Greenfield Advisors

Economic, Market and Valuation Analysts

Greenfield Advisors LLC

The Greenfield Advisor

Issue 4-2, March, 2008

Inflation? Did someone say inflation?

Our economic models here at Greenfield include fairly solid support for inflation in the 2% range, depending on whether you're talking about the GDP deflator (what we use) or the CPI adjustment. Either way, consensus puts us in the 1.8% to 2.2% range for 2008. (The GDP price deflator for 2007 was 1.58%, according to the Bureau of Economic Analysis.)

Nonetheless, real estate (and real estate finance) is acutely sensitive both to inflation itself and to changes in the consensus forecasts about inflation. In recent weeks, we've seen significant conversation in the popular press about consumer prices – particularly energy and food. The former has been anticipated for a while now, but recent changes in food prices may be something of a surprise. According to the Bureau of Labor Statistics, the CPI for the 12-months ending December (U.S. City Average) was right at 3.1%. When you take out food and energy, it's 2.3%. Of course, $100 per barrel oil is now priced in that, so price changes in energy are less likely going forward.

Energy costs, in turn, affect food costs, since nearly all of us eat food that is shipped from somewhere distant. Recent reports suggest food costs have been accelerating. According to the BLS, December, 2007, food and beverage only was a relatively modest 4.8% — higher than the overall level of inflation, but still within a manageable range.

Other significant components of inflation are behaving counter-cyclically right now. Housing costs are flat-lining, and notwithstanding the ARM re-sets ($500 billion projected for March alone), the actual cost of housing (home prices) is flat-to-down. Of course, rents will probably enjoy a surge as a direct result of the sharp decline in housing starts, but new mortgage loans are considerably cheaper today than a year ago. The one-year LIBOR index stood at 5.39% at the end of February, 2007. It closed at 2.82% on Wednesday, 2/27/08. (On the other hand, and oddly enough, the FNMA 30-year fixed rate 60-day commitment rate this week is almost exactly where it was a year ago).

Where does all this take us? Not withstanding the whining we hear at the gym every morning from neighbors and friends wanting free economic advice, the world of inflation seems to be firmly under control.

Green Real Estate

The writers at Fast Company recently wrote a piece for MSN Money titled "Grab the Green Real Estate Boom". Leading corporations, including Goldman Sachs, Hearst, IBM, JPMorgan-Chase, and Toyota, are increasingly moving into "green" headquarters. Bank of America is building a 52-story eco-friendly skyscraper near Times Square, and Accenture is leasing green space all over the U.S.

It's estimated that 5% of all new U.S. commercial construction received LEED certification last year, and this is projected to grow to 10% by 2010 according to McGraw-Hill's 2006 Smart Market Report. In addition, some REITs and others are buying distressed office buildings and retrofitting them to green standards. On average, these buildings are commanding 3% higher rents and 7.5% higher values, again according to McGraw Hill. On average, these buildings save 10% on utility costs annually, with some buildings reporting energy reductions as high as 42%.

One leading player in this space is Liberty Property Trust, which now has 21 green buildings among its portfolio of 700 properties, and they are reportedly aggressively renovating existing properties as well as acquiring new green buildings. Also, the Spectra Green Fund is directing assets toward green real estate plays.

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Upcoming Article – Preservation Easements

Vicki Adams and I have co-authored "Preservation Easements", slated to appear in the next issue of the Journal of Wealth Management. In this piece, we outline the various conditions for a valid preservation or conservation easement, the tax benefits, and the underlying processes for a successful dedication. We also present several case studies, both in urban and non-urban settings, showing the various applications of preservation easements for estates, family offices, and overall wealth management applications.

If you'd like a copy of this article after it comes out, please drop us an e-mail and we'll be sure to put you on the list for a reprint. The Journal of Wealth Management is published four times per year by Institutional Investor, and primarily serves the very high net worth investment advisor and family office manager community. Greenfield also contributed "Real Estate Investments of the Rich and Famous" back in 2007. For more information about the Journal, please visit them on the web at http://www.iijournals.com/JPPM/.

…and the Rest of Real Estate

According to *Hedge Fund Daily* (3/14/08), Real estate is the most popular alternative investment among public pension plans in the U.S. and Canada. This comes from a survey conducted by Bear Stearns and the Government Finance Officers Association. According to them, 85% of respondent pension plans indicated that real estate was their favorite alternative asset class, followed by private equity (60%), venture capital (44%), and hedge funds (42%). According to that survey, 52% of respondents (N = 150 pension plans) say they either currently invest or plan to invest in alternative assets. Of the plans that do not invest in alternative assets, the explanation is usually that they are barred by law or a very conservative investment policy.

At the other end of the spectrum, *GA* readers have probably already heard of the impending collapse of Carlyle Capital, which defaulted this week on more than $16 Billion in assets. This may be one of the highest profile collapses yet in the sub-prime unraveling. In the December issue of *GA*, we talked about the hedge funds which borrowed to buy "Z" tranches in sub-prime pools. This is essentially what happened. They got caught in a default squeeze. The list of hedge funds or REITS which are falling into disarray reads a bit like a who's who – Thornburg failed to meet margin calls last week, Peloton Partners was forced to liquidate assets recently, and Drake Management recently suspended investor redemptions and is considering liquidations. Out of fairness, Carlyle Group manages $81 billion in assets and has averaged a return of around 26% on nearly 60 funds over its 20-year history.

But, it seems that the most important impending news for real estate and related debt markets is also some of the "quietest" news, probably because it's the least understood. I first picked up on this from a CNBC interview with NY's Sen. Chuck Schumer last week. He's on the Senate Banking, Housing, and Urban Policy committee, and Chairs its Economic Policy Subcommittee. In short, he has a lot of influence on the way our Federal government regulates money, and particularly real estate money. He noted last week that the capital markets in the U.S. can be roughly divided into three categories: Banks (the sort that are members of the FDIC), Investment Banks (such as are regulated by the SEC), and the Private Equity and Hedge Fund markets (which are nearly unregulated). Sen. Schumer suggested that this sort of regulatory model was out of date, given the intense interaction among these three groups which contributed to the current liquidity crisis, and that a more holistic approach needed to be considered in the future, after this "mess" is sorted out. This sentiment is analyzed, without quoting Sen. Schumer, in an article contained in his state's most widely read newspaper, the Wall Street Journal (March 27, 2008). The Journal article notes that other countries, such as the U.K., have both healthy capital markets and a unified national regulatory structure. The Journal implies that the New York FED's involvement in the Bear Stearns takeover may very well technically overstep the bounds of the Federal Reserve System as it is currently empowered, but is certainly consistent with the way its counterpart agencies in the U.K. would approach this problem. All of this, collectively, would be called "handwriting on the wall" for the future of banking and investment regulation in the U.S.

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