

## Trophy Property — Below the Radar

Getting a little tired of doom and gloom? Same here...

Last month, we talked about our various sectors of the real estate economy, with **Greenfield's** forecast of which to avoid and which to embrace in the coming year. One area we didn't discuss — which is getting a lot of attention lately — is "Trophy Property". Perhaps it's a good time to take a peek at this little corner of the real estate investment world.

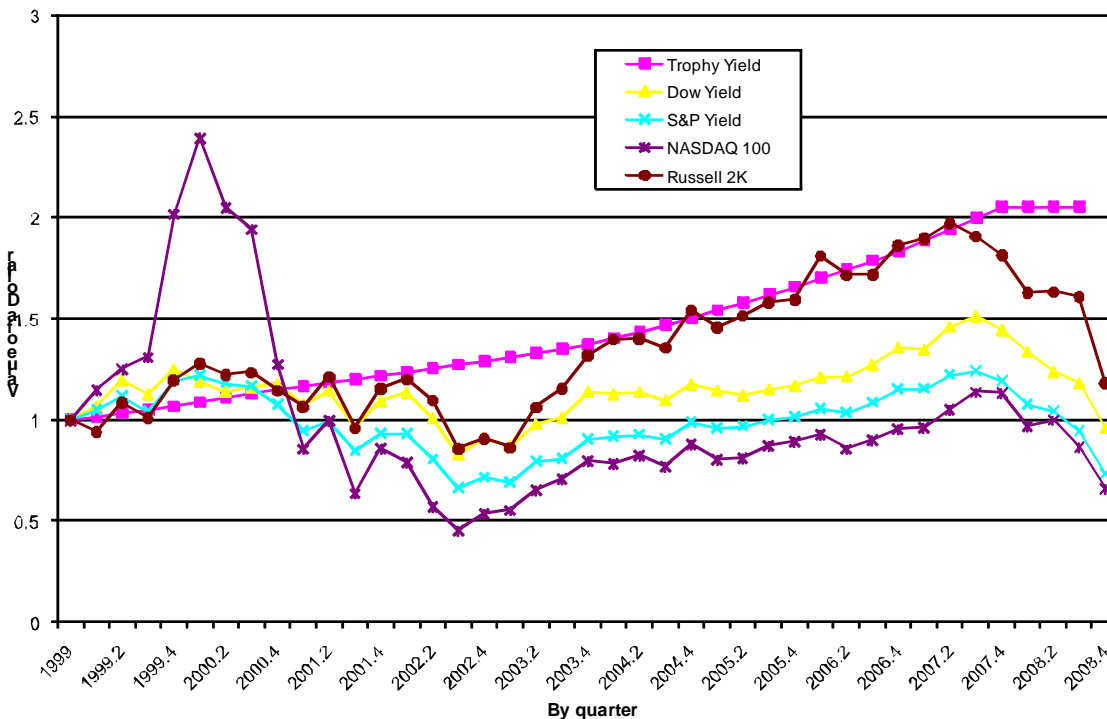
This category transcends other property types: one could own a trophy residence, a trophy office building, or a trophy hotel. Here at Greenfield, we generally focus our attention on high-amenity, natural-resource-rich trophy lands, with a particular emphasis on trophy ranches. However, we've been called on to evaluate all manner of trophy properties. For example, several years ago, we consulted on the U.S. Steel Tower in Pittsburgh, at 2.3 million square feet, it constitutes about 25% of the rentable class-A CBD office space in Pittsburgh, and is one of the biggest buildings (if not the biggest) between NYC and Chicago. Clearly, the building fits into the "trophy" category, but by-and-large, **Greenfield** focuses its attention on trophy ranches and other natural resource lands.

While the concept of trophy property as a sub-class has been around for a while, we can thank our firm's founder, Dr. Bill Mundy, for really bringing attention to the special analytical and investment challenges in a series of Appraisal Journal articles on the subject. In general, Dr. Mundy noted that trophy properties constitute the top half-percent of a given class of real estate. Characteristically, trophy property evidences a demand which is very different from non-trophy property in the same sub-category. For example, **Greenfield** recently consulted on the preservation of the *Farnsworth House* — a architecturally extraordinary, collectable residence designed by Mies van der Rowe and built in Plano, Illinois, in the mid-

1900's. Our clients were one of several bidding groups in an auction which eventually yielded \$7.51 million (to an anonymous bidder, who immediately titled the home over to the National Trust for Historic Preservation). On the surface, the property consisted simply of a 2-bedroom house on 51 rural acres bordered by a stream. If the house wasn't architecturally unique and worthy of preservation, the price tag would have been a small fraction of the eventual auction price.

