The marketing professional or developer then uses the information about unmet needs and preferences to design a product specifically for the target segment. This process involves a great deal of analysis of secondary sources and in some cases expensive, direct, consumer level market research. The process is graphically presented in Figure 5 below:

FIGURE 5: Segmentation Attributes Characteristics and Process



Market Segmentation Process

1. Divide market with one or a combination of segmentation attributes & characteristics
2. Select a target segments based on unmet or underserved needs
3. Research target segment to determine what will make a product meaningful
4. Design product or project based on findings in step 3

The end result of this process is the creation of a product that is meaningful to a target segment and thoughtfully positioned within a marketplace. Despite the effort and expense, market segmentation presents an opportunity for a developer to make an informed decision about how to position their development within the market place and potentially realize the benefits offered by a thoughtful and well executed market segmentation effort.

Professor Art Weinstein, a leading researcher in the field of market segmentation, presents the following benefits of market segmentation in his book, *Market Segmentation: Using demographics, psychographics and other segmentation techniques to uncover and exploit new markets*[xxxi]:

1. Designing responsive products to meet the needs of the marketplace- The firm places the customer first and refines its product and service mix to satisfy the needs of the market providing customer satisfaction at a profit.

2. Determining effective and cost efficient promotional strategies: As a planning tool, segmentation, identification, and analysis is extremely valuable in developing the firms communication mix. Appropriate advertising campaigns can be designed and targeted to the right media vehicles.

3. Evaluating Market Competition: A segmentation study explores the firms market position- how the company is perceived by its customers and potential customers relative to the competition.

4. Providing insight in present marketing strategies: It is important to re-evaluate your marketing efforts to ensure that your conclusions are still relevant in the market.

The consumer segmentation method and process is just as applicable to real estate as it is to any other industry. The process is driven by a customer centric way of thinking where the product is a by product of thorough demand analysis as opposed to supply analysis. The result is the creation of real estate development projects that are targeted at well researched consumers and incorporate meaningful features, amenities, and tenancy for the target segment. Some of the potential, real estate specific benefits of market segmentation include:

1. Above average market rent- If the new building offers meaningful and well researched options that the target segment values over nearby apartments that offer more generic amenities, than the target consumer may pay more for rent.

2. Informed design- As opposed to spending money on costly features and amenities that the consumer segment does not value, the developer only has to provide meaningful amenities that drive higher rents.

3. Reduced vacancy- If the apartment suits the needs of the target segment better than nearby competitive buildings, lease up and stabilization should occur faster, structural vacancy may be lower.

4. Reduced Sales and marketing expense- With a well defined and researched consumer segment, the developer can select advertising and media outlets that the target segment knows and uses as opposed to a broad based marketing campaign. Further, the developer can tailor their message specifically for the target segment making the message more informative and relevant.

5. Improved Underwriting- If a developer targets and properly researches a consumer segment they will likely have a more informed sense of what a target consumers is willing to pay for rents as opposed to relying on market comparables. The improved underwriting may help demonstrate a project's viability to debt and equity providers.

6. Informed Market Measurement- A defined consumer segment allows the developer to more accurately quantify the potential market for tenants and make intelligent forecasts on how the potential growth or decline of the market in the future. Once a specific segment is clearly identified, it can also be quantified.

Whether a developer realizes any of the real estate specific benefits in segmentation is a question of how thoroughly they engage in the process of demand segmentation. If nothing else, the process of segmentation will help a developer better understand the demand side of a market and focus on the important task of specifically identifying a consumer. As an industry, real estate has a great deal of access to supply side data from brokerage houses and research firms. Real estate also has advanced econometrics firms like PPR and CBRE Torto Wheaton that can make informed forecasts of market conditions. However, there is little industry emphasis on exploring demand at the consumer level. Real estate market researchers and academicians like Malizai and Howarth advocate for this level of research, yet industry practitioners have not thoroughly or consistently embraced it.

While real estate developers and marketing professionals have used physical attributes to understand markets for years, particularly in retail, they rarely use behavioral segments. In retail, median income and trade area population are closely examined during the due diligence process but this is the extent of the research. Even if a developer did a thorough job of identifying physical attributes, they rarely went through the process of selecting a market segment based on an evaluation of a consumers needs and preferences or perform any direct consumer level research. Using consumer segmentation to develop real estate, similar to how consumer goods manufactures use it to create new products, is an opportunity that is largely ignored in real estate development.

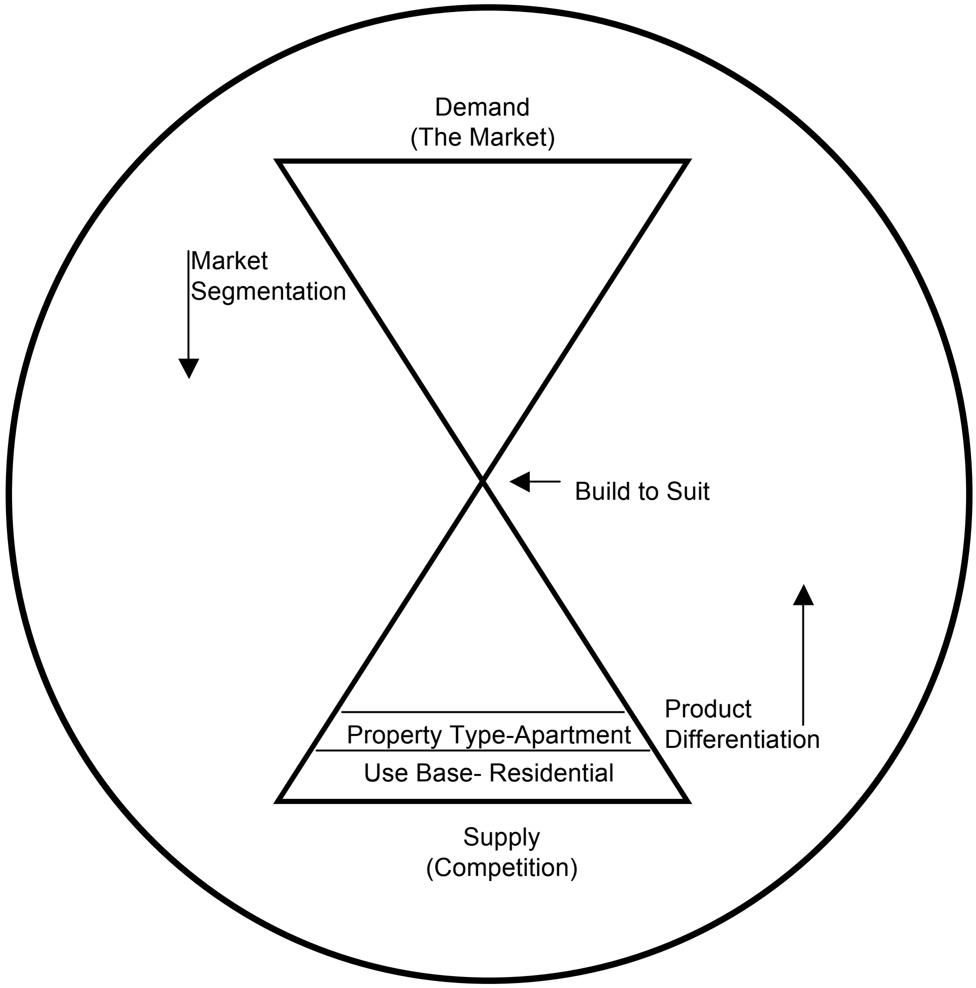
Marketing research professionals have developed sophisticated and quantifiable methods to explore consumer preferences, purchasing motivations and their decision making process. These techniques include conjoint analysis, ZMET studies and advanced survey techniques. This thesis does cover market research methods and interested parties should consult with consumer research firms to learn more.

CHAPTER 6: Revisiting The Hourglass Model

This chapter will summarize the major points from the preceding chapters and present a modified Hourglass model to aid in the explanation of the selected development examples in Section II of the paper. Chapter I established the purpose of the real estate market analysis as a marketing effort to determine whether or not a developer should pursue a speculative development or repositioning project and if so, make specific recommendations on how to position the project within a market. Chapter 2 introduced a graphic Hourglass model developed by Emil E. Malizia PhD and Robin Howarth that helped to explain the process of real estate market analysis and advocate for the use of demand segmentation to better inform the marketability study of the real estate market analysis. Chapter three reviewed the real estate industries focus on markets based on supply and presented trade industry classifications that segmented supply by property use, property type and sometimes by quality. Chapter 4 advocated for demand segmentation and the adoption of modern marketing techniques and concepts frequently used in the manufactured goods industry. Chapter 5 elaborated on the methods and concepts used in demand segmentation and defined a four step process and briefly explained commonly used segmentation attributes and introduced the emerging concept of tribal segmentation.

Maliza and Howarths Hourglass model has been presented in an evolving form throughout the first half of this paper to help illustrate the existing real estate market analysis process and demonstrate the mechanics of demand segmentation. The following version of the hourglass model presents a comprehensive summary of changes and modifications made to the model as well as a review of the mechanics. The changes made to the model and interpretation of its mechanics have been approved by Emil E. Malizia with the exception of one concept that will be discussed later in this chapter. The modified Hourglass is not intended to replace Malizia's original model but is instead intended to assist in the presentation and organization of the selected development examples presented later in this thesis. Figure 6 below shows the modified hourglass model with a sequential explanation of the changes made so far.

FIGURE 6: The Modified Hourglass



Additions to the hourglass Model:

The first addition consists of the circle around the entire hourglass to represent the specific geography selected by the market analyst and developer. As established in chapter one, the selection of a specific geography is the first step in the real estate market analysis. The second addition is the inclusion and description of the naturally occurring supply segmentation that occurs within real estate as discussed in chapter 3. The third addition or change is the renaming of the intersection of the hourglass as the Build to Suit point. In the interpretation resented in this thesis, the intersection is the singularity where supply perfectly meets demand. However, Professor Malizia prefers to think of the intersection as the project that is intended to be developed. As further explained by Professor Malizia, the "build to suit represents a specification from the prospective tenant/buyer that defines exactly what you build. Therefore the build to suit is a demand specification where there is presumably no exact match (supply) in the market." For the purposes of this thesis, the intersection of the hourglass will represent a build to suit project.

