



Greenfield Advisors LLC

# The Greenfield Advisor

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## Key Quotes to Consider

David Krasne, NY Times January 27: *Merrill Lynch lost \$27 billion last year, and yet still managed to rush through \$4 billion worth of year-end bonuses in the days before it was taken over by Bank of America...* (Merrill CEO John Thain spent 1.5 million redecorating his new BoA office while lobbying for a bigger bonus—and finally got fired.)

Ben White, NY Times January 29: *“employees at financial companies in New York ...collected an estimated \$18.4 billion in bonuses for the year”* down from \$32.9 billion in 2007.

Joe Stiglitz (Nobel Prize, chief World Bank economist), January 26 post on CNN.com: *“The question is at last being raised: Perhaps the entire strategy is flawed? ... The Paulson-Bernanke-Geithner strategy was...based on a failure to grasp some of the fundamental changes in our financial sector since the Great Depression....”*

Anthony Faiola, January 24 Washington Post: *“The problems in Europe now appear to be as bad if not worse than those in the United States.”* (British banks are broke.)

Jeremy Grantham, *Quarterly Letter* from GMO, LLC: *“We really need to halve the level of private debt as a fraction of the underlying asset values... somewhere between \$10 and \$15 trillion of debt will have to disappear.”*

George Soros, January 28, BBC News: There are about \$1.5 trillion in bad loans. There is about \$1 trillion in world banking system capital.

Michael Lewis & David Einhorn, January 3 New York Times op ed: *“And here’s the most incredible thing of all: 18 months into the most spectacular man-made financial calamity in modern experience, nothing has been done to change...any of the... bad incentives that led us here in the first place. In the past year there have been at least seven different bailouts, and six different strategies. And none of them seem to have pleased anyone except a handful of financiers.”*

Alan Greenspan, October 23, House Committee on Oversight and Government Reform testimony: *“Those of us who looked to the self-interest of lending institutions to protect shareholders’ equity—myself especially—are in a state of shocked disbelief”...* (this is) *“a flaw in the model that I perceived as the critical functioning structure that defines how the world works.”* (Oh!)

Montagu Norman (Bank of England chief who in 1926 restored Britain to the gold standard, now regarded as a colossal mistake by most economists, quoted in February 2, *New Yorker*) *“Nothing that I did...produced any good effect—or indeed any effect at all except that we collected money from a lot of poor devils and gave it over to the four winds.”*

## Housing Indexes Reveal . . .

Changes in median prices may reflect different quality houses selling rather than market price changes. The Case-Schiller Index (CSI) solves the constant quality problem by comparing sales and re-sales of the same properties. That method gives a quality controlled estimate of price changes. Case-Schiller reported recently a 20 city average 18.2% year on year decline to November 2008. However, local changes vary considerably from the national 20 city average. The best November to November price decrease was Dallas with -3.3%, the worst was Phoenix with a -32.9% drop. Seattle’s CSI fell -11.2%.

Sales in the current market include many foreclosure sales. A sheriff’s sale might not bring as good a price as a longer exposure to the market. And, since the index is calculated only for 20 cities, it may not reflect value changes in smaller cities and towns or rural areas. If you are a seller with a desirable property in a good neighborhood you could hope to beat your city’s index.

Rising unemployment and tighter credit lead experts to forecast further house price declines. The good news is that as prices fall, housing becomes more affordable to purchasers.

## . . . The News May be More Positive Than Reported

Most long term homeowners are still ahead. Since January 2000 when the index was 100, Detroit (83) is the only CSI index city to have experienced a nominal house price decline. New York and Washington house owners were still sitting on substantial capital gains over 2000 prices with their November CSIs at 186 and 180 respectively (Seattle, our home town, is at 166). The 20 city index average for November 2008 was 145. The national CSI peaked at near 190 in the second quarter of 2006, so the decline to 145 represents an average fall near 24% from a high peak.

## Bottom Line: There Continue to be Real Estate Opportunities During the Melt Down

Amid all the grim news, a few general thoughts on real estate worthy of attention:

1. Troubled projects and land. In times of illiquidity, land sellers or developers may get caught by slower than expected sales or leasing. Not all troubled projects are underpriced or destined for future success, but some will eventually prove to be winners. These are the best opportunities in a decade to acquire future development sites.
2. Construction costs tend to fall in hard times when contractors try to cut bids to keep their crews working. Now could be a time to build, especially if long construction times make recovery likely before project completion.
3. Certain categories of demand will tend to be less sensitive to macroeconomic conditions than others. Examples might be student housing, elderly housing, basic needs such as groceries. Ask, "If a big chunk of the economy goes out of business, which properties would still be occupied, who still gets paid?"
4. Foreclosures and tighter home lending standards push more households into the rental markets. Apartments may be a defensive investment. Cap rates for Seattle apartments have increased less than cap rates for other types of real estate.

The volatility of real estate and stock markets extends to currencies. A flight to safety has lifted the dollar. If you move money into overseas real estate, you acquire a position not only in real estate but also in a foreign currency that may appreciate due to long term fundamentals. If the real estate and the currency both perform well, profits can be spectacular.