Throughout the world — but particularly in the western U.S. — collectable trophy real estate

**Value of a Dollar Invested in 1999**



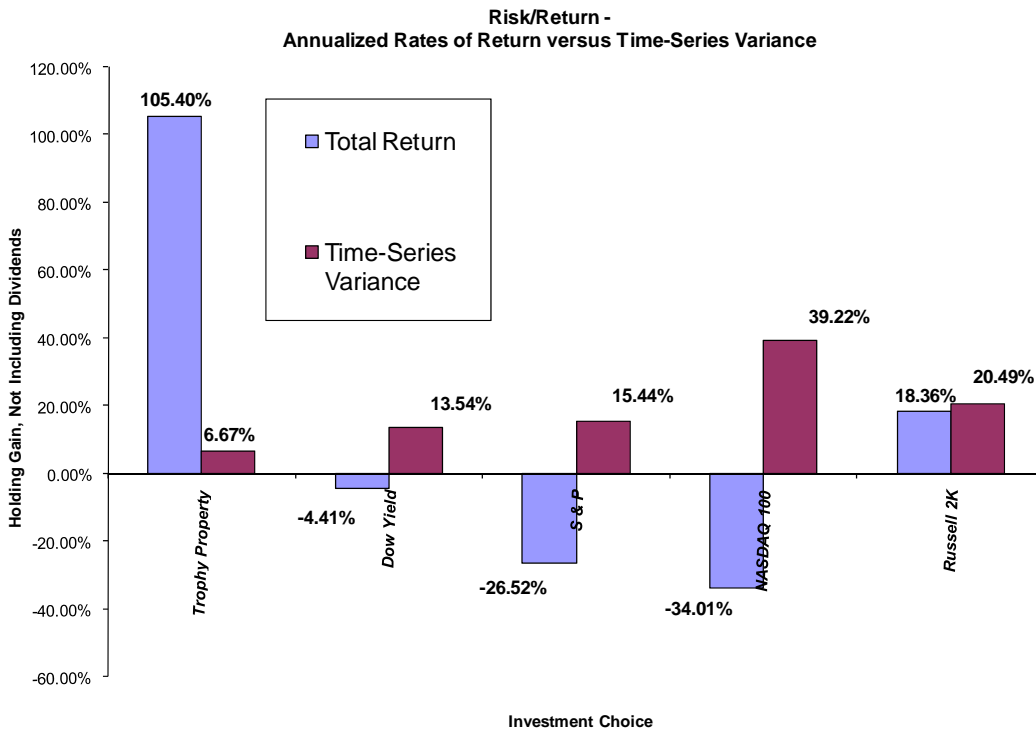
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carries a preservation value well beyond its intrinsic worth. Trophy ranches in the western U.S. (and elsewhere, for that matter) continue to be viewed from three perspectives — social “good”, recreation, and a value play. In the first case, preservation of trophy ranches may include habitat enhancement, optimization of water rights (and diminishing water supplies) and potentially tax credits or tax deductions for the owners. Recreational value can be achieved not only from private use but also in various shared-use scenarios, ranging from clustered homes with a tenancy-in-common on the preserved land, to interval ownership, to an outright for-profit resort plan. Finally, trophy ranch holding gains have probably been the least documented among real estate asset sub-classes, even though there is plenty of anecdotal evidence to support the notion of holding returns and exceptionally low volatility.

To get a better handle on this, **Greenfield** has begun tracking a series of trophy property metrics. The first index, which is illustrated on the preceding page, tracks holding gains on waterfront trophy ranches in four states (Idaho, Montana, Wyoming, and Colorado). The appraisal-based index is made up of 130 properties, and includes transactions, listings, and appraisals over the course of a 10-year period. While our underlying data is quarterly, we’re currently only prepared to release the index on an annual basis. Future indices will include other states, as well as state-by-state breakdowns, holding returns (e.g. — rents) and other information gleaned from our proprietary data base.

The holding-gains index has been charted against other major pricing indices. Since the Trophy Property index does not include interim holding returns such as rents, the stock-price indices do not include dividends.



One of the more interesting facets of this study is a comparison of the volatility of Trophy Ranch holding gains to the other indices. The chart on the following page illustrates the comparative ten-year holding returns of Trophy Ranches with those of other assets, as well as the comparative volatility (measured as standard error of the time-series). As shown, none of the other investment classes even come close when comparing return to lack of volatility.

For more information about **Greenfield’s** Trophy Ranch studies, please contact us at [info@greenfieldadvisors.com](mailto:info@greenfieldadvisors.com).

## Structural Shift in the Economy?

Back in the very early 1980's, I was a stockbroker at Dean Witter. Wall Street and Madison Avenue were joined-at-the-hip in trying to understand the consumption and investment habits of the baby-boom generation. Without going into great detail, the birth rate in America soared in 1946 (nine months, to the day, after the end of WW-II). In 1982, the earliest baby-boomers were 36 years old. America was just coming out of a huge recession (unemployment topped 10%) which was at the tail-end of about 14 years of stag-flation and intermittent recession (1968—1982). Demographically, these baby-boomers were entering their peak earning-and-spending years. Madison Avenue wanted to turn them into consumers, and Wall Street wanted to turn them into investors. In an economic sense, these are competing goals, but there was so much potential money laying around, it was in everyone's interest to work together.

Someone had coined the term "Yuppies" — for Young Urban Professionals — and Madison Avenue quickly saw that Yuppies had the best possible spending patterns. Terms like "conspicuous consumption" were coined to define a category of consumers who, despite great incomes, managed to spend \$1.10 for every \$1.00 they earned. Madison Avenue veritably salivated at the thought.