Interpretations and Clarification of the Hourglass Model:

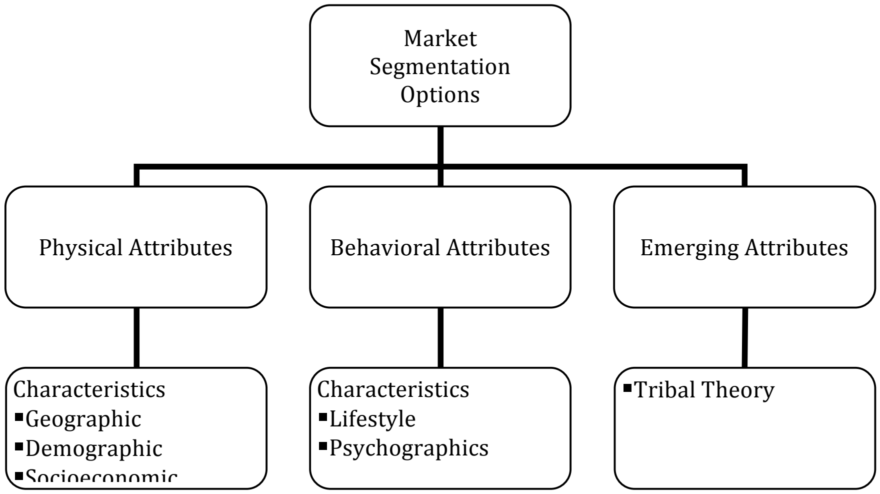
As discussed in earlier chapters, the outline of the hourglass represents the market as defined by the market study. Malizia points out "a symmetrical hour glass implies supply-demand balance including natural vacancy. Those line segments could be of unequal length indicating excess demand or supply." Conceptually, the hour glass could be severely skewed at the top and bottom lines, defining market demand and market supply respectively should be proportionately related to the quantity of supply and demand within a market.

Mechanics of the Market Analysis with Demand Segmentation Using the Hourglass Model:

The following is a sequential list of tasks to complete a thorough market analysis using proper demand segmentation techniques. Each task corresponds to some point on the Modified Hourglass model.

1. Establish Market Geography- Represented by the circle
2. Conduct Market Study- Outline of hourglass including the natural segmentation of real estate supply as defined by use and property type.
3. Conduct demand segmentation based on a selection of the attributes and characteristics shown in Figure 7 below

FIGURE 7: Demand Segmentation Options and Sequence



Market Segmentation Process

- Divide market with one or a combination of segmentation attributes & characteristics
- Select a target segments based on unmet or underserved needs
- Research target segment to determine what will make a product meaningful
- Design product or project based on findings in step 3

4. Once the market has been segmented the marketing analyst or real estate developer attempts to identify unmet or underserved needs and preferences among the segments and select this segment for further study. Identifying the segment is the process of moving from the top of the hourglass within the demand section toward the intersection of the hourglass. Once a target segment has been identified, the market professional engages in a thorough consumer level research effort to determine what features and amenities can make a potential development more relevant or meaningful to the subject segment. The by product of this research effort positions the project within the demand section of the hourglass somewhere in between the naturally occurring "property type" segment and the intersection of the hourglass.

Step 4 of this process is where the specific real estate product is created. So far, this paper has discussed this step as the research and inclusion of meaningful and relevant features and amenities that will appeal to the target segment. How does a real estate developer determine what is meaningful and relevant? Defining where a speculative development should lie within the supply differentiation section of the hourglass is the final part of the process. There are a myriad of ways to customize a real estate development for a specific demand segment including design, layout, lease length and terms, common area amenities, tenancy and programming and management. How a developer decides to customize a project should depend on the research efforts in step 4. Proceeding chapters in this thesis reviews three select projects that were developed for a specific demand segment and explores the real world application of demand segmentation in real estate development.

CHAPTER 7: An Introduction to Selected Cases

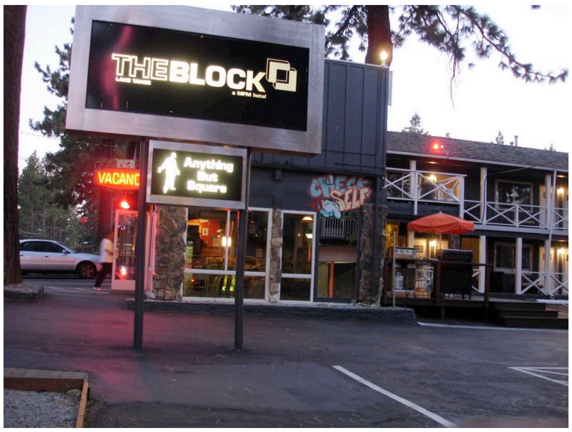
So far, this thesis has reviewed the practice of real estate market analysis and advocated for more extensive use of demand segmentation to better position speculative development or repositioning projects in a market. This second and final section of the thesis reviews three select examples of real estate projects, developed for specific demand segments. Each development review includes a description of the project's concept, a physical description, an overview of the business model, a specific description of the target demand segment, a discussion of the way the project was designed to serve the target segment and finally a qualitative evaluation of the projects success or failure based on online consumer ratings websites like Tripadvisor.com and Yelp.com as well as interviews with project principal's and owners.

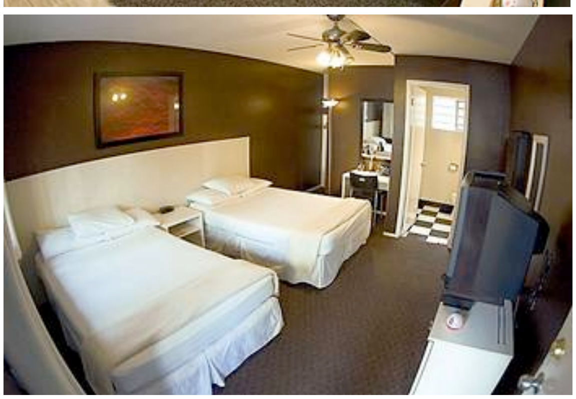
Determinations about a projects success or failure have to be considered in context. Online ratings sites, while informative, are not statistically valid as they are limited to reviewers who have internet access and are willing to post reviews online. This is not a randomly selected pool and the number of reviews is not sufficient to make valid statistical conclusions. However, these sites are still valuable to review as they provide some measure of direct consumer acceptance. Without a concerted customer assessment program, there is no way for an organization or developer to know how their development is being perceived by customers. Also, not all of the reviews are from a developments target segment. As presented later, many people clearly not in the target consumer segment review these projects unfavorably. Despite their negative reaction, this information can still be used to make informed speculation about how a development is being received and why it is popular or unpopular.

Regardless of a projects popularity, it has to be economically viable. This thesis does not try to establish economic causality or claim that using demand segmentation will result in a more financially successful project. There are too many interrelated variables to make determination about the specific causes of a projects success or failure. One of the development reviewed in this thesis, The Block Hotel, had to recently close both locations due to a failure to pay a municipal Transit Oriented Tax. The project obviously failed due to insolvency but it would be difficult to establish if this was due to a failure of the project concept, a failure in management or due to the significantly weakened condition of the economy. This thesis relies on the representations of the principals and owners to determine why a project succeeded or failed. Accordingly, all conclusions about a projects success or failure should be examined in context. Ultimately, the purpose of the reviews is to move the discussion of demand segmentation from the theoretical to the practical to demonstrate how it is has been applied in the real estate market.

CHAPTER 8: The Block Hotel

I. Introduction and Background





The Block in South Lake Tahoe was a 52 room, courtyard motel located near multiple Tahoe casinos, night clubs and ski resorts. Purchased in 2003 by founder, Liko Smith, The Block was positioned as the world's first hotel for snowboarders by snowboarders. Smith, an experienced hotel manager, recognized "that by 2015 there will be no skiers on the slope. ….more than likely first time users and neophytes are gonna start off snowboarding[xxxii]." This optimistic but compelling view on the market is supported in the 2008 IBISWorld Industry Report on Ski Resorts in the US. IBISWorld states that, "Snowboarding is one of the industry's fastest growing activities. According to industry sources, there were about four million snowboarders in 2001 compared to about one million in the early 1990s[xxxiii]." Tahoe is a national, four seasons, recreation destination with 12 ski resorts situated along the California Nevada border. According to Smith "Tahoe [had] all kinds of places for skiers but there was very few places for snowboarders. Snowboarders were staying in what I call Kennels… wherever they could stay[xxxiv]."

The Block's South Lake Tahoe location opened in 2004. Smith partnered with celebrity snowboarder Marc Frank Montoya to help promote the hotel to his core tenant segment. To Smith, "the brand had to be relevant[xxxv]." To bolster The Block's authenticity and brand meaning, Smith found other celebrity snowboarder investors who would regularly hang out in The Blocks lobby and participate in Block sponsored events. He even allowed pro snowboarders to stay at The Block for free. The entire customer experience from giving new guests a free Pabst Blue Ribbon upon check in and a hangover kit every morning was designed to cultivate a meaningful hotel experience for The Blocks target segment.

In addition to running the hotel, Smith focused heavily on promoting snowboarding events called "Block Parties," featuring celebrity entertainers and professional snowboard competitions. G4 networks created a reality television show based on The Block's staff and their challenges while working in the hotel. Smith cross promoted his hotel with as many related companies as possible all in an effort to create a snowboarding epicenter and recognizable brand name for future expansion. When contrasting The Block's brand to other well known hotel brands like the ultra hip W hotel, Smith says "People don't want to know how cool you are, they want to know how cool you make them feel …. that's the key. They want to come in and feel like they are learning something about your brand by being involved in your brand …being part of a greater story and being cool for being there[xxxvi]."

