

## So how's the real estate market? -- take two

Last month, we wrote about the subprime “mess” – specifically the way many hedge funds and others levered up and speculated in the bottom tranches of mortgage pools. When the real estate cycle turned against them, and foreclosures edged up, they were left with the equivalent of unsustainable margin calls. If it all seemed a bit overly complex, don't feel bad – I was asked to explain this to an east-coast attorney on the phone earlier this month, and half way thru the explanation he asked me to stop and complained about what a terrible headache it was giving him.

While we've said almost enough about that, I was interviewed today for a radio show, and one of the questions was whether this was solely a subprime crisis or a more systematic real estate downturn. My answer was that there were three things going on, which are somewhat interrelated:

1. Broad commercial real estate down-cycle, stimulated mainly by a slow-down in GDP growth
2. Housing down-cycle, stimulated both by builders retrenching from excess supply as well as an end to easy money
3. The death (or at least a long “coma”) of sub-prime lending.

As we mentioned last week, #3 feeds into #2, but even if the speculators hadn't ruined the sub-prime game, we were still long overdue for a housing pull-back. We've just finished one of the longest housing booms in history, comparable in breadth and depth to the GI-fueled boom at the end of WW-II. Home ownership rates in the U.S. hit record highs. To a large extent, the excess demand was becoming exhausted, and further increases in home ownership rates were probably not sustainable. A pull-back in demand was inevitable. The end of cheap money (the death of sub-prime lending) was partially the cause and partially the effect of this demand pull-back.

Coupled with this, housing supply had over-reached a bit, and there was every reason to believe that homebuilders and developers were sensing the need for some caution. In addition, in some of the hottest markets in the country, building for the starter-home market was simply becoming infeasible. Costs were rising faster than prices – hard to believe, but true – and \$100 per barrel oil wasn't making it any easier. (Seattle, where we're home-based, was the poster child for this phenomenon).

But enough about housing – what about the rest of the real estate market? On the next page, we're introducing a new quarterly publication of Greenfield Advisors, called *Greenfield Capital*. It's aimed at the real estate investor market, and captures our thinking on commercial real estate as a function of larger economic variables. In short, we currently think that commercial real estate is on a slight pull-back as a result of declining projections in GDP growth. However, there are significant bright spots.

In the radio interview earlier this month, I was asked what real estate investors should do today if they're looking for “bottom fishing opportunities in the real estate downturn.” Real estate down cycles aren't short, and I think we have 18 to 24 months to go with this one. That having been said, I used the analogy of fishing – when you get up in the morning, planning on a day on the boat, you have a lot of prep work to do before you drop the first line in the water. You have to get your bait ready, get the boat ready, get all of your fishing tackle lined up, and actually drive the boat out to where the fish are schooling. The same is true today for investors. While the optimum time for “bottom fishing” may not be upon us, it is certainly time to get ready for opportunities. In addition, there is some sense out there that interest rates may be at their best levels right now. It may not make sense to wait 6 to 12 months for the best pricing deal if you see the financing opportunities moving away.

## New Publication – *Greenfield Capital*

We're happy to announce a new addition to the Greenfield roster of publications: *Greenfield Capital*, which will be web-based as well as available for download as a .pdf. At this time *Greenfield Capital* is free and by subscription only. Interested subscribers may receive a copy via e-mail by sending a note to [info@greenfieldadvisors.com](mailto:info@greenfieldadvisors.com), please refer to *Greenfield Capital* in the subject line or in the body of the email.

*Greenfield Capital* is our opportunity to synthesize and summarize our "big picture" thinking about current real estate investment opportunities. Naturally, specific recommendations are client-specific, and *Greenfield Capital* should in no way be construed as specific investment for a specific client. Note also that our advice for specific clients with specific needs may run counter to situations described in *Greenfield Advisor*, and that our clients as well as principals and employees may stand to profit from market movements in investments discussed in *Greenfield Capital*.

With all of that legalese aside, what exactly is in *Greenfield Capital*? Our goal is to do three things:

1. Synthesize the key economic variables which are affecting the real estate market and discuss the implications for various subcategories of real estate.
2. Summarize our reading of other real estate research and show how that fits into our own real estate strategies.
3. Discuss implications of all of this for real estate portfolio management, including timing decisions, allocation strategies, and special situations.

Our first issue spends a bit more verbiage on one of our models (a macro-econ model we're in the process of implementing), but later editions will spend more time on special situations, upcoming opportunities, and financing topics.

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## Dr. Mundy – retired or not?

Many of our friends, clients, and colleagues may hear us use the "R" word concerning Dr. Bill Mundy, our founder and Director Emeritus, in the coming weeks and months. As it happens, Dr. Mundy is still with us, but is scaling back his work load considerably in 2008. As many of you know, while Dr. Mundy is one of the nation's leading scholars in real estate valuation, his one true love is farming and particularly viniculture – the science of wine grape growing and wine making. It is a little known fact, but before becoming a land economist, Bill Mundy's college degree was in agriculture! Anyway, he now wants to spend a bit more time focused on grapes (and all the wonderful things you do with them!), traveling, and his love of cross-country bicycling.

So our good friend and colleague Bill Mundy is further reducing his workload in 2008, finishing up a number of projects currently on his plate and serving as a sometimes consultant on trophy property and other complex, high-amenity real estate projects. Let's all wish him the best in this new phase in his life.

**John A. Kilpatrick, Ph.D., MRICS**

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