Madison Avenue has always been research driven, and the bean counters wanted to know just how big this market really was. After all, if you're going to sell ad space to for Range Rovers and couture fashions, it would be handy to know just how big the market will be. This is where it gets interesting — as it turns out, in PRACTICE, the "yuppie" market wasn't that big at all in the early 1980's. What Madison Avenue discovered, instead, was that there was a much bigger co-hort of consumers who got labeled "Worker Elites". Now, you've probably heard of "yuppies", but you've probably never heard the term "worker elites". Want to know why?

From a Madison Avenue perspective, "worker elites" have a bad habit — they don't consume enough. They have the same income characteristics as yuppies, but rather than buying Range Rovers, they bought Fords. Rather than buying couture fashions, they bought off-the-rack (and usually on sale!). They bought significantly smaller and cheaper houses than they could have potentially afforded, and instead of running up credit card debt, they opened money market accounts and IRAs. From a Wall Street perspective, these folks were God-sent. From a Madison Avenue perspective, the challenge was two-fold — sell them stuff they want (and the Dodge Caravan was born) and turn as many of them as possible into high-consuming yuppies (which is why, in part, Superbowl ads cost \$3 million each).

Don't get me wrong — I'm not OPPOSED to consumption. In the proper amount, consumption is a wonderful thing, and for decades has been the driving force in the world's economy. However, consumption is like driving on an Interstate Highway — 60 or so miles per hour is fine, but 90 or 100 is a bad idea. (Conversely, driving 30 or 40 on the Interstate is ALSO a bad idea, but I'll deal with that on the next page.)

Over the past year or so, our collective economy has hit a brick wall doing 90 or 100 miles per hour. Ignoring the sub-prime mortgage meltdown, which was just the last straw on the overloaded camel's back, we're also facing a crisis on home equity loans and credit card debt. Consumption in America has grown in recent years disproportionately to growth in household disposable income in no small part due to the ability of households to "lever up" with these credit cards and home equity loans. Over the next year, we're going to see significant "levering down" for two big reasons. First, the credit simply isn't there. Of course, "new" home equity lines are largely frozen today, and even existing lines of credit are problematic. Credit card companies are melting down, and in a most ironic way. As credit gets paid down, it's the MOST credit-worthy customers who pay down first, leaving the credit card companies holding the bag for a disproportionately un-credit-worthy cohort of borrowers. When and as this comes to a head this year it won't be pretty.

The second reason for the levering down is it simply makes sense. I can't remember who said it, but "...you might have a problem if you've ever bought a pizza on credit." Conspicuous consumption is w-a-a-a-y out of favor today, and conservative

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spending habits are suddenly the rage. This means, essentially, that we may be moving back to a “worker elite” society, at least for the short-term.

A number of years ago, more conservative economists held a theory called the “crowding out effect”, which simply said that government borrowing would “crowd out” private sector borrowing. However, unbridled spending of the past couple of decades caused that theory to be put back on the shelf. As it happens, we may see at least the *coincidence* of increased government borrowing and decreased private sector borrowing in the short run, even if “A” doesn’t *cause* “B”. There’s another little theory that conservatives hold — government is far less efficient at spending money (from a stimulus perspective) than the private sector. That’s the underlying premise behind stimulating the economy via tax cuts rather than fiscal spending. The next couple of years will provide mountains of empirical data to explore these issues. There is a fair amount of indication that this is where we’re headed. The Obama administration has shown no reluctance to tackle “big” problems like health care, education, and science/technology which require government leadership versus private sector.

Remember the comment about driving at 30 miles per hour on the interstate? Well, our GDP (which is shrinking at the rate of about 6% this year) is the sum of consumption expenditures plus private sector investments plus government spending plus the excess of exports over imports. A decrease in consumption causes a direct decline in the first component and an indirect decline in the second. The government then steps in and spend (in a Keynesian world) to make up the difference. Back in the 1930’s, we tried to tinker with the fourth component but erecting huge tariff barriers so as to decrease imports without decreasing exports (the Smoot-Hawley Act, signed into law in June, 1930, but President Hoover). This was one of the most disastrous ideas ever — trade barriers always have the two-pronged effect of destroying both imports and exports *as well as* making domestic production less efficient and more costly. (Google the “Law of Comparative Advantage” if this isn’t self-evident to you.)

The bottom line is finding the *right* level of consumption. For the past couple of decades, we’ve over-consumed in this country to the detriment of our overall economic health. Right now, and for the next year or so, we run the very real danger of *under*-consuming. This is of significant interest in the real estate sector for two reasons. First, much of our real estate (particularly second homes, time-shares, and resorts) are discretionary in nature, and would be severely hurt by a long-term, generic downturn in consumption. Second, all of this enters into the matrix of the credit markets, which currently are in total disarray. If a structural shift in the economy includes greater government participation and less credit for real estate, that may point to a real change in the nature of what we do for a living around here.

## Some Legal Caveats

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