The Blocks initial success lead to the opening of The Block in Big Bear, CA in 2007. The Block was designed to be a scalable concept that could be developed in major ski resorts and adapted in different markets for other youth oriented segments like skateboarders and surfers. Smith's management company, Rouge Hospitality, scouted other well traveled snowboard destinations and looked into expanding their concept to new markets while refining their brand.

Despite the growing strength of The Block brand and Smith's claim that he was capable of charging market premiums of up to $200 a night for rooms[xxxvii], The Block abruptly closed both its locations in January of 2009. The city of South Lake Tahoe shut down the Tahoe location due to the failure to pay over $200,000 in transit oriented taxes. Smith contends the failure to pay taxes was due to the loss of important records after changing bookkeeping companies. Regardless of why The Block closed, Smith's combined success and failures provide important insights into segment based real estate development. Smith has no intention of abandoning The Block and plans to maintain his customer focus but reformat the business model based on his experiences. Ultimately his future efforts will define the success of his segment focus hotel concepts.

After purchasing the Lake Tahoe property, Smith focused his efforts on selective renovations and the installation of relevant amenities. The Block was divided into branded, theme oriented signature suites and traditional old school rooms. Signature suites were co-sponsored by companies like Napster. Most rooms were equipped with flat panel televisions, wet bars, game systems, boot and glove dryers and furnished based on the sponsoring company's brand image. Old school rooms had spartan furnishing and few upgrades from their original condition.

The hotel's common area amenities included a roof top hot tub, poker room and lobby lounge area with overstuffed bean bag chairs and flat panel tv's playing snowboarding videos. According to Smith, "the amenities were very relevant to what we were doing, we had hangover kits because we were sending people to clubs every night. We had free beer …. Pabst Blue Ribbon because it was brand that resonated with snowboarders[xxxviii]."

While a great deal of though was put into the aesthetics and amenities, many of the core utilities and infrastructure were left untouched. The plumbing and wiring were old and the interior corridors in the old school section of the hotel were….old school. Smith created considerable value through his branding and promotional efforts but had to wrestle with managing a fundamentally old motel. Further, Smiths decision to use snowboarders as workers created an additional layer of management complexity.

According to Smith, "The only problem with the 'for snowboarders by snowboarders' [concept] is the 'by snowboarders' part. These guys aren't exactly workaholics[xxxix]." The Block was staffed by young, transient snowboarders who were chosen in an effort to ensure an authentic guest experience. In his season opening address to the staff, Block co-founder and professional snowboarder, Marc Frank Montoya, emphasizes that "the whole point of this hotel is for these snowboarders to be treated like kings instead of [being] treated like crap… like I always was when I went into a hotel." Yet, as the staff openly admits, the major motivations behind working at The Block were a combination of the prestige of working at the worlds first snowboarding hotel (The Block received hundreds of applications when they announced the opening of the Big Bear location), the basic need for a job and the ability to take advantage of South Lake Tahoe's abundant ski resorts. In the first season of The Block tv series, staff members regularly expressed surprise about the amount of work required to operate a hotel[xl].

The experience of the staff is well document in the G4 Network reality TV series. In the first and second seasons, the show thoroughly documents the challenges of running an older hotel in a seasonally dependent environment with a core customer group that enjoys the South Lake Tahoe party scene. The Block relied heavily on events and holidays to drive occupancies and higher than average room rates. The substantial management required to promote The Block brand name combined with the infrastructural deficiencies of an older motel with mostly cosmetic upgrades and a staff that was often more focused on snowboarding than hotel operations at least partially explains why The Block ultimately closed in early 2009. However, the failure was not in the creation and execution of the concept. In many respects, The Block is an excellent example of developing real estate based on demand segmentation.

II. Applying the Demand Segmentation Method

As reviewed previously in this thesis, creating a product based on demand segmentation is a well defined process. Fundamentally, it begins by identifying and understanding a demand segment. Smith an experienced hotelier and Montotya a world famous snowboarder brought the complimentary skills and perspectives well suited to create the world's first hotel for snowboarder. However, they engaged in little consumer level research prior to creating The Block. A review of the four step process, proposed in section one, to develop real estate for a particular demand segment leads to some insights that may offer a partial explanation of some of The Block's failures.

Step one is dividing the market by segments: Smith originally came up with the idea of creating a hotel for snowboarders through conversations with co-founder Montoya. The decision to target snowboarders as a segment was borne more from their personal experience and perspective than disciplined research. However, it was a deliberate decision to target a distinct segment and capitalize on the compelling market reality that "snowboarding is one of the industry's [ski resort industry] fastest growing activities[xli].” Smith and Montotya knew the behavioral and lifestyle attributes of their core consumer but may not have been aware of the distinct demographic attributes of the segment.

According to Smith, The Blocks customers were “Echo boomer to baby boomer…any person that is enthusiastic about action sports and the casual mood of tomorrow’s lifestyle[xlii].” Smith also estimated a surprising “80% of the [guests] were not snowboarders they just wanted to be part of the scene[xliii].” These descriptions and estimates lead to some large and loosely defined segments. Further, they indicate that The Block may have had lifestyle appeal beyond those who simply enjoyed snowboarding. While The Blocks appeal may have been broad, the characteristics of a snowboarder can be more specifically defined.

According to IBISWorld “the largest market segment (20%) for ski resorts in 2008 is 18-24 year olds[xliv].” The report also states that “Snowboarding accounted for about 31% of ski resort visits, which is a significant increase over the past five to 10 years.[xlv]” Further, IBISWorld reports that “males dominate participation rates in downhill skiing and snowboarding” with a 67% of males versus 33% of females participating in downhill snow sports. Based on this data, the industry is growing and the strongest demographic characteristics of a snowboarder are males, age 18-24 years old.

Yet, this information does not fully answer the question who are snowboarders? Although, The Block was advertised specifically for snowboarders, it was intended to have a broader appeal “as a central place that defines the psychology and lifestyle of action sports[xlvi].” By choosing snowboarders, Smith and Montoya segmented the demand based on behavioral attributes. The Block was designed for and advertised to snowboarders but had an appeal beyond the limited demographic characteristics described by IBISWorld’s report. Either way, the intended demand segment becomes confusing. This lack of a specific definition of what The Block meant by ‘snowboarder’ or whether a snowboarder is purely defined through demographic or behavioral characteristics lead to complications that are discussed later in this chapter.

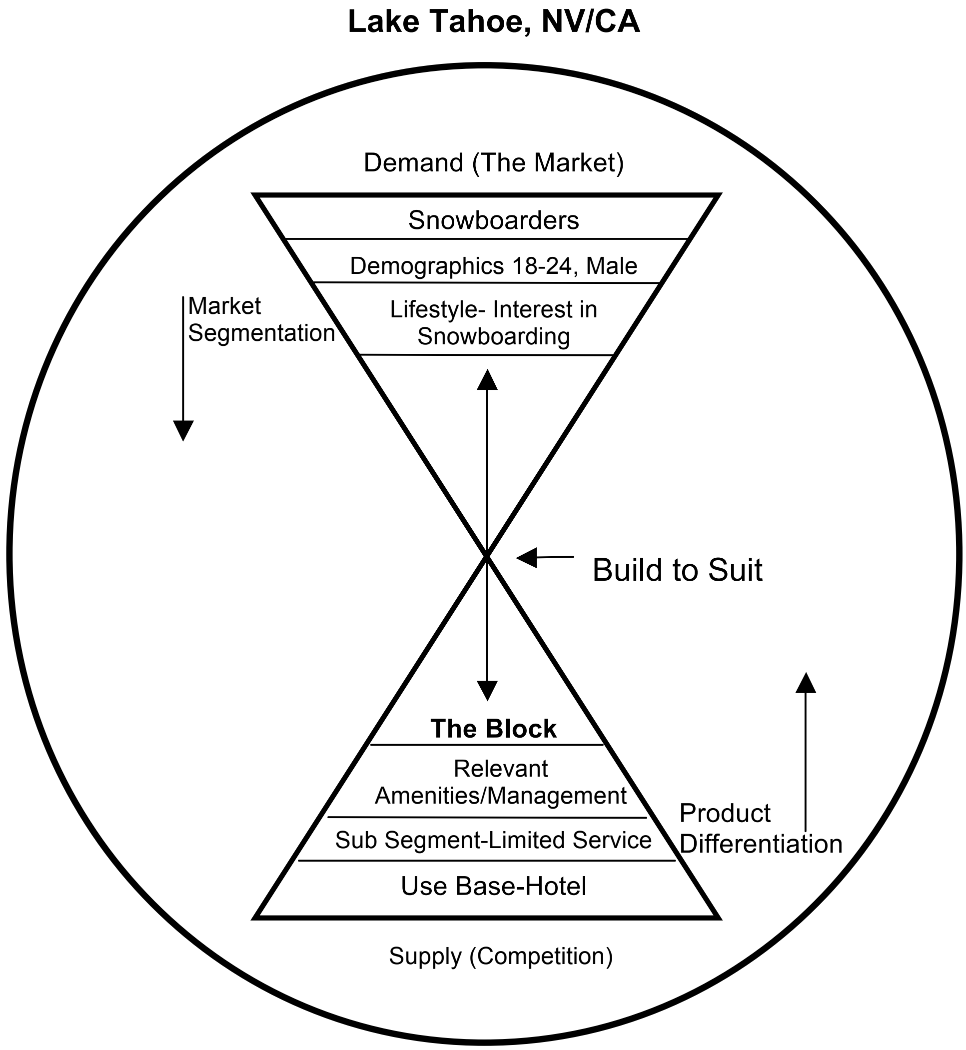
Step two of demand segmentation requires the identification of unmet or underserved needs. While there were a myriad of hotels in Lake Tahoe, no hotel specifically accommodated snowboarders. As discussed earlier, Smith saw that "Tahoe [had] all kinds of places for skiers but there was very few places for snowboarders." While any hotel would serve the basic needs of lodging, no hotel served the specific needs of snowboarders. This certainly qualified as underserved needs. As the first snowboarder hotel, The Block was uniquely positioned to design a product that specifically met the needs of snowboarders.

Step three in developing for a demand segment requires that developers research what features or amenities will make a speculative development meaningful to the target segment and step four is designing the development product based on that research. Smith relied heavily on Montoya in helping design the overall concept and determining what amenities and features were the most appealing to the target segment. Montoya, as a professional snowboarder who traveled extensively, knew what amenities and overall experience would appeal to The Blocks core demand segment. Rooms included X-Box game counsels, large screen Televisions and iPod adaptable stereo systems. All guests were given free beer upon check in, hangover kits in the morning, free DVD rentals and access to the property's hot tub, barbeque, lobby pool tables and poker room. These amenities were included based upon the founder's experiences and insights as opposed to direct, pre development, consumer research.

Despite the lack of consumer level, pre development research, The Block opened in 2003 and received substantial media attention including the previously mentioned reality television show. People beyond just snowboarders were paying attention. Smith was approached multiple times by established hotel operators and to license the name and concept[xlvii]. Instead, Smith and Montoya focused on developing the Brand and expanding to new locations until The Blocks abrupt closure in 2009.

Although the demand segmentation process was not executed in a disciplined fashion, an hourglass model can be constructed to explain the The Blocks segmentation as shown in Figure 8 Below:

FIGURE 8: The Block Hourglass



The hourglass model shows the specific demand segmentation and resulting product differentiation for The Block. Smith reported that many guests who stayed at The Block were not part of the core snowboarder segment[xlviii]. Smith's description of the The Block's current customer as "Echo boomer to baby boomer…any person that is enthusiastic about action sports and the casual mood of tomorrow's lifestyle. Normally, middle to upper income, educated, working and very intense about the love for their children, the environment and being part of a movement to redefine hotel stays[xlix]" is very broad. If this description represents the type of customer common to The Block, it presents a myriad of problems for the demand segmentation effort. Echo boomers and baby boomer probably don't value the same features and amenities even if they both like action sports and they likely have very different concepts of value. Further, The Block's amenities and management style were not tailored to all action sports enthusiasts; they were tailored to snowboarders based on Montoya's insights into the snowboard lifestyle. The broad appeal reported by Smith was not part of the pre-identified, snowboarder demand segment. Nor does this description match the demographic characteristics defined through the IBISWorld report.

If anything The Block may have suffered from segment dilution where a specific hotel was designed for a specific segment but spun into something else. The Block was the focus of a great deal of attention but tried to become too much to too many people. The Block was clearly a new and different and the concept appealed to people beyond simply snowboarders. There is a dislocation between who The Block was designed for an some of The Blocks guests that were beyond the core segment. This loss of focus, regardless of the reason, helps explain some the extremely divergent views of The Block experience reported through online ratings websites.

III. The Consumer Response

Online ratings sites like Yelp.com and TripAdvisor.com offer an important perspective of how guests viewed their experience at The Block and reveal some insights into the benefits and risks of targeting a specific tenant segment. If nothing else, guest reviews are defined by extremely strong opinions. The two Trip Advisor sample review below help show the substantial difference of opinions among reviewers and demonstrate how The Block resonated with its core demographic but alienated other guests.

1. RUN AWAY SCREAMING![i]

Elk Grove, CA

"Never made it past the lobby... violent & graphic murals painted in parking lot, screaming obscene vulgar music videos in lobby, and a letter from owner on reception desk with obscene and threatening language every other word. We turned & ran covering our children's ears. Unbelievable."

Date of stay July 2005

2. Time of My Life[li]

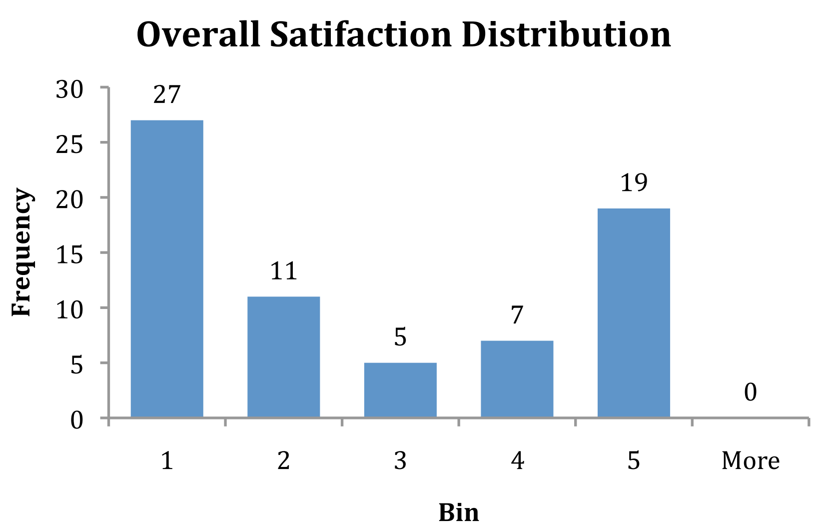
Sacramento, CA

"First of all anyone who stayed at the block and thought it was terrible is stupid you need to do your research before you go there. Its not a family place its not where you go to get away its where you go to party…. i went up there for an incubus concert and when you check in they give you beer if your 21 also everyone else in the hotel is there to party music is on all day we barbequed there had some drinks with the employees. it was amazing you can be as loud as you want no one complains they just join the party. So if your going to stay here do some research."

Date of stay July 2007

Figure 9 below shows a histogram of the overall satisfaction rankings (from 1 to 5 with 5 being the highest level of satisfaction) of 68 TripAdvisor.com reviews over 4 years for the Lake Tahoe location. The number of respondents is on the Y axis while the overall satisfaction rating is on the X axis.

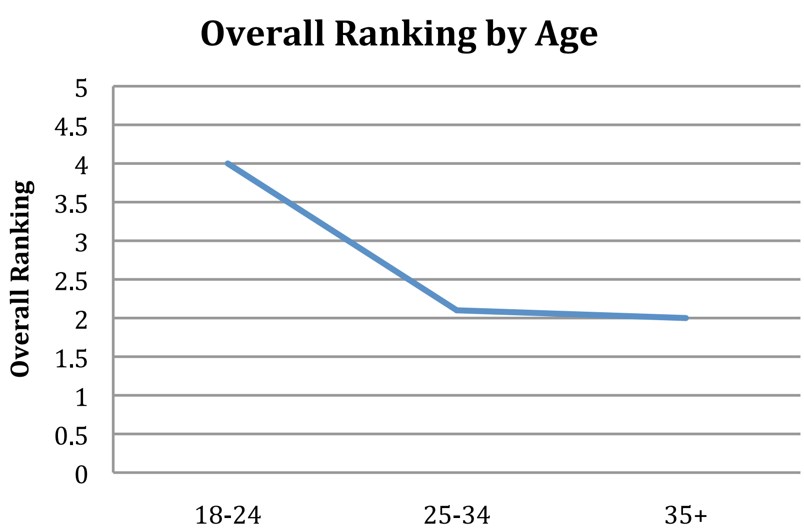
FIGURE 9: Tripadvisor.com Satisfaction Distribution



The double peaked satisfaction distribution clearly show that guests either enjoyed their experience or hated it. This is not surprising given the intense focus of providing a hotel experience primarily for snowboarders. The Block was not designed to cater to all guests. A commodity hotel that had less of a segment focus would likely have a more normal distribution of overall satisfaction. In the case of The Block, the issue is less about how many people loved or hated the experience, but more about who loved or hated the experience. The Block was never intended to be all things to all people.

Figure 10 below shows the average level of satisfaction (from 1 to 5 with 5 being the highest) of the three distinct age segments tracked on Tripadvisor.com. The Block received their highest average rankings among 18-24 year old TripAdvisor.com users. While the Tripadvisor.com reviews do not represent a statistically significant sample, as discussed in the first chapter of section 2 of this thesis, the results support the intuitive conclusion that The Block was most popular with younger guests. Further, this age range is the same age reported by IBISWorld's as the largest age segment frequenting ski resorts.

FIGURE 10: Triadvisor.com Rankings by Age



This data helps demonstrate how Smith and Montotya were successful in creating and operating a hotel within their core segment demographic. They defined snowboarders as their segment and designed a hotel for that segment. Despite a lack of pre development consumer research, Montoya and Smith had personal knowledge of the snowboard lifestyle that informed the design, amenities and management decisions that defined The Block as a hotel for snowboarders. This specific limitation on the definition a core segment is simultaneously the strength and weakness of the demand segmentation method. You surrender broad based appeal in exchange for the benefits of a customized project described in Chapter 5 of this thesis.

IV. Conclusion

The recent closing of both Block locations overshadows the accomplishments of Smith and Montoya. The Block's closing in early 2009 has to be considered in context. Smith and Montoya achieved their goal of developing the first hotel for snowboarders by snowboarders, operated it for over four years and opened a second location. Further, Smiths Rouge hospitality group was in the midst of developing a poker themed hotel chain called 5th Street and a surfer focused hotel called The Break. Smith and Montotya were extremely talented at creating value through branding and promotions efforts and managed to turn an old courtyard motel into a popular destination for snowboarders that received a great deal of attention in the hotel industry and was the subject of a reality TV series.

Ultimately, Smith attributes the closing of The Block to a combination of the seasonality of the market and the blocks modest 52 room capacity. According to Smith "In Lake Tahoe and Big Bear….April, May and June it's like the surface of Mars…nobody is there. ….regardless of your brand, you still got your carrying costs[lii]." While The Blocks events were immensely popular the hotel only had 52 rooms, and no other revenue source aside from lodging. According to Smith, "we had events and we had 2000 or 3000 kids but we just passed business on to all the other hotels and all the other bars.[liii]" Further, as discussed above, there may have been a loss of focus on the identity of the customer. The Block was designed for snowboarders and likely only appealed to snowboarders. In addition to these considerations, the overall economic downturn has had a devastating effect on the travel and lodging industry and The Block was no exception.

Regardless of the combination of reasons The Block ultimately closed, many important conclusions can be drawn about developing and managing a segment focused hotel:

- By targeting a specific segment, you risk alienating more mainstream segments
- If you develop for a specific demand segment, it is important to stay focused on serving that segment

- How you manage a property, in addition to the features and amenities you include, is a viable way to customize your project for your target segment
- Direct consumer research is extremely important early in the demand segmentation process to understand what your segment values and why
- General business consideration like seasonality, diversity of revenue stream and capacity are even more critical to consider when developing demand segmented projects

CHAPTER 9: The Press Club

I. Introduction and Background

The Press Club is a co-op wine tasting room located in downtown San Francisco, featuring eight, boutique Napa Valley wineries as tenants. Founder Andrew Chun and Jan Wiginton formed Taste Partners, LLC to bring the famous Napa Valley tasting room experience to the city. The Press club offers limited edition wines not available in any other location. Millennium partners, owners of the adjacent Four Seasons Hotel, invested over $4 million in the project[liv]. According to Millennium Principal, Sean Jefferies, the Press Club would "enhance the experience of Four Seasons guest and residents[lv]."

Although The Press club has a retail storefront, Chun insists that the Press Club "is not a wine shop" but an opportunity to "offer intimacy with each of our wineries[lvi]." Mary Calhoun of Landmark wineries, a tenant at the Press Club, believes that "the opportunity is not only to sell wine at retail but it's also a tremendous opportunity to sign up wine club members and to introduce people to our friends of the vineyard program.[lvii]" Accordingly, The Press Club focuses its marketing and promotions efforts on visitors and conventioneers "with limited time in the city and [who are] unable to make a day long trip to wine country[lviii]."

Tenants include wineries like Chateau Montelena, famous for beating world renown French wineries in the 1976 Judgment of Paris as well as lesser known wineries like Fritz that "sell all of its wines on allocation, making The Press Club their only retail location.[lix]" Each winery is well known locally among connoisseurs but produces 50,000 bottles or less annually. The Press Club offers an opportunity for tenants to showcase their wine to a broader audience outside of Napa Valley.

The wineries lease 15' long tasting counters and provide their own representative to pour the wines and promote the winery. Each winery serves flights of select wines to customers and sell bottles or cases in the common retail storefront. Customers are also allowed to purchase wine flights and limited food at a common bar. Upon arrival, customers are given an RFID card called a "Press Pass.". Wineries swipe the pass to track how much and what type of wine customers drink. When customers leave, the total is charged to a credit card held on file by The Press Club to accurately track sales and customer traffic.

Although The Press club is popular with locals, Chun maintains that locals "have easy access to Napa Valley and we weren't rotating the wineries [in Press Club] so we knew the out of town customer should be our focus[lx]." The Press Club was targeted at "Wine enthusiasts, not necessarily wine experts, from out of town[lxi]." The focus on "out of town wine enthusiasts" drove a series of design and business decisions intended to benefit their target segment of time deprived, out of town wine enthusiasts. Ultimately, Chun concedes that a "most of our customers have come from the local market[lxii]" and is considering ways to readapt Press Club.

The Press Club is located in a 9,000 square foot basement space adjacent to The Four Seasons Hotel on San Francisco's Market Street. While the majority of the space is underground, the Press Club's entrance and sizable retail area are at street level. The individual tasting counters and common bar are surrounded by intimate lounge areas with well appointed furniture. Customer can drink wine flights at the individual counter or sit in the common lounge area.

The press club is designed to be "an urban expression of the wine country."[lxiii]The finishes are a distinctive blend of high end and utilitarian materials including concrete, stone, glass, fabric cork, black walnut wood and indirect lighting. According to architect Christian Von Ekartsberg, the Press Club "had to be a place to not only capture the tours and business travelers….[but] a place that locals feel great about[lxiv]." Ekartsberg, the designer of the immensely successful Ferry

Building Marketplace, did not want to create "the wine 'food court' of San Francisco.[lxv]" The result is a dramatic space that is aesthetically more refined than most Napa Valley tasting rooms.

Chun and Wiginton are actively involved in the day to day management of The Press Club. Although wineries provide their own representative to work their respective tasting counters, The Press Club also has a staff of retail sales associates, servers and dishwashers. The common staff is managed by taste partners, LLC. Additionally, Chun and Wiginton are responsible for promotions and marketing..

The Press Club contracts with a local catering company to provide limited food items. According to Wiginton "We never wanted to be in the food business. Being a restaurant was never our goal. The food is intended to enhance the wines[lxvi]." This is another example of how The Press Club's operations focuses on the out of town wine enthusiasts as opposed to the local customer. Many local wine enthusiasts would prefer a full service restaurant but this is not consistent with the tasting room model created for The Press Club. The decisions on food, hours of operations, long term leases and service of tasting flights only, are all deliberate operational consideration intended to reinforce the image of The Press Club as a tasting room in the city and not a night club.

Chun and Wiginton describe the Press Club business plan as a "shared services model[lxvii]." The Press club was designed to give smaller, boutique wineries the benefits of scale by clustering them together and providing common services and amenities designed to reduce operations cost. Having multiple wineries in one location would increase customer traffic and eliminate service redundancies. According to Chun "If each one of those wineries tried to independently come down and create this thing in the city, they would all be paying for the same channels the same advertising the same everything. By co-locating [Press Club]can be one single destination for all of their brands[lxviii]." The Press Club provides common equipment and staff that all wineries share including servers and retail agents and dishwashers. By clustering the wineries together, they eliminated operating cost redundancy and gave smaller wineries the opportunity to sell their products in a high end environment.

Similar to Napa Valley tasting rooms, wine is poured in 1 to 3 oz "tastes" and sold in "flights" featuring up to five tastes of the tenant wineries different vintages. Bottles and full glasses are not sold for consumption in the Press Club but bottles can be purchased at the street front retail location. In addition to tasting flights and retail bottle sales, the tenant wineries sell monthly wine club memberships to customers interested in receiving a different wine every month from the winery. This tasting format is partially a licensing requirement and partially designed to appeal to the out of town wine enthusiast interested in tasting a broad variety of wines, similar to a Napa experience.

Taste partners, LLC master leases the 9,000 square foot Press Club space from the building owners and sub leases the eight tasting counters to the individual wineries. Wineries pay $3500 a month in rent for a 5 year lease term as well as a predefined percentage of retail sales. Gross rental revenue, assuming no vacancies, is $336,000.00 not including revenues from retail sales or any contractual add backs. Taste Partners is responsible for management, promotion and operations.

Chun and Wiginton estimate that there are between 700 and 800 active wineries in Napa requiring a lean 1% market penetration to reach full Press Club occupancy of 8 wineries. Yet, Wiginton concedes that not every winery would be a good candidate for the Press Club. Taste Partners, LLC focused on high quality, independent wineries with a solid local reputation. We chose the current tenant wineries because they had "stories we wanted to share with our friends and family[lxix]." Further, each winery offered a different specialty and signature varietal ensuring that customers would have a well represented tasting experience.

II. Applying the Demand Segmentation Method

While there is a traditional retail storefront, the majority of the space is a co-op tasting room. Co-op tasting rooms are a form of specialty retail traditionally found in wine producing regions where multiple small wineries gather together to and benefit from concentrated and increased customer traffic. There were no co-op tasting rooms in San Francisco but Taste Partners did not develop Press Club based on a supply analysis. Instead, they applied the "marketing concept," as defined in section one of this thesis and focused on demand analysis to create their concept.

In many respects, the Press Club has two demand segments including the tenant wineries and the end user. According to Wiginton, "Our focus has always been on the end customer experience. There are eight different wineries with eight different reasons they are down in Press Club. We kind of have to focus on the end customer so that we are delivering the best customer experience overall[lxx]." The focus on the time constrained, out of town wine enthusiast as their core segment, has guided their design and management considerations but come at the cost of fully serving the needs of the local wine enthusiast.

Step one of the demand segmentation process requires the identification of a specific target segment. Chun and Wiginton decided to target out of town wine enthusiasts. They did not create the Press Club based on specific tenants but instead focused on the end user. As a retail developer you have to consider both the tenants and the end user or customer. However, Chun and Wiginton deliberately "focus on the end customer.[lxxi]" They chose to segment demand based on the end customer so the segmentation process will be analyzed on that basis only and not from the perspective of the wineries.

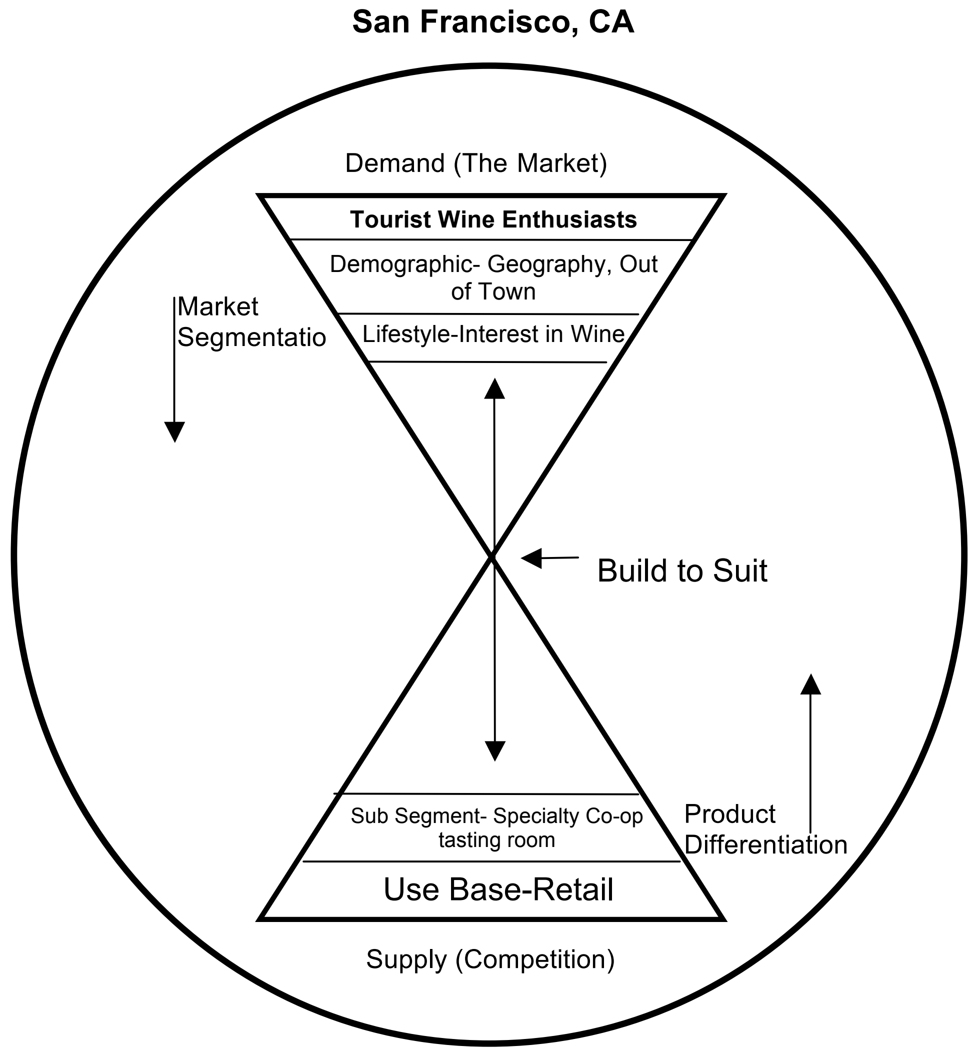
In Step two, Chun and Wiginton identified that out of town wine enthusiasts were underserved because they often did not have time to take advantage of one of California's major tourist activities, the Napa and Sonoma wine country. While San Francisco offers and abundance of wine bars and restaurants, there were no tasting rooms that allowed wine enthusiast pressed for time the same experience that they could have in Napa or Sonoma.

In step three, Chun and Wiginton did not undertake extensive consumer level research. Instead, they relied on existing co-op tasting rooms and the Napa and Sonoma experience to inform them of what wine enthusiasts valued. The basic concept was a place to try and purchase multiple wines in one building and be informed of the winery and process by a knowledgeable representative. It was not a restaurant or a night club. Finally. Chun and Wiginton knew that a trip to Sonoma or Napa often took an entire day and realized that convenience was extremely important to the core segment which is why they chose a central point in downtown San Francisco for Press Club.

In step four, Chun and Wiginton made a series of decisions that were intended to customize the Press Club to their specific demand segment, the time deprived, out of town wine enthusiast. Wine was served in tasting flights, not full glasses. The tenants were small, boutique wineries who's wines were not offered in wine stores or restaurants in the city. The design and layout were patterned after a co-op tasting room and not a bar or night club. The Press Club was not a restaurant and only offered limited food service to compliment not compete with the wine. In summary, the tenants, management and design were specifically based on the demands segments preferences.

The following hourglass model, Figure 11, represents the demand segmentation and supply differentiation variables that defined The Press Club.

FIGURE 11: Press Club Hourglass



Compared against other tasting rooms, The Press Club does not possess any new features or amenities that help distinguish it from other co-op tasting rooms with the exception of the urban location and the extremely high end design and finishes. The supply differentiation on the model stops at the sub segment of specialty retail, co-op tasting room. The management, and tenancy would be similar to any other co-op tasting room. The biggest difference, the urban location, is focused squarely at the out of town wine enthusiast and is covered by the geographic circle around the model. However, the simple relocation from Napa to a downtown basement serves the need for convenience and time saving for the time constrained tourist and still appeals to anyone interested in wine.

Simply because Chun and Wiginton's demand segmentation analysis did not result in the creation of a highly differentiated project does not mean that the Press Club doesn't have important insights to offer about the process and results of developing real estate based on demand. Demand segmentation does not have to be highly specific it just has to be clear. It is the developer's decisions of how specifically they want to define and segment demand. Chun and Wiginton chose broad, but clear, demand segments and their project has broad but clear appeal that directly caters to the demand segments underserved need.

As a subtle but well executed example of demand segmentation, Press Clubs offers additional insights into demand segmentation by highlighting that segments don't need to be specific just clear and highlighting the complication of including volatile characteristics like "out of town" in your demand segment analysis. An examination of the customer response to Press Club helps show that while Chun and Wigintons definitely created a product for a particular segment, problems arise if that segment is subject to swift changes.

III. The Consumer Response

Online ratings sites like Yelp.com and TripAdvisor.com confirm that Press Club is extremely popular. Over 187 Yelp.com users give the Press Club an aggregate 4 out of 5 stars. The quantity of user reviews for a business that has been open for a little over a year is almost as surprising as the resoundingly favorable response. Favorable comments focus on the quality of the interior build out, general atmosphere and having the ability to try multiple boutique wines in one place. Criticisms generally focus on price, The Press Club wines are not inexpensive, and the small portions of food served through the bar. The unique RFID card payment system is frequently commented on both favorably and unfavorably.

Yet, Yelp.com's reviews are primarily from San Francisco residents as opposed to The Press Clubs 'out of town' demand segment. TripAdviror.com generally offers a better perspective on users from different cities but the site currently only has two 'out of town' reviews. While there are few quantitative metrics for tracking out of town customers opinions, Wiginton "talk[s] to [customers] from all over the country who say 'you should open one of these in my home town,' so definitely we talk to a lot of visitors who view the Press Club very favorably[lxxii]."Regardless of the small volume of out of town reviews, TripAdvor.com's popularity index rates the Press Club as the 25th most popular attraction of 635 San Francisco attractions. TripAdvisor.com uses a "proprietary algorithm for determining popularity that takes into account quantity and quality of TripAdvisor.com reviews, guidebook ratings and comments from all over the Web[lxxiii]."

Yet, this highlights a fundamental problem in the Press Clubs demand segmentation profile. The selection of the 'out of town' demographic characteristic proved to be very volatile. IBISWorld's report on Tourism believes the immediate impact of the global recession will be a "disaster" for tourism and "reduced growth in travel both for business and leisure purposes, is expected…in both the number of trips and per person-trip expenditure.[lxxiv]" San Francisco is no exception and less travelers spending less per person trip impacts Press Club. Like other entrepreneurs, Chun and Wiginton did not see the global economic recession coming, but their segment focus of 'out of town guests' and resulting decisions on how to cater Press Club for this segment presents a serious challenge Press Clubs economic viability and underscores the importance of including demand segments that are at least partially insulated from dramatic shifts and changes.

While The Press club is extremely popular with local wine enthusiasts and well recommended by travel sites like TripAdvsior.com, the winery tenants are still evaluating the success of The Press Club. In spring of 2009, one of the tenants quietly vacated their space. According to one winery manager who requested to remain anonymous, "it is extremely difficult to make money with this model. The $3500 a month rent, five year term on the lease and the percentage of sales requirement makes it almost impossible to be profitable[lxxv]." The business structure requires a substantial volume of visitors to allow the wineries to at least cover rent costs. According to the anonymous winery manager, "The Press Club is geared for people from out of town who don't have time to go up to Napa, but we are not getting many people down here. The economy is definitely having an impact[lxxvi]."

The Press Club is loved by locals but is targeted at and operated for out of town visitors. Business and leisure travel, as well as convention attendance has been adversely impacted by the economic climate. The Press Club's core demand segment is not visiting and the specific operational decisions that differentiate press club are serving a non existent demand segment (out of town wine enthusiasts) at the expense of the actual customer (local wine enthusiasts). A summary of some of the most common comments found in Yelp.com reviews show how Press clubs managerial decisions deigned for the out of town segment adversely impact the needs and preferences of the local segment. These distinctions are included as Table 1:

Table 1: Comparison of Local v. Out of Town Preferences

	Out of Town Wine Enthusiasts	**Local Wine Enthusiast**
Hours of Operation	Closing at 10:00 works well	Would prefer later hours similar to a bar or night club
Serving Size	Flights and 3 oz tastes are ideal	Would prefer full glass or on premises bottle consumption
Variety of Wines	Ample and novel for visitors	Locals may tire of same wineries over 5 years
Food Options	Small plates are fine	Would prefer full service restaurant
Convenience	Ideal for visitors who cant make it to Napa but want the wine country experience	Can go to actual Napa Valley

The preferences listed in Table 10 are part of step three and four in the demand segmentation process, the identification of underserved needs and the fulfillment of those needs for your target segment. While seemingly small operational concerns, these factors have significant impacts on how The press Club targets its core segment.

Although the local wine enthusiasts response has been favorable, The Press Club may not appeal to local wine enthusiasts for a sustainable time period. Most local wine enthusiast have seen a co-op tasting room and have the time to drive to Napa The novel aspect works well with end users from out of town, but tourism and business travel will likely continue to be constrained until the economy recovers. The combination of the these consideration leads to questions about the Press Clubs current focus on out of town wine enthusiast and how their existing model would have to be adapted to cater to the local wine enthusiast that is their actual primary customer.

IV. Conclusion

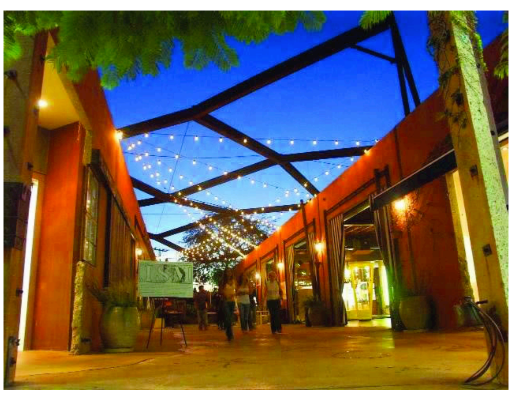
The Press club successfully developed real estate for their consumer segment. However the depth of the market for that segment changed when the economic downturn crippled tourism, business travel and conventions. This has impacted the Press Club's tenant wineries struggling with fixed rent and slumping sales. Ultimately, the Press Club may have to shift their focus to local wine enthusiasts and consider some of the consumer needs outlined in Table 1. This complication also highlights the challenge of selecting demand segment characteristics, like out of town, that are potentially volatile.

The Press Club that has been well received by San Franciscans. The space was built to the highest aesthetic standards offering a unique opportunity for smaller wineries to promote their business. Although, Chun and Wiginton's concept of providing a more convenient Napa valley experience to tourists and business travelers makes a great deal of intuitive sense, it is extremely vulnerable to current economic conditions. The wineries have sales thresholds necessary to cover the cost of their leases that require a great deal of traffic that is not currently present. Whether it adapts or simply waits for an economic recovery, the Press Club example offers the following insights into developing for demand segments:

- Demand segments do not need to be very specific or complicated, they simply need to be clear
- It is the developer choice of how much to segment demand which will inform how much a supply is differentiated
- It is important to consider the volatility of characteristics used to identify a demand segment
- Focusing on a specific consumer segment requires specific design, operational and economic considerations that are not always easily adaptable to different segments

CHAPTER 10: The LAB Anti-Mall

I. Introduction and Background



In 1994, Shaheen Sadeghi opened The Lab Anti Mall in Costa Mesa, CA, an apparel focused retail center for Generation X and Y shoppers. Standing for "Little American Businesses," The LAB was a stark contrast to the immensely successful, traditional and high end South Coast Plaza, located a mere 1.1 miles away. The LAB was developed on the 3 acre site of a light industrial facility that manufactured optical equipment for the US military. The one story concrete tilt up structure was adapted to retail by Ron Pompei of Pompei A.D. LLC of New York. Pompei focused on working with the existing building and "explored the materials in a very down to earth, visceral level. Materials were unfinished and porous versus polished veneers. We used a lot of found objects. Rather than come up with something else to make the buildings more presentable in a more mundane way, we cut into them[lxxvii]." The result is a stark contrast from the surrounding Orange Country architecture. Where Costa Mesa is new, polished and clean The LAB is rusted, partially finished and asymmetrical. According to New York Times Magazine writer Stephen Drucker, "to the world of endless summer [Orange County, CA], Pompei brought a touch of nuclear winter[lxxviii]."

The Lab sought small, entrepreneurial businesses that sold merchandise relevant to the 18-30 year old generation X and Y target segment. The LAB was one of the first shopping centers to have an Urban Outfitters, a small apparel company that has since expanded dramatically to over thirty five states and nine countries. Other tenants included a popular local second hand store, independent record store, a “streetware” boutique for men, a shoe store specializing in limited edition sneakers and a restaurant and café. Everything from the tenants to the design was specifically catered to the tastes of its target consumer. According to Mark Schoifet of the International Council of Shopping Centers, “the LAB is the first mall in the nation to be conceived of for a generation[lxxix].”

The thirteen tenants are oriented along an internal main street that creates an insulated environment away from the busy Bristol Street traffic. A partially covered courtyard, called “the Living room” is prominently situated in the center of the development and features a small stage, eclectic furniture and colorful area rugs. Many of the storefronts were roughly saw cut through the tilt up concrete walls leaving jagged edges and exposed rebar. The landscape is a mixture of the left-over concrete floors with new rock mosaics and a series of indigenous planting areas. Sculptures in small enclaves line the main street and a collection of rusting oil drums are used to make a fountain in the parking lot entrance. Metal scaffolding is a permanent fixture throughout the site. According to Sadeghi, “we wanted to create something that wasn’t perfect[lxxx].”

Even though it is billed as an Anti Mall, The Lab’s tenant mix seeks to have “2-3 very unique and specialized anchors to compose approximately 25-50% of the project[lxxxi]” more specifically defined as “seasoned leaders in the youth specific market, in growth positions and typically non mall operators[lxxxii].” Additionally, The Lab seeks restaurant tenants to compose 15-20% of the project with the remaining balance as entrepreneurial in line tenants. The inline operators are defined as “local/entrepreneurial type business [that] incorporate the important community/neighborhood flavor[lxxxiii].” Further, The Lab requires owner tenants who are passionate and involved on a day to day basis in their business and offer unique services and products[lxxxiv].”

Sadeghi, a former executive for apparel company Quicksilver, felt that Instead of reinventing the retail experience for everyone, he would focus solely on a consumer segment he understood and designed a project based on their needs. Not simply a mall, the LAB aims to be a “community center[lxxxv]" that encourages its core customer segment to hang out. The common area "living room" regularly hosts live poetry readings, fashion shows and concerts for local bands.

Being an executive at Quicksilver, a surf wear apparel company, Sadeghi clearly understood the principals of consumer segmentation and adapted them to real estate development. Despite the niche focus based on 1994 consumer demographics and psychographics, the LAB has proven to be a sustainably successful development. Many of the original tenants, including Urban Outfitters, remain fifteen year after the grand opening. Further, in 2000, Sadeghi reported annual gross sales revenues between $250-$450 per square foot[lxxxvi] depending on the tenant. The Lab has proven that a retail project developed specifically for a target consumer segment is not simply a novelty but a viable business model.

Sadeghi has since formed Lab Holdings, LLC to continue developing segment focused retail projects. In 2000, Lab Holdings opened The Camp, a 3.4 acre retail center across the street from the Lab that focused on baby boomers interested in "human powered sports" like cycling, surfing, skateboarding and scuba diving. Currently, Lab Holdings is working on a food focused retail center in Portland, OR called Seed. According to Ryan Aeh of Lab Holdings, the company is more "artists with an interest in real estate than traditional real estate developers.[lxxxvii]" Lab Holdings is one of the few examples of a development company that regularly pursue consumer segment focused projects and have scaled the concept beyond a single development.

Although the goal of Lab Holdings is to create a different experience for a defined consumer segment, the development process is very traditional. Lab Holdings purchases sites that are well suited for their concept, engage a series of consultants and specialists to help define the project, obtain entitlements and approvals from the local government, build their projects using contractors and pursue relatively traditional leases with their selected tenants. Despite describing themselves more as artists than real estate developers, the only material distinction between Lab Holdings, LLC and a traditional developer is the use of demand segment analysis to create projects.

II. Applying the Demand Segmentation Method

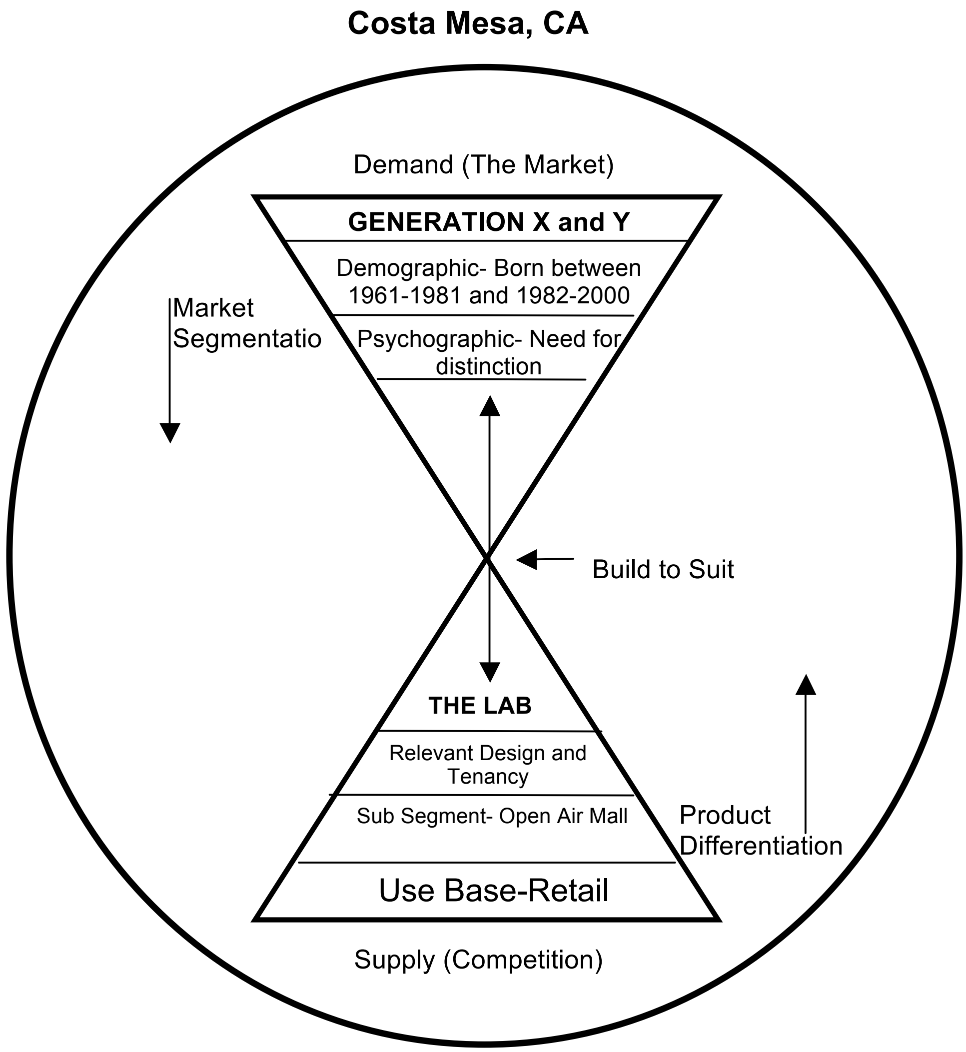
In step one of the demand segmentation process a demand segment is identified based on some combination of characteristic. Sadeghi chose the simple demographic characteristic of a generation. In their book Generations, William Strauss and Neil Howe define generation X as people born between 1961 and 1981 and Generation Y or the Millennial as being born between 1982 and 2000. While a valid segment, an entire generation still has a broad range of demographic and psychographic diversity.

In step two, Sadeghi identified that generations X and Y were underserved by existing malls and retail developments. According to Sadeghi, "there was a void in the retail shopping experience. All the malls are so homogenized. The romance is gone for the average consumer[lxxxviii]."The South Coast Plaza, a traditional enclosed mall with a broad range of tenants that attracted a broad range of demand was located a mere 1.1 miles away from the LAB site. In Sadeghi's opinion, "The American mall tries to be all things to all people which is hopeless[lxxxix]."Accordingly, he decided to develop the LAB.

In step three, Sadeghi relied upon his experience as a surf wear designer and executive for Quicksilver to understand the needs of his target demand segment. His experience in an apparel company focused on this exact segment allowed him considerable insights into the preferences and needs of generations X and Y and was born from direct consumer research, albeit for an apparel company and not a mall. However, the trends in apparel were clear. Large, homogenous brands like The GAP were no longer valued by Generation X and Y shoppers. Instead, they valued emerging brands that were small scale and distinct.

In Step four, Sadeghi decided to target his demand segment through tenancy and design. Although positioned as an anti-mall, the development and management process for the LAB is very traditional. The elements that are used to serve the needs of the target demand segment are tenancy and design. Very few of the initial tenants had credit ratings and most were sole proprietorships. The major anchor Urban Outfitters, was a growing business but was nowhere near the size it is today. From the shoe store that sold limited edition Japanese sneakers to the store offering men's 'streetware' all of the tenants offered unique and hard to find merchandise that appealed to Generation X and Y's desire to be distinct. The LAB's tenancy directly appealed to a major psychographic of a generation. Further, the design was completely different from any other mall. The LAB would likely not be in its fourteenth year of operation had it purchased a strip mall and leased it out to the same tenants. The physical space was an intentional contrast to the South Coast Plaza that also resonated with the target segments psychographic desire for distinction. The hourglass model for The LAB is shown as Figure 12 below:

FIGURE 12**:**



The principal elements used to serve the target demand segment were the tenancy and distinct deign. Lab Holdings, LLC took on considerable risk by having a significant portion of their tenancy as non credit-rated, sole proprietorships. However, these tenants are what served the demand segment and made The Lab a differentiated project. According to Sadeghi, "any retailer that would go into a mall, I don't want them.[xc]" The design also served the needs of the target segment by providing a physical atmosphere that was consistent with the independent and alternative tenancy. However, it was not significantly expensive. Designer Ron Pompei described the budget as "less than a million dollars – miniscule."

The LAB has had the longest running operating history of the three examples of demand focused real estate presented in this thesis. There has been some inline tenant turnover, as would be expected in any mall project, but the anchor Urban Outfitters and some of the original restaurants are still in operation today. One of the few things that has changed is the preferences and taste of the consumer in Generation X and Y. Based on the Smith and Howe definitions, current generation X consumer are age 29-48 years old and Generation Y are age 9-27 years old. By this definition, The LAB would appeal to few people in Generation X and an aging portion of Generation Y. Since its opening in the mid nineties, the preferences and needs of this age group have surely changed leading to an important question about demand segment focused development, namely, what is the life span of projects that focus on characteristic that are bound to change in time?

III. Customer Response

The LAB, like other developments focused on a specific consumer segments, is subject to widely varying and sometimes impassioned opinions. The LAB intentionally set out to contrast itself with the more traditional South Coast Plaza that serves a far broader base of customer. Accordingly, comments about the development are rarely neutral and range from highly supportive to derisive and critical. Further, online consumer opinion has to be considered in context. The LAB's strong consumer focus and branding began in 1994 when online consumer ratings forums like Yelp.com or Tripadvisor.com were distant possibilities. The people rating it today, though from the same generational definition used by Sadeghi to segment demand, are different from The Labs first shoppers. Further, anchor Urban Outfitters is no longer an obscure, youth oriented retailer but is now a well known international chain.

Regardless, online forums still offer an important perspective on consumer opinion. Like all retail centers, developer must pay attention to both their core tenants as well as the malls end user. Assessing end user or customer opinion is particularly important for developers of consumer segmented projects to ensure that their design, tenancy and programming are addressing the needs and preferences of their targeted segment. The LAB has a respectable 87 reviews on Yelp.com with an aggregate score of 3 of 5 stars. The Block Hotels had a double peaked distribution that reflects the strong opinions of customer who either liked or hated the hotel. The LAB engenders a far greater sense of consumer neutrality and while it has less hard core fans than The Block it also has fewer detractors.

While The LAB development as a whole is ranked 3 out of 5 stars, the average rating for all of the individual tenants is a more favorable 4 out of 5 stars leading to the conclusion that individual tenants are more popular than the LAB development as a whole. A comparison to online consumer opinions in 1994 would be helpful to compare against today's reviews but that is obviously impossible. While online response show a normal distribution of satisfaction with a lackluster 3 stars, they do not help answer the question about the segment demand lifespan.

IV. Conclusion

While The LAB is only moderately well reviewed by online consumer ratings sites, its established record of operations may be a better indicator of the centers overall health and Lab Holdings ability to develop for a defined consumer segment. The original anchor tenant, Urban Outfitters is still leasing space and many of the original inline tenants are still in operation. While some inline tenants are new, the general concept of a mall that serves alternative, youth oriented consumers age 18-30 (within Generation X and Y) is still sufficient to generate leasing interest. However, the needs and preferences of this consumer group are subject to change. In 2000, Sadeghi even admitted that "generation Y has been Madison-Avenued out. There is so much focus on Gen Y and I feel there's definitely going to be saturation[xci]." While the needs and preferences within the target demand segment may have shifted over time, the tenancy seems to have evolved organically and is still capable of attracting young shopper in the target segment and new business that have either grown or evolved to serve the segment.

Yet, the LAB highlights an important question of developing a retail project for a demand segment defined by a generation. Real estate is not a fast moving business model. Leases run for five to ten years which is far longer than the ever changing and fickle worlds of fashion and youth culture. Developers cannot control wider social or demographic trends and if they develop a project for a fast moving segment, will their project face conceptual obsolescence? If the project ceases to be relevant or interesting to the target segment, the developer may be forced to make major changes in programming, tenancy and potentially major capital expenditures to reposition the asset for a new segment.

Ultimately, The LAB does not appear to be facing conceptual obsolescence and is a well leased retail center even in the current, challenged economic conditions. The South Coast Plaza was originally built in the 1960's but is still in operation after many renovations over the years. The LAB is no different. Eventually, it will require new capital expenditures and maybe repositioning. At that time, Sadeghi may have to engage in a renewed demand analysis process. The LAB highlights some important conclusions and questions about developing for consumer segments including:

- It is important to have relevant tenancy when developing real estate for consumer segments
- Customizing the physical property for a demand segment is not necessarily expensive.
- Do changing needs and preferences within a demand segment threaten a development with conceptual obsolescence?
- Can the life span of a demographic characteristic be used to help developers plan for conceptual obsolescence?

CONCLUSION

Demand segmentation is but one of the many concepts used in consumer packaged goods marketing that offer different ways of thinking about real estate development projects. Fundamentally, demand segmentation is focused on the deliberate identification of a specific customer segment and figuring out how to serve that segments unmet or underserved needs. While simple in concept, the execution is considerably more difficult. As the cases demonstrate, demand segmentation can be applied to varying degrees and has different impacts on a consumer's response and the developments success. A review of the backgrounds and common mistakes of each developer helps further the discussion of how to apply demand segmentation to real estate development.

Unsurprisingly, the three developers who chose to create a real estate project based on demand had no prior real estate development experience and came from industries where demand segmentation was more common. Liko Smith managed Best Western Hotels prior to creating The Block. When asked whether he considered himself a hotel developer he hesitated before finally answering "yeah … I guess I do," Andrew Chun and Jan Wiginton had consulting backgrounds prior to creating Press Club and now consider themselves value add developers. Shaheen Sadeghi was an executive for an apparel company before creating The LAB and then his development company Lab Holdings, LLC. He has since successfully developed The Camp in Costa Mesa, CA, a development focused on human powered sports enthusiasts and is working on SEED in Portland, OR, a project focused on Portland's culinary community. Some of the mistakes that caused problems for their respective developments were born of their relative inexperience in real estate development. As they refine their knowledge of the real estate development process and continue to focus on demand segmentation, they may represent the first in a new class of demand focused developers.

While each of the selected developers engaged in some part of the demand segmentation process defined in this thesis, they all did a poor job of performing direct, consumer level research and quantifying their demand segments. As opposed to actually performing focus groups and conducting surveys of their demand segment, they relied upon their own knowledge to customize their developments to their segment. Liko had Marc Frank Montoya to identify what snowboarders value, Chun and Wiginton had other tasting rooms to see what consumers expected and Sadeghi relied upon his previous experience in demand segmentation in a youth focused apparel brand. While direct consumer level research is time consuming and difficult it is probably the most important step in developing real estate or creating products for demand segments. With the exception of commodities, no product serves all consumers equal and it is critical to know exactly what demand segments value. That can only be determined by conducting statistically significant consumer level research.

Once a demand segment s elected it is also extremely important to verify that the segment exists in sufficient numbers to form an economically viable market. Smith could have adapted the IBISWorld findings to the number of lift tickets sold in Lake Tahoe to determine a specific market size and the necessary market penetration to make the hotel work. He may have found that the seasonally adjusted number of snowboarder, hotel customers were not enough to form a realistic market size. It is critical to ensure that the target segment is large enough to make your project a success.

This thesis is by no means a comprehensive attempt to adapt all modern marketing methods and concepts to real estate development. Instead it focused on a specific concept that might improve on current development practices or offer an alternative method of development. The specific project based findings and common mistakes made by the subject developers form a body of conclusions and questions about adapting the process of demand segmentation to real estate development. Ultimately, this thesis expanded on existing academic work, Like Malizia and Howarth's Hourglass model, that advocates for the use of demand segmentation. It also reviewed three cases where developers created projects for specific demand segments and presented specific conclusions and questions based on their experiences. Hopefully real estate developers and marketing professionals can continue to refine the use of demand segmentation to real estate development